

Putting IFRS in motion*

The impact of International Financial Reporting Standards (IFRS) on the Canadian forest, paper and packaging sector



Introduction



More than 100 countries have adopted the use of International Financial Reporting Standards (IFRS) by public companies. The Canadian Accounting Standards Board will require publicly accountable enterprises to adopt IFRS as Canadian generally accepted accounting principles (GAAP) for interim and annual financial statements for fiscal years beginning on or after January 1, 2011 with early adoption expected to be permitted.

The move to IFRS will fundamentally change the way Canadian companies report their business results to analysts, investors and other stakeholders.

For some organizations, implementing IFRS will be quite a simple exercise, but for others it will be a highly complex process that goes well beyond the finance and accounting functions. Other business operations such as human resources, investor relations, business development and information technology (IT) departments will likely be involved in the IFRS conversion plan.

Our experience in assisting global companies that have already adopted IFRS shows that for some, full conversion and adoption can take anywhere from two to five years, depending on the complexity of the organization. Are you on track?

Certain industries have a long and complex conversion process because significant accounting policy changes are required. It is often extremely difficult to extract the historical information necessary to make these changes and the accounting processes and systems have to be modified on a go forward basis.

One of the most significant challenges in converting from Canadian GAAP to IFRS is determining which Canadian GAAP differences will impact the organization. This publication outlines some of the significant accounting differences that arise between Canadian GAAP and IFRS in the forest, paper and packaging sector. The background and context behind the decision to adopt IFRS and the key strategic issues you will face in converting to IFRS are outlined in our publication, *Putting IFRS in motion – Are you on track?* To obtain a copy, contact a PwC professional or visit www.pwcifrs.ca.

Companies that have already implemented IFRS understand that the new standards may place a sizeable responsibility on management to be able to communicate effectively to the market in the new IFRS language.

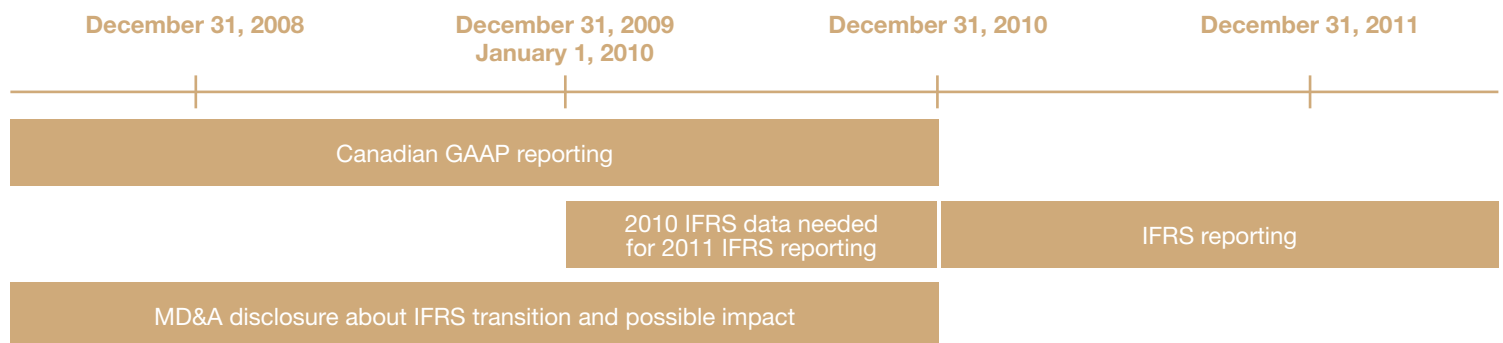
Accounting under IFRS

Canadian publicly accountable enterprises must use IFRS to prepare interim and annual financial statements for financial years beginning on or after January 1, 2011 with early adoption expected to be permitted. The move to IFRS will change the way Canadian companies present their business results to analysts, investors and other stakeholders. The implementation of IFRS for Canadian forest, paper and packaging companies may at first look like a complicated, expensive and difficult process. However, the size and complexity can be managed if companies plan ahead before the new accounting and reporting standards become effective.

