www.pwc.com/ca/ifrs

A market perspective

Insights into IFRS standards in motion – high priority projects

A PwC Canada survey report

September 2011

pwc

Over four years in the making, the changeover to International Financial Reporting Standards (IFRS) in Canada is in full swing. Canadian public companies with calendar year ends have filed their first two quarter reports in accordance with IFRS.

Companies with non-calendar year ends will soon follow and even though there are deferrals for some entities, such as rate-regulated entities, they too will have to convert by January 1, 2012.

Described by the Ontario Securities Commission as a fundamental change to reporting standards and one of the most significant changes that issuers will have to deal with over the next few years, IFRS is a massive undertaking—not just nationally but internationally, involving regulators, accounting standards boards, companies and educational institutions. The International Accounting Standards Board (IASB) continues to work with its global counterparts in order to refine and improve standards based on analysis, feedback and insights emerging from the financial fallout of 2008.

This means that although most of Canada's public companies know what they need to do to comply with IFRS today and are taking the necessary steps, they will need to stay current on new developments as the standards are changed. The IASB and the US Financial Accounting Standards Board (FASB) are pursuing convergence projects with the goal of improving financial reporting. In 2010 and 2011, the Boards focussed heavily on three high-priority projects: Leasing, Revenue Recognition and Financial Instruments. It is these projects which the need for improvement of the current IFRS and U.S. GAAP is the most urgent. PwC has surveyed Canadian companies to gain insights into how these projects are perceived and understood as well as their potential impact on Canadian companies.

Major themes

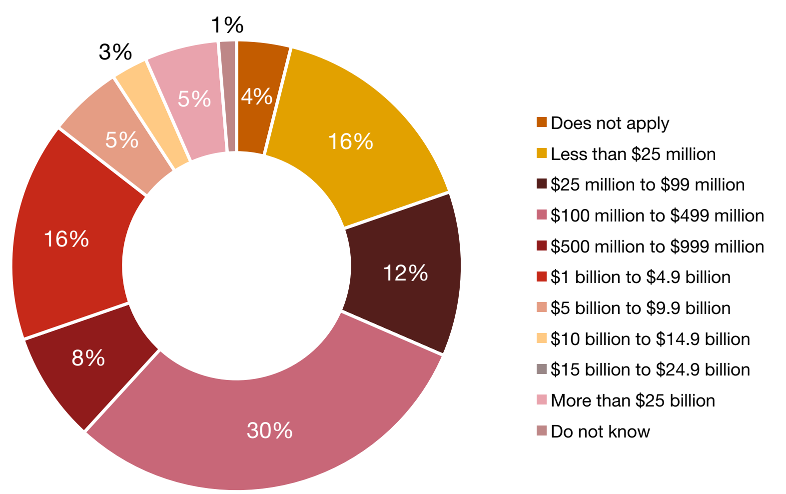
A few key themes emerged from our survey:

- Among respondents, the leasing project is expected to have the greatest impact due to the nature of the proposed changes, particularly for operating leases.
- Financial Instruments ranked second in terms of anticipated impact.
- Most respondents have a high level of general awareness of the convergence related changes, what's needed and how these changes might impact them.
- A large group of the respondents have performed a high-level assessment of the potential implications or have deployed resources and have already begun to actively plan for implementation.

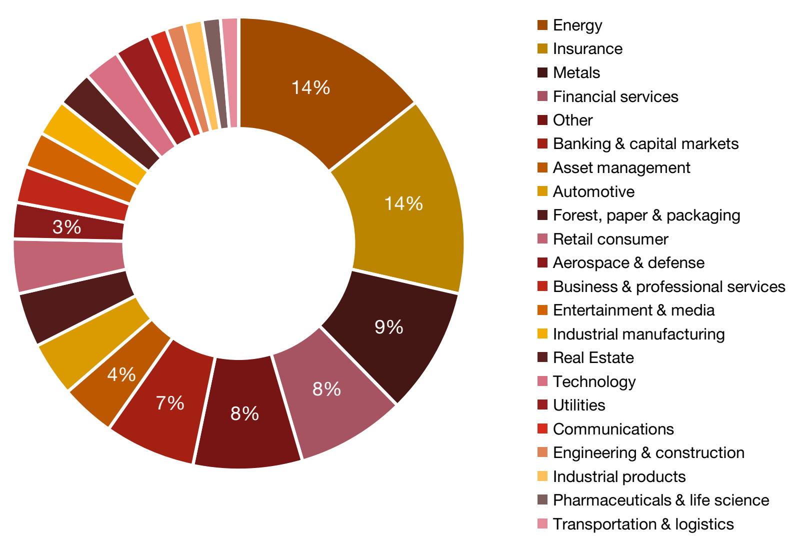
Survey participants

PwC's online survey gathered 266 responses over a four-week period, starting April 16, 2011. Respondents were mostly finance executives and professionals. The Canadian companies ranged in size and industry.

