



Keeping your head above water...

Recent issues in financial reporting

In this issue

What's happened since the last time we got together? Some might say nothing, but that's a very short-sighted perspective indeed. A lot has been bubbling away below the surface. A few things have even floated to the top. What's that? No, not like dead fish for goodness sake.

As tradition demands, we begin by considering the state of long-standing joint efforts by the IASB and FASB to improve and converge IFRS and US GAAP. Fundamental projects – revenue, leases, loan measurement, loan impairment, and insurance – remain undone. Are the Boards getting any closer to striking pay dirt? Will the new standards be hitting your financial statements any time soon? We reveal all in the following pages.

Converging IFRS and US GAAP was supposed to be a temporary measure, of course, pending the US's decision to adopt IFRS for domestic financial reporting purposes. We're still waiting. Is this becoming a case of jam tomorrow but never jam today? You might well ask considering what's going on now.

In our last issue, we told you about the IASB's new strategic vision for the next decade. That vision now has been translated into a detailed work program. Will it have implications for Canadian financial reporting? You bet. Read on to find out what they are.

Speaking of new perspectives, we're starting to see national standard setters and regulators intervening more on questions of when and how IFRS applies in their home jurisdictions, with some even debating overrides. Will Canada join the club? It's at least worth thinking about.

Also, you Canadian investment entities and rate regulated enterprises out there, get ready! It's time to start shifting your focus towards IFRS. At least one of you has got some work to do.

We've got a few specific accounting developments to tell you about too – a soon to be final standard on hedge accounting (hooray), an exposure draft clarifying how you calculate depreciation (seriously), and more on disclosure effectiveness (groan).

Lastly Canada has begun to examine ways to improve audit quality. We review their proposals and how they stack up to what rest of the world is thinking.

And there you have it. Bubble, bubble, toil and trouble.

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The future of global GAAP convergence

“For a moment or so, nothing happened. Then, after a second or so, nothing continued to happen.”

– Douglas Adams

It was way back in 2002 that the IASB and FASB embarked on their joint program to improve and align their respective standards. Ten long years. During that time, some projects have been completed and safely tucked in bed, others have been kicked aside to die a snivelling death in the streets, and still others are waiting out in the cold for Momma to call them home. Here's an update of where things stand now.

- **Revenue.** The project, now entering its 11th year of deliberations, is on the verge of completion, or so they say. Warning! The new requirements will carry forward existing principles but some companies may be facing significant changes because of the elimination of industry specific interpretations and new spins on old rules.
- **Leases.** The primary objective is to recognize all long term leases as assets and liabilities. Hans Hoogervorst, the Chair of the IASB, defends this treatment using the time honoured “if it looks like a duck, and swims like a duck...” principle of accounting. The trouble is, the Boards are proposing an income statement treatment for some leases that is showing distinctly non-duck like characteristics. So much so that some now are wondering if this project will ever get off the ground. Quack, quack, quack.
- **Impairment in trade receivables, loans and investments in debt securities.** The Boards agree, and have for awhile now, that a company should recognize impairments in these assets based on the credit losses the company expects to incur, rather than waiting until they actually happen as we do now. The trouble is the FASB wants to recognize losses as loans are made while the IASB wants recognition later in the credit cycle. The Boards now are talking calmly and rationally about their differences, which is progress of sorts. A few months ago all that was going on was a lot of yelling.
- **Classification and measurement of financial assets.** A tentative deal has been struck. The FASB has agreed to adopt the IASB's “business model” for determining when you measure loans and other similar assets at cost and when you measure them at fair value. The IASB has agreed to allow changes in fair value of these assets to be recognized in other comprehensive income instead of profit and loss if certain criteria are met (it issued an exposure draft proposing this a month or so ago). Not familiar with the business model? Don't worry. You won't have to adopt it until 2015 at the earliest (see our discussion on hedging for one possible exception).

- **Insurance.** This project is close to being an adult – it was started in 1997. A new model is in the hopper that delinks the measurement of liabilities and the assets backing them. Recognizing fair value changes through other comprehensive income is an important part of this project too – a compromise that shields profit and loss from unwanted volatility.