Many forest, paper and packaging companies throughout Europe and Australia have completed their transition and have been applying IFRS since January 1, 2005. The transition to IFRS for forest, paper and packaging companies in these countries has shown there are some interpretation and application challenges unique to the forest, paper and packaging industry.

The following sections of this publication highlight some of the significant differences between Canadian GAAP and IFRS that will specifically impact forest, paper and packaging companies.

Even though the Canadian changeover to IFRS is scheduled for 2011, the scale of the transition means there are decisions to be made today.[†]



[†] The table assumes a calendar year in which a company first reports under IFRS in 2011 and presents a single year of comparatives.

First-time adoption of IFRS

Under IFRS 1, the underlying principle on adoption of IFRS is retrospective application of all IFRS standards (with certain mandatory and optional exemptions) at the entity's first reporting period. Where differences exist and there is no exemption available, companies may have to put in significant effort to remeasure various historical transactions under IFRS. Early identification of Canadian GAAP differences and consideration of the exemptions are very important for a successful conversion.

Timber

A variety of accounting practices are currently followed in Canada with regard to the capitalization, classification and

amortization of timber assets. The majority of harvesting rights are provided by provincial governments under various types of licenses, although there are significant areas of privately owned timberland as well.

The accounting for timber harvesting licenses can be quite complex under IFRS, depending on the nature of the license. Careful consideration will need to be given as to whether such licenses would be subject to the accounting for leases (IAS 17), intangible assets (IAS 38), or biological assets (IAS 41).

Private timberlands are covered by IAS 41, agriculture, which generally requires fair value accounting for biological assets during the period of growth. When this standard was adopted in Europe, it proved difficult to implement. Canadian companies will need to plan now for the change.

Impairment of property, plant and equipment

IAS 36, the international standard on impairment, differs significantly from the current Canadian GAAP standards. Both require assets to be tested for recoverability whenever events or circumstances indicate that the carrying amount may not be recoverable. However, under IFRS, there is no initial assessment of recoverability based on undiscounted cash flows as there is under Canadian GAAP. Rather, the carrying value is compared to the higher of “value in use,” which is based on the present value of estimated cash flows from the asset, and “fair value less costs to sell”, which is based on the amount obtainable on a third party sale of the asset, in determining whether an impairment charge is required. This difference may result in companies’ requiring writedowns of assets under IFRS that were previously considered recoverable using the undiscounted cash flow test under Canadian GAAP.

There are also a number of complications in the application of IFRS when calculating value in use. These include the following:

- Determination of appropriate long-term price assumptions;
- Requirement to use spot exchange rates at the date of the calculation (which may be inconsistent with the exchange assumptions embedded with the price assumptions); and
- Restriction on inclusion of future capital improvements or cost savings.

There is no similar specific requirement to use spot exchange rates to translate foreign currency cash flows in value in use models under Canadian GAAP. The use of future exchange rates discounted back to spot values may or may not produce significantly different outcomes.

Another significant difference from the current Canadian standards is that IFRS requires the reversal of previous impairment losses where there is an indication that the loss may no longer exist or may have decreased. This requirement may lead to volatility in the income statement, with impairments recorded and reversed in relatively quick succession in response to changes in the commodity cycles.

Joint ventures

Joint ventures are common in the forest, paper and packaging industry, as they allow entities to share the risks and capital costs of new plants with other entities.

The accounting for joint ventures under IFRS and Canadian GAAP is currently similar, except that, under IFRS, an entity may choose to account for its investment in a jointly controlled entity using either proportionate consolidation or the equity method of accounting. The IASB, however, is in the process of revising its joint venture standard, having issued an exposure draft in September 2007. One of the most significant changes expected in the final standard is a requirement to use the equity method of accounting for most joint ventures other than those carried out through co-ownership (undivided) interests. At its

April 2008 meeting, the IASB decided to proceed with finalizing the standard generally as proposed in the exposure draft.

Joint venture arrangements will, therefore, need to be carefully analyzed to determine the appropriate accounting under the revised IFRS standard.