Demographics: Revenue



Demographics: Industry

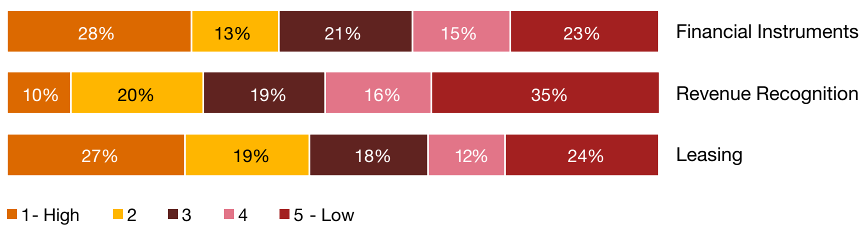


The big picture

Before asking specific questions on each of the three key IFRS priority projects, we posed some overview questions to respondents to get a sense of their thoughts and perspectives on the expected impacts of the Financial Instruments, Revenue Recognition and Leasing projects. We also asked respondents to rank the projects in a few key areas.

Overview: Financial Instruments vs. Revenue Recognition vs. Leasing

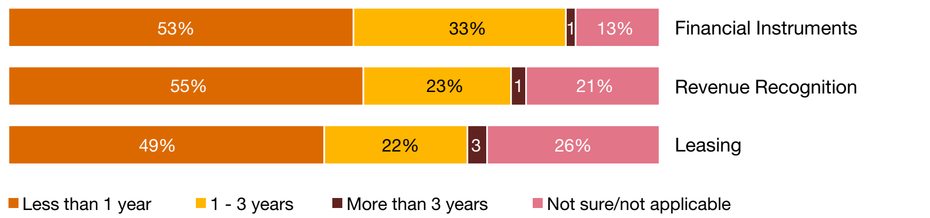
Rate the expected level of impact on your organization for each of the following proposed changes



A significant number of respondents expected the proposed IFRS changes to have a moderate to high impact on their organizations. Drilling down, almost half, 46%, of respondents cited the IFRS changes to leasing as having a moderate to high impact. This is likely a reflection of the nature of the proposed changes to lease accounting relative to the current model, particularly for operating leases. Financial Instruments followed at 41%. When it came to the potential impact of changes to Revenue Recognition, less than one third, 30%, believed that changes to Revenue Recognition would have a moderate to high impact. Certain industries may experience more significant impacts, particularly telecommunication companies, which are actively engaged with the IASB on certain key issues. However, the revenue project does not require the same degree of fundamental change that leasing and financial instruments do.

Timing of implementation

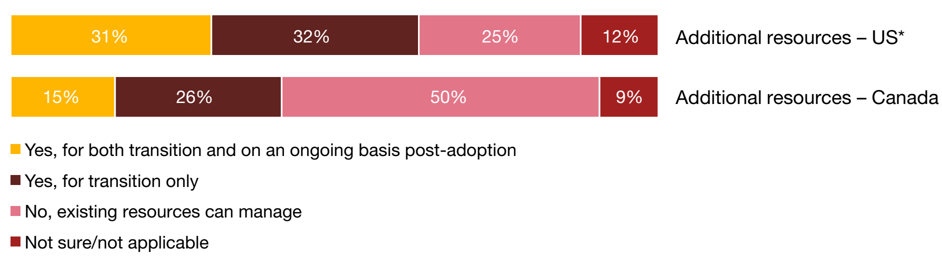
How much time do you expect it will take to implement each of the following proposed IFRS changes



Half of the respondents think that the implementation of the proposed changes will take less than one year. This is in sharp contrast to findings from the PwC U.S. *2011 U.S. GAAP Convergence & IFRS Survey*, which assessed the views of U.S. companies on the same topic. For example, in that survey, 63% of U.S. respondents expected leasing changes to take more than one year. This may be due to Canadian companies already having had some experience in filing IFRS statements, while U.S. companies are still in the early stages of assessing the impact of convergence of U.S. GAAP and international accounting standards. At the same time, Canadian companies tend to be smaller and less international than their U.S. counterparts, therefore, the impact of IFRS changes could be less complex.