PwC observation. The Boards originally promised that these projects would all be done by the middle of 2011. That then was pushed back to 2013. This latest deadline is sure to be missed as well, and the Boards, older but wiser now, have stopped forecasting completion dates. Based on the way things are now the earliest any new standards will become effective is 2016 or 2017. That'll be almost a decade after the financial crisis hit and the projects were raised in priority to become among the Boards' most urgent. Hmm...

Towards a single global GAAP

“I wish I had an answer to that because I’m tired of answering that question.”

– Yogi Berra

There are three things that are certain in life: the sun coming up each morning, the seasons following one another and the IASB’s annual pilgrimage to the AICPA SEC Conference in December to plea for the SEC to adopt IFRS for US domestic reporting purposes.

In 2012, the IASB Chair was especially forceful, saying that there is really no other reasonable alternative to achieving global comparability in standards. Get on with it, was his blunt message, there are no insurmountable obstacles standing in your way. He also warned, as he has done many times before, that the level of influence the US can expect to exert over the IASB and its oversight bodies will be commensurate with its commitment to IFRS.

The SEC’s response was muted, with the Acting Chief Accountant saying only that the staff will discuss next steps with the Commission and to “stay tuned”. Notably absent was any discussion of how the US might transition to IFRS, a key feature of the previous year’s discussions. Remember “condorsement”?

Until the SEC does make a decision, said the Chair of the FASB, let the IASB and standard setters in major capital markets work together informally to make global standards more comparable. The Chair also stressed how demanding the US financial reporting culture is, the importance of the written words in applying standards, and the necessity for interpretations in the US marketplace. She suggested factors such as these might be an ongoing concern for the SEC in relation to IFRS. You think?

PwC observation. Considering that a new Chair of the SEC has only just been appointed, that her appointment is rumoured to be temporary, that there’s a vacancy among the Commissioners creating the potential for voting deadlock, that important staff positions at the SEC remain unfilled, including a permanent Chief Accountant, and that the FASB Chair’s term is about to expire, we see little prospect that the US will make any move towards embracing IFRS in the near future. Will it happen in the longer term? Good question. In a recent survey of US investors, almost 60% of respondents thought that the SEC eventually will adopt IFRS. Of course, “eventually” might be a very long time.

IFRS – the way forward

Part 1

“I’d rather be dead than singing ‘*Satisfaction*’ at 45.”

– Mick Jagger

Joint convergence projects with the US might have dominated the IASB’s agenda in the past, but no more. Following the completion of a major strategic review of its objectives for the next decade earlier in 2012, the IASB released its new work program in December. Here are the key initiatives:

- Improving the interpretation and maintenance of IFRS. This will be achieved by reviving a moribund IFRS Interpretations Committee, providing more educational guidance, and carrying out post-implementation reviews of recently implemented standards to see if they need fixing.
- Providing a period of relative calm so constituents can catch their breath after 10 years of almost continuous accounting change. The Board is adding only three standards level projects to its agenda – the equity method of accounting in separate financial statements (a big issue for Latin America), agriculture (a big issue for Asia-Oceania) and rate-regulated accounting (a big issue for guess who – more on this later). Of course, there are also those pesky joint convergence projects to finish too, which complicates life more than a little.
- Completing the rehabilitation of the Conceptual Framework and actually using the Framework in developing standards.
- Establishing a new process for engaging national standard setters and regional bodies on technical issues. See the next page.

And there you have it – singing a completely new tune from a completely different songbook. Tra-la.

PwC observation. There’s much to like about the IASB’s new work plan. Nevertheless, the decision to abandon convergence with US GAAP as a fundamental strategy puts more pressure on Canadian policy makers to accommodate the legitimate needs for US GAAP reporting in this country. We’ve said it before and we say it again – if US GAAP is going to continue to survive as a separate and distinct basis of accounting for a really long time, Canada needs to consider giving all Canadian companies the option of using this basis of accounting, not just SEC registrants.

IFRS – the way forward

Part 2

“A girl phoned me the other day and said... Come on over, there’s nobody home. I went over. Nobody was home.”