Operations

There are a number of areas of accounting in the production phase of a forest, paper and packaging entity which will require careful consideration on adoption of IFRS. Some of these areas include:

Major maintenance – There are a number of ways Canadian forest, paper and packaging companies currently account for major maintenance costs, including in-house labour. Under IAS 16, Property, Plant and Equipment, provided the costs meet the definition of an asset, they should be recognized as a separate property, plant and equipment component and be depreciated over the period to the next major maintenance program.

Derivatives and hedging – The recent adoption of the new financial instruments standards in Canada has closely aligned Canadian GAAP with IFRS. There are, however, certain subtle differences in the standards applicable to derivatives and hedging, which will require consideration on transition. This is a complex area that affects many forest, paper and packaging companies that use financial and non-financial derivatives to hedge cash flows and the value of assets and liabilities.

Asset retirement obligations – Canadian standards differ significantly from IFRS in two important ways. First, IFRS require the use of current interest rates at each reporting date to determine the obligation, as opposed to the interest rate used when the liability was initially measured under Canadian GAAP. Second, IFRS require the use of management's best estimate of each outflow rather than fair value measurement on initial recognition. Obligations measured under IFRS may therefore be subject to greater volatility.

Conversion is not just a technical accounting exercise

IFRS will present unique challenges for senior management, the financial reporting function, the treasury function and many other areas across the organization. IFRS may impact existing management reporting including budgets, forecasts, performance measures, reward schemes and bonus structures, key performance indicators and covenants. Furthermore, new procedures should be considered to ensure IFRS implications are considered as part of the approval process for all new strategic investments. Depending on the size and complexity of the organization, most forest, paper and packaging companies will likely find that their human resources, IT, investor relations and business development departments will need to be involved in planning the transition to IFRS.

IFRS across the organization		
<p>Implementation Resources</p> <ul style="list-style-type: none"> • Need for resource over 12-18 months • Competing projects • Not just a finance issue <p>Training and Education</p> <ul style="list-style-type: none"> • All finance staff will need some training • Broader awareness of the issues • Other business professionals within organization • Executives need to be able to understand and explain the “new” numbers 	<p>Acquisitions</p> <ul style="list-style-type: none"> • Need for IFRS figures for due diligence • Models required for annual goodwill impairment tests <p>Financing/Refinancing</p> <ul style="list-style-type: none"> • Impact of IFRS on earnings or asset-based debt covenants <p>Remuneration</p> <ul style="list-style-type: none"> • Impact of earnings volatility on profit-based bonus plans 	<p>Systems and Processes</p> <ul style="list-style-type: none"> • Need for different/new data • New systems <p>SOX/ICOFR Certification</p> <ul style="list-style-type: none"> • Process/control documentation updates <p>Investor Relations</p> <ul style="list-style-type: none"> • Preparing analysis for the impact of IFRS <p>Management Reporting</p> <ul style="list-style-type: none"> • Budgets, forecasts, management accounts and KPIs (Key Performance Indicators) need to be on an IFRS basis

Communication

The financial statements of a Canadian forest, paper and packaging company will look different under IFRS than they currently do under Canadian GAAP. Senior executives need to be prepared to discuss the reasons for, and the nature of, the differences to board members, shareholders, the investment community and financial analysts. A detailed communication plan is necessary to educate stakeholders and actively manage perceptions.

There are a number of areas within IFRS that are subject to interpretation. While a primary aim of the IASB is to have a global set of standards applied consistently, the reality is that there are differences in the specific application of a particular accounting rule from one company to another.

Communication of key policy choices, interpretations and accounting decisions in some detail may also be necessary to differentiate and explain a forest, paper or packaging company's financial results under IFRS as compared to its peers.

Our experience with companies in Europe has shown that early communication, including the sharing of pro forma financial statements with preliminary figures and/or opening balance sheets under IFRS – in advance of transition date – has allowed investors and analysts to understand and get comfortable with financial results and their presentation. In contrast, late or absent dialogue with key stakeholders concerning the financial implications of the adoption of IFRS could result in a direct impact on share price.



Impact on systems and processes

IFRS compliance may require the realignment of reporting systems for new and additional data.

Our experience has shown that many companies implementing IFRS underestimate the time and resources needed to meet this challenge. This is especially true with existing management systems or legacy systems from past acquisitions that have never been updated and are not geared to provide sufficient or appropriate data for preparing new and increased disclosures. To make the best decisions on IT investment and achieve user engagement, it is important that company IT executives have sufficient time to perform systems realignment and are not forced to complete this work in a “fire-drill” environment.