Additional resources needed (again a breakout for all three)

Do you believe you will need additional resources to manage the change associated with the proposed IFRS changes? (Canadian vs. U.S.* responses)



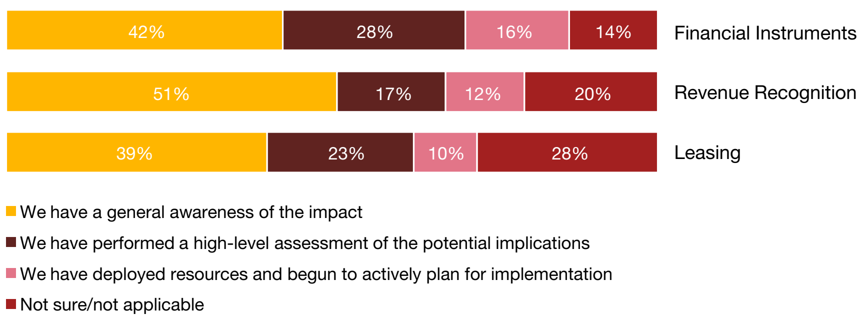
* Information from the PwC 2011 US GAAP convergence & IFRS survey

Half the respondents, 50%, indicated they can manage the implementation of the proposed changes with their current resources. This contrasts sharply with the U.S. survey findings, which reveal that only 25% thought existing resources would be sufficient.

Looking at the specific proposed changes there is a level of concern among the Canadian respondents. For the proposed changes in Lease Accounting, 49% of the respondents have moderate to high concerns when it comes to the resources required to gather data and continually re-assess estimates. At the same time, some 44% said the likelihood of hiring additional resources or outside consultants to assist in the implementation was low.

State of readiness

Where is your organization in the process of analyzing the implications of the proposed IFRS changes?



It's clear from the findings that the majority of the respondents believe they have a general awareness of the impacts of the three priority projects. But, the concept of general awareness can be subjective, and while some respondents may have personally delved deep into the issues, others may base their level of awareness on conversations with their external advisors, auditor or publications. The dedicated IASB (www.ifrs.org) and the PwC IFRS websites (www.pwc.com/ca/ifrs) are a rich resource for those looking for more in-depth information and include podcasts, live webcasts and the latest news and updates.

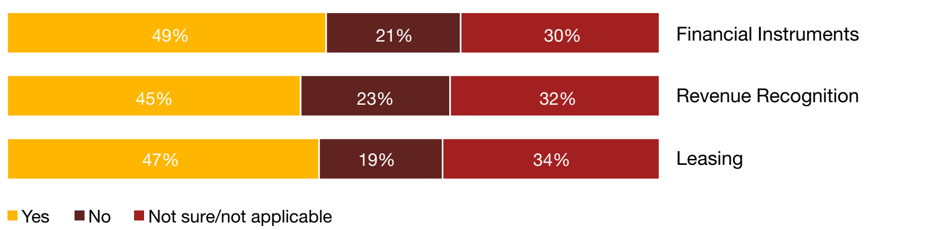
Many organizations have gone further and performed a high-level assessment of the potential implications and/or have already deployed resources and begun to actively plan for implementation. Not surprisingly, with respect to the proposed changes to Financial Instruments, 44% of respondents have done this. It is quite likely that respondents cited Financial Instruments as the area where there is the most planning done, given the largest group of respondents are within the financial services industry.

The reality is the projects and the re-deliberations on proposed changes are ongoing. As a result, most respondents are likely monitoring the situation until the final standards are approved which is proposed for 2012. We believe, under most circumstances, this is a good strategy. It simply doesn't make sense to allocate significant time and effort on implementation before standards are finalized. Yet, we do recommend that companies keep abreast of the discussion and perform a high-level assessment on the possible impacts of the leasing, revenue and financial instruments projects to their business.

There is no one-size fits all assessment. For some companies it will suffice to do a straight forward analysis to understand which aspects of the proposed changes will require the most time and effort to implement once they are finalized. For others, the assessment could involve a detailed gap analysis to determine the potential impacts outside the finance function.

Re-exposure is favoured

Do you believe the IASB should re-expose the proposed standards prior to issuance?



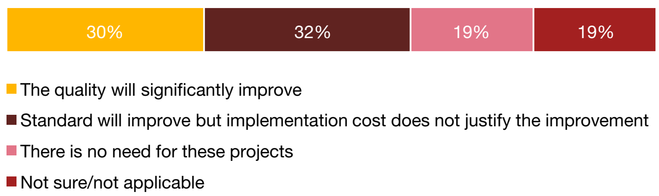
A large group of respondents believe that the IASB should re-expose the proposed standards prior to issuance. This is understandable because the feedback and comments of companies and practitioners is vital to developing quality and realistic standards. Yet, the response is perhaps a little surprising given that a large majority (more than 75%) didn't comment on the original exposure draft.