– Rodney Dangerfield

IASB interactions with national standard setters and regional accounting bodies always has been a sensitive political issue – countries that don’t believe that they’re being heard by the Board, or that their interests have been taken into account, can lose their allegiance to IFRS pretty darn quickly. In the past, an important part of the Board’s strategy has been the holding of regular meetings with these bodies, especially with the big players – the FASB, the European Financial Reporting Advisory Group (“EFRAG”), the Japanese Accounting Standards Board, etc. Alas, there’s a limit to the number of meetings you can have and it’s getting harder... national standard setters and regional bodies new to IFRS want to have their say too.

So now, in conjunction with its new work program and priorities, the Board is proposing an alternative, a non-voting Accounting Standards Advisory Forum of 12 national standard setters and regional bodies. The idea is that the Forum would meet with the Chair or the Vice Chair four times a year for a few days to exchange views on detailed technical issues. Yup, you read it right – just 12 representatives and just four meetings. It’s an efficiency thing you see. The IASB wants meetings to be productive and effective, not dog and pony shows.

Of the 12 representatives, the IASB’s proposal is that three would be from the Americas, three from Europe, three from Asia-Oceania, and one from Africa. There’d also be two at-large members. The IASB has already indicated that the FASB will be a member as will EFRAG and new regional IFRS associations of countries in Asia-Oceania and Latin America. The remaining membership isn’t known yet but you can bet there’s some furious lobbying going on. Remember, with access comes influence!

The IASB wants to move quickly to finish arrangements, and is hoping the Forum will have its first get together early in 2013.

PwC observation. A major challenge the IASB will face in setting up the Forum is avoiding disenfranchising national standard setters that have a valuable contribution to make – who, having accepted the siren call of IFRS, would want to find out that no one’s around to listen to what they have to say? In our view, the Forum would work best as a complement to, rather than as substitute for, the many other opportunities for engagement with national standard setters and regional bodies. We also think it’s necessary to temper expectations about what the Forum can reasonably achieve. It will be very difficult to obtain comprehensive insights on a broad range of technical activities with only a few days of meetings.

IFRS in Canada

Part 1

Cora: I hope I don't hear sounds of a disagreement.

Lady Grantham: Is that what they call discussion in New York?

– Downton Abbey

This may be the start of something...

In the past few months, the Canadian Accounting Standards Board ("the AcSB") debated on two separate occasions whether to provide local interpretations on how Canadian companies should be interpreting particular aspects of IFRS. The Board decided not to proceed in both cases, but the mere fact that it considered doing anything at all is newsworthy. AcSB official policy, you see, is not to tamper in any way shape or form with IFRS, on the basis that if everyone was to do it an unacceptable level of regional diversity soon would creep in.

The AcSB's policy is not universally shared. Other jurisdictions have issued local interpretations, deferred effective dates of new standards, and even refused to adopt aspects of them to address local concerns and circumstances. For example, EU companies won't have to apply new standards on consolidation and joint arrangements until 2014, a full year later than IFRS requires. Also, the Australian Accounting Standards Board has decided to delay adoption of a recent change in IFRS affecting investment entities (see next page) until the Board considers whether to mandate additional compensating disclosures (the Aussies have even muttered darkly about deep sixing the amendment). Finally, according to UK press reports, the European Commission has agreed to reassess some aspects of IFRS affecting financial institutions early in 2013 and, if necessary, propose complementary remediating measures.

Has Canada been too slavish in its adherence to the global ideal? Is the comparability of Canadian financial reporting suffering as a consequence?

PwC observation. The absence of local interpretative processes has been keenly felt since Canada has adopted IFRS. We expect that the recent actions of other jurisdictions in relation to their application of IFRS will further encourage the AcSB to reconsider its no tampering policy.

IFRS in Canada

Part 2

“Nothing takes the taste out of peanut butter quite like unrequited love.”