Other process changes under the move to IFRS can be equally as important and may include the following:

- Revising existing reporting templates and other checklists to incorporate data required for disclosures under IFRS;
- Rationalizing or expanding the chart of accounts to post additional measurement changes and/or collect additional disclosures under IFRS;
- Reviewing period-end close procedures to achieve efficient close times;
- Reviewing outsourced operations’ controls and capability in producing IFRS compliant information; and
- Obtaining IFRS information from significantly influenced investees and/or variable interest entities.

Education, awareness and culture

The migration to IFRS may also require a training program that combines knowledge transfer with the ability to address skills, attitudes and motivation. The entire organization, not just finance and accounting, will need to be trained in this area (e.g. functions such as internal audit and investor relations). Training should focus on what information individual business units will

need to provide in order to comply with IFRS and how IFRS will affect their decision-making and value creating strategies.

Early awareness training on the important impact areas and changes under IFRS will enable key stakeholders, including key executives and board members, to be fully briefed on the new requirements and help drive a positive spirit of change management throughout the organization.

Regulatory requirements

The adoption of IFRS will require Canadian entities to consider various regulatory requirements.

Use of IFRS by Canadian SEC registrants

A significant benefit to a Canadian SEC registrant of adopting IFRS-IASB is that the entity will no longer have to reconcile its primary financial statements to US GAAP in SEC filings. The SEC also has extended an accommodation to first-time IFRS reporters, enabling them to present only a single year of comparative financial statements, rather than the two years it usually requires.

The SEC’s IFRS accommodations are effective now but are not available to Canadian SEC registrants before 2011 unless an early adoption of IFRS as an option is approved for 2009.

On adopting IFRS, a Canadian SEC registrant will no longer have to reconcile to US GAAP but might lose its option to prepare financial statements using US GAAP.

Internal controls over financial reporting

Public companies will also need to consider Multilateral Instrument 52-109 (certification of disclosure in issuers’ annual and interim filings) and Sarbanes-Oxley requirements (management assessment of internal controls) as they transition to IFRS. Specifically, entities will need to update their documentation on the internal controls over financial reporting and related evaluation procedures for processes and changes impacted by the IFRS migration.

Merger and acquisition implications

The move to IFRS may add increased complexity to merger and acquisition (M&A) transactions in countries that have not yet adopted IFRS.

The main challenges will be the need to translate the target's historical and projected performance into IFRS to assess the accounting implications of the transaction and to understand the impact on the acquirer's earnings per share.

Complexities in IFRS accounting will lead to tougher due diligence requirements when evaluating targets in the forest, paper and packaging sector, even if the target is already reporting under IFRS.

Given that a number of areas of IFRS specifically affecting forest, paper and packaging companies require judgment and interpretation, comparability and consistency in the application of IFRS across countries, and companies could vary markedly. Acquirers may need to devote more time and resources to scrutinizing how the target's numbers have been produced.

The potential cost of bringing the target's reporting systems up to the acquirer's standards and, the time required to do this, could significantly affect a company's ability to realize integration synergies, especially, as we get closer to the transition date.

To the extent that a Canadian entity completes any acquisition of a target company not currently reporting under IFRS before 2011, it will need to include the target companies in its IFRS conversion and readiness plan.

Our experience assisting companies with M&A transactions has shown that they have struggled to obtain the additional data and disclosure requirements of target companies under IFRS.

Planning an effective conversion

It is easy to underestimate the volume and complexity of the work involved with the implementation of IFRS.

Our experience in Europe and Australia has shown that some companies transitioning to or applying IFRS for the first time will try to make manual adjustments from local GAAP to IFRS using spreadsheets or similar tools. These quick fix conversions are often not the most cost-effective choice in the long run – especially, as these fixes can be prone to error, confusion and typically lack the appropriate internal controls surrounding their preparation.

To ensure sustainable and uniform application of IFRS throughout your organization, you will need to document your accounting policy selections and make sure they are consistently followed.