The fact is the Boards are willing to listen to constituent input and even to change their course when the feedback is compelling. The Boards recognize that theory can be improved with insight from practitioners. The IASB is known for developing conceptually sound and robust standards from a technical point of view. Those in the trenches, working out the debits and credits of a lease agreement, have to implement those concepts and standards from an accounting point of view, which is precisely why the comment process in this re-deliberation phase is important. The IASB website encourages people to get involved and comment on the convergence projects. With the timetable having been extended to the end of 2011 as opposed to mid 2011, the Boards may be inclined to re-expose all or major portions of these three standards.

Recently, the IASB has announced they will re-expose both the leasing and the revenue recognition exposure drafts in the second half of 2011.

Quality and cost of standards

The IFRS improvement project is designed to improve the quality of IFRS and achieve US GAAP convergence. In general do you believe:



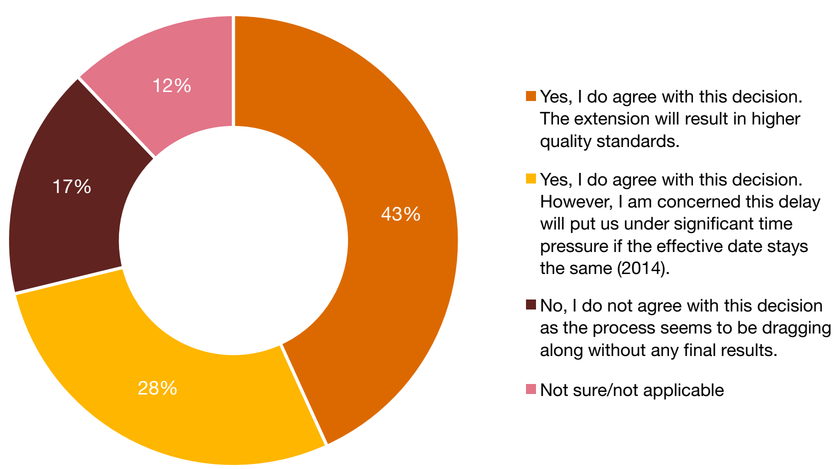
This question elicited mixed responses from Canadian company finance executive professionals. While 30% believed the quality of standards will improve significantly as a result of the ongoing projects, 32% believed the standards will improve but the cost of implementing them does not justify the improvement. And 19% believed there is no need for these projects at all.

Do the benefits outweigh the costs? That is the question on many of the respondents' minds. This concern speaks to the real-world challenges of implementing the new standards, the time and cost in doing so and the perceived benefits.

Reaction to the extension

In an interview on April 14, 2011, the chairmen of the IASB and FASB responded to concerns expressed by the users of the standards, regarding the Boards' ability to deliver high-quality standards while at the same time completing their work by the June 2011 target. Both chairmen responded that they have decided to extend the project timetable for leases, revenue recognition and financial instruments.

Do you agree with the extension of the timetable?



A large majority (71%) agrees with the decision by the Boards to extend the project timetables for a few additional months. But, of this majority, 28% of the respondents are concerned that the delay will put some pressure on their organization to implement the proposed changes before their effective date. The IASB is discussing what the likely impact of the extension will be. We believe that the extended project timetables are a positive decision by the Boards. The extended timetables will provide the necessary time to finalize the re-deliberation process, resulting in high-quality revised standards. We are also of the view that after finalizing the re-deliberation process, organizations should be given adequate time to implement the revised standards. The IASB has issued a discussion paper asking for feedback from the preparers on how they should develop effective dates for standards. These are ongoing, active discussions. All those respondents who would like to see extensions for filing and all those who agree with them now have the opportunity to be heard if they speak up.

Leasing

In our survey, we asked respondents specific questions about the leasing convergence project, how they currently track their leasing information, the analysis done to date and anticipated impacts to systems.

In August 2010, the IASB and the FASB released their joint proposals to improve the reporting of lease contracts for public comment. More than 800 comment letters were submitted and the Boards are re-deliberating the exposure draft. Already the Boards have made tentative decisions and changed some aspects of the proposals based on the feedback. The Boards have announced they will re-expose the leasing exposure draft in the second half of 2011. If adopted, the proposals will improve the financial reporting information available to investors. Current requirements for the accounting of leases depend on how the lease is classified. The proposed new standards take a "right-of-use" approach, which is designed to result in a more consistent approach to lease accounting for both lessees and lessors as they require all leases to be included in the statement of financial position.