– Charlie Brown

Bet you thought we were all done talking about transition to IFRS. But we can't – Canadian rate regulated enterprises (“RREs”) and investment entities have yet to experience that particular pleasure. Recall that the AcSB and Canadian securities administrators deferred IFRS transition for these sectors pending the completion by the IASB of projects that might allow the sectors to continue to apply the specialized accounting principles they've always used under old Canadian GAAP. No sense changing over to IFRS using different principles and then changing back again a short while later was the thinking.

In 2012 we saw significant progress on the projects. Indeed, the IASB finalized amendments to IFRS requiring investment entities to account for investments in subsidiaries at fair value instead of consolidating them. With that the only thing standing in the way of Canadian investment entities adopting IFRS went poof into the night. These entities will have to begin reporting under IFRS in 2014.

For RREs, the situation is a little more unsettled, well, a lot more. In December, the IASB voted by a narrow margin to issue an exposure draft proposing to allow RREs transitioning to IFRS to carry forward their existing national GAAP principles for recognition and measurement but require them to conform to IFRS presentation and disclosure requirements. As we mentioned earlier, however, the IASB also has a separate project on rate regulated accounting on the go. One possible outcome of that, of course, is the end of rate regulated accounting altogether. As a result, the interim solution might pave the way for Canadian RREs to adopt IFRS, but it does nothing to mitigate the uncertainty over the ongoing appropriateness of their Canadian GAAP specialized accounting practices.

PwC observation. Over 100 countries have transitioned to IFRS without needing a special accommodation for RREs, so there's fierce resistance in some quarters to providing a special one for Canadian companies now. Canada hasn't earned everybody's love on this one, not by a long shot.

Hedge accounting

“Outside of a dog, a book is a man’s best friend.
Inside of a dog it’s too dark to read.”

– Groucho Marx

And now, eight pages in, onto some actual accounting.

A few months ago, the IASB released a “final review draft” of proposed new rules on hedge accounting. For the uninitiated, hedge accounting is a convention that allows companies to defy GAAP gravity. If a transaction qualifies as a hedge for accounting purposes, the company always gets to report offsetting gains and losses on the hedge and the position being hedged in the same accounting period, even when GAAP otherwise would dictate recognition in different periods. It’s a matching kind of thing. What’s that you say? Isn’t matching supposed to be dead under GAAP? Shush. Someone might hear.

Good news! Under the proposals hedge accounting requirements will become less burdensome, some strategies that didn’t qualify for hedge accounting in the past now will, and others that did can be rejigged to become even more effective than they were. As a result, financial statement reporting of hedging activities may align more closely with a company’s risk management strategies and income statement volatility may diminish.

The new IFRS requirements are expected to become final in 2013 with mandatory adoption in 2015. Earlier adoption is possible so long as a company also adopts the other changes to IFRS for financial instruments the IASB has released but that aren’t yet effective. The hedging proposals are sufficiently attractive that some Canadian companies are eagerly waiting to embrace them. Alas, adoption in 2013 may be challenging depending on when the IASB finalizes the new rules and the AcSB approves them for use in Canada.

PwC observation. Don’t make the mistake of thinking that the proposed rules will carry us back to the old days in the 20th century, when GAAP never met a hedge it didn’t like. There still will be some significant hurdles to jump; e.g., documenting hedging relationships before, not after, you start doing hedge accounting; assessing relationships for effectiveness, and recognizing hedge ineffectiveness in the income statement when it happens. Nevertheless, the hedging rules have become a much easier book to read and apply.

Depreciation

“There’s a fine line between fishing and just standing on the shore like an idiot.”

– Steven Wright

We know what you’re thinking... what on God’s green earth possibly could be new about depreciation? What can we say? The good news is that what’s happening doesn’t have a widespread impact. The bad news is that those that are caught may soon be angling for a new method by which to depreciate certain of their assets.

A few months ago, the IASB issued an exposure draft proposing to clarify that depreciation determined based on an entity’s revenue is inappropriate (e.g., calculating the percentage that current period’s revenues is to current and future periods’ revenues and applying that percentage to the carrying amount of the asset at the beginning of the period). What’s the trouble with that? Under GAAP concepts, depreciation is a charge for the use of an asset. Using revenue may not be faithful to this concept because revenue can be affected by factors that have nothing to do with use, such as changes in current or expected selling prices.