Each individual company will have unique circumstances that require sound judgment and expert advice. Advanced planning and an in-depth diagnostic of how IFRS will affect your company's financial reporting will reduce the risk associated with compliance and lower the overall cost of transition.

This publication does not provide a complete list of Canadian GAAP differences that Canadian forest, paper and packaging companies need to consider upon transition to IFRS.

How we can help



PricewaterhouseCoopers has unparalleled experience in helping many of the world's largest companies adopt IFRS. We have assisted with IFRS conversion projects in Canada and elsewhere for a wide range of companies across all industries. Our dedicated resources and experience in working with many of the more than 12,000 companies that have already made the transition to IFRS have taught us valuable lessons that will help Canadian forest, paper and packaging companies with their own conversion process.

Our industry-focused teams specialize in IFRS/GAAP conversions for a wide range of organizations – from large, complex institutions, requiring detailed analysis, to organizations with more straightforward requirements. These teams are supported by our Capital Markets Group, a global team of over 500 IFRS conversion experts, who specialize in multi-GAAP environments and the related conversion implications.

PricewaterhouseCoopers' global forest and paper practice is comprised of a network of 1,400 industry professionals located in over 30 countries around the world. We provide professional services to 50 percent of the world's top 100 forest, paper and packaging companies.

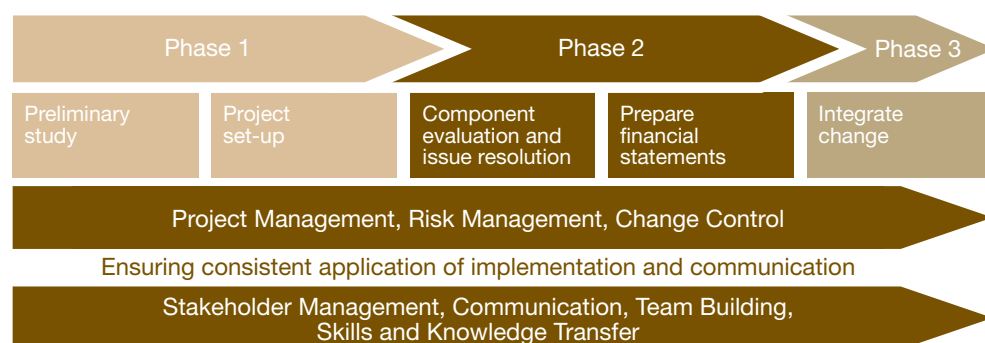
PwC's Transition/IFRS™ Methodology

While compliance with new rules is the driver for IFRS projects, our experience indicates that a methodical approach to the conversion process can yield wider benefits. Our Transition/IFRS™ methodology is a robust, tried and tested framework that has an inherent flexibility, enabling us to adapt it to work most effectively within your organization and one that we would tailor to your needs and phases, as outlined below. This methodology has consistently delivered successful results.

Typically, each IFRS transition project consists of three phases. In Phase 1, the diagnostic stage, we carry out an initial impact analysis and plan the later phases. Phase 2 consists of the detailed steps necessary to prepare the first complete IFRS financial statements. In Phase 3, we take the information, issues and solutions gathered, and integrate them into your underlying financial systems and processes.

Transition/IFRS™ acts as a springboard from which you can launch and control your conversion project, accessing the support and guidance you need as the implementation progresses.

We are ready to help you manage the conversion process with fewer headaches. To learn more about how we can help, visit our website at www.pwcifrs.ca or contact one of the IFRS professionals listed on page 12 of this publication.



PwC professionals can help you plan and complete your transition to IFRS by providing:

- An initial diagnostic of Canadian GAAP/IFRS accounting differences
- Advice on selection of appropriate accounting policies
- Advice on development of an IFRS implementation plan
- Training for all levels of your staff, including your board of directors
- IFRS trained and experienced people to supplement your IFRS team
- Project management support to your IFRS team
- Communication strategies and change management support
- Assessment of your requirements for data, processes, systems and controls
- Advice on process and system solutions to embed IFRS
- Competitor benchmarking
- M&A target accounting conversion assistance
- Valuation advice under IFRS fair value and impairment models
- Tax planning considerations on conversion to IFRS

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