The IASB has offered an olive branch of sorts. For some assets (e.g., certain film rights), you can still use a revenue based depreciation method provided the result is no different than using a units of production method. Of course, if you can do this, then presumably you’ve already made the calculation that GAAP requires anyway. Hmm, the branch is looking kind of wilted, isn’t it?

The film sector and certain public private service concession arrangements are among those especially affected. If you want to squawk you have until the beginning of April. No fooling.

PwC observation. Revenue based depreciation methods usually are used for assets whose life is limited by contract. While many might argue that these methods better reflect the economic reality of the underlying contractual terms (their use is required by US GAAP in the media and entertainment industry) this clarification would mean that there’s nothing in IFRS you can hook onto to justify this accounting.

Disclosure effectiveness

“Lord God, if I have but one life to live
I hope this isn’t it.”

– George Bowering

If you start repeating things too often, readers become cranky, and nobody wants to listen to you anymore. And so it is with some trepidation that we introduce our next topic – disclosure effectiveness.

As we mentioned in our last issue, the IASB will be addressing disclosure as a separate component in its Conceptual Framework project. In preparation, the European Financial Reporting Advisory Group and national standard setters from France and the UK (with an assist from the FASB, which has a similar project on the go), have produced a discussion paper proposing a set of broad disclosure principles. The report addresses such things as the purpose of disclosure, the impact of risk and uncertainty on disclosures, using an integrated approach for establishing disclosure requirements, how the materiality principles should apply, etc.

The IASB also is hosting a Disclosure Forum of securities regulators, auditors, investors and preparers to explore opportunities on how those applying IFRS can improve and simplify disclosures within the existing requirements. The hope is the Forum could lead to short-term improvements without the need for standard-setting intervention.

PwC observation. When it comes to disclosure, the world is divided into two camps: those that believe that excessive, burdensome and too complex requirements are the root cause of the problem; and those that think that boilerplate and checklist approaches to compliance that aren’t tailored to the substance and reality of the business is. Disclosure will continue to be a misery unless these attitudes can be reconciled on some meaningful basis.

Enhancing audit quality

“If it’s beautifully arranged on the plate you’ll know that someone’s fingers have been all over it.”

– Julia Child

One of the consequences of the financial crisis has been a renewed focus by regulators and other policy makers on improving audit quality. The last time we counted, there were 18 (count’em 18!) separate initiatives underway in various jurisdictions, including the EU, the US, and the UK. The International Auditing and Assurance Standards Board also has projects on the go.

Canada, never one to shy away from a challenge, is among those participating. Under the auspices of the CICA and the Canadian Public Accountability Board, a blue chip Steering Group has been formed to oversee and co-ordinate the activities of three working groups set up to consider auditor reporting, auditor independence, and the audit committee. What’s the overarching objective? To develop Canadian perspectives and make a meaningful contribution to global discussions of these issues.

Two working groups have issued two draft reports for comment in the last six months or so. Key findings include:

- Mandatory comprehensive review of the auditor’s performance by the audit committee is superior to mandatory auditor rotation or tendering as a means of enhancing audit quality.
- It would be appropriate to continue the existing Canadian principles-based approach to evaluating threats to auditor independence raised by non-audit services rule with rules-based prohibitions when threats cannot be overcome.
- Requiring audit only firms or joint audits would not improve audit quality.
- Including an “auditor commentary” in the auditor’s report can give useful information and may lead to improved disclosures and audit quality. The report also should describe the auditor’s responsibility for information included in documents containing the financial statements and the auditor’s conclusions but shouldn’t include a discussion about the entity’s ability to continue as a going concern.

- It’s worth exploring whether there is demand for auditor assurance on information beyond what the auditors currently have and how this involvement might be communicated.

A third discussion paper addressing audit committee is set for release in 2013.

PwC observation. The Working Groups’ recommendations have been carefully arranged to take into account the Canadian regulatory and business environment. They differ in some notable respects from more far reaching proposals in other jurisdictions, notably the EU. Is it possible, or even appropriate, to establish common global requirements in all areas? That remains to be seen.

For more information

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