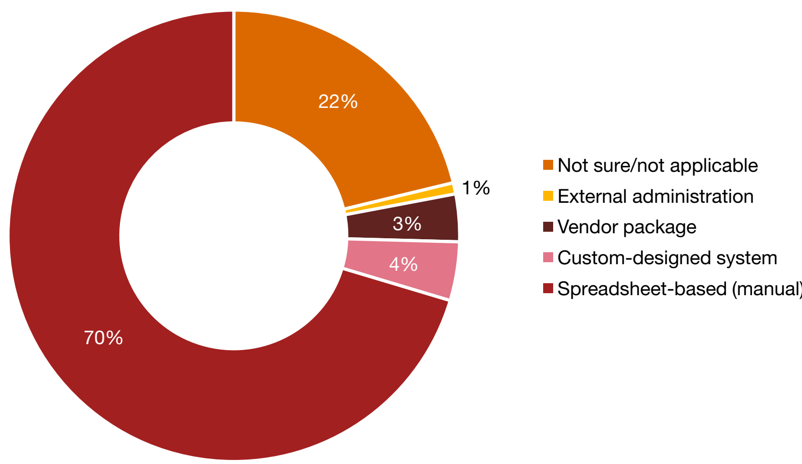
Where is the data?

When it comes to the potential impact of the proposed IFRS Leasing project, data requirements is a top issue.

Where does the information on your lease reside?

Half of the companies surveyed currently have one central location for their lease information. This will serve them well in meeting the ongoing reporting requirements under the proposed new standard. On the other hand, those companies that have decentralized the leasing function could find compliance challenging.

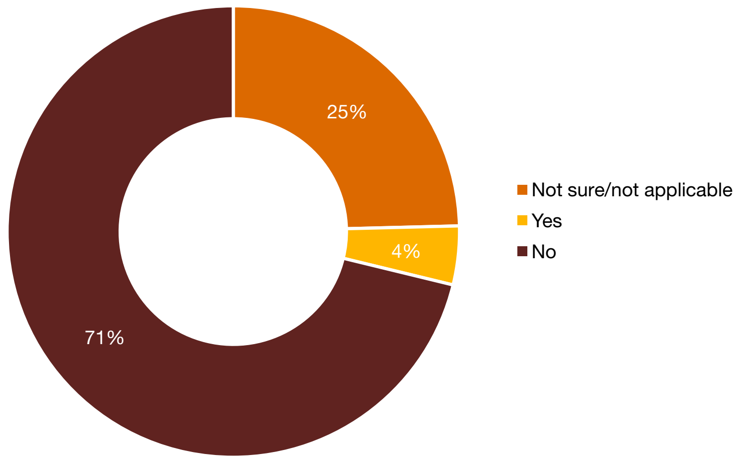
What is the predominant system your organization currently uses to account for leases?



Currently, spreadsheet-based solutions are by far the predominant platform for lease accounting, with 70% of respondents using them. It'll be important to assess the scalability of spreadsheet solutions in an environment where all lease arrangements are reported because using spreadsheets increases the chances of errors. We believe organizations would be well advised to evaluate how to improve their control environment around leases.

Third-party vendors

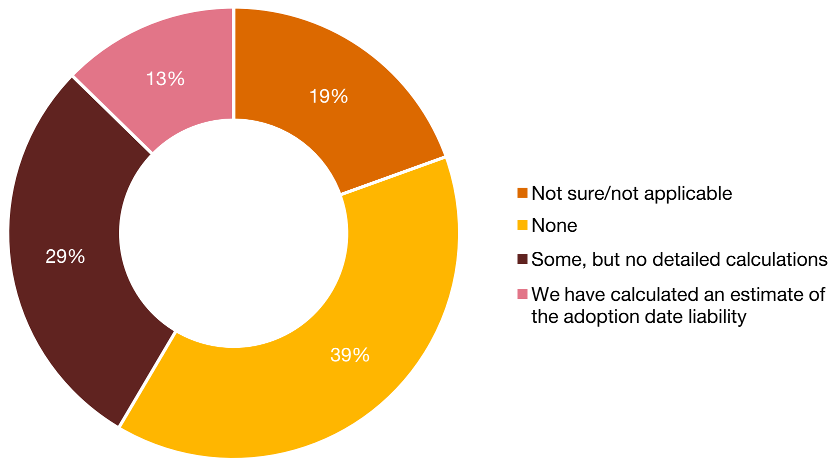
Have you had discussions with third-party vendors?



Almost half of the respondents (46%) think that because of the proposed changes they need a system upgrade, but very few (4%) have spoken with a third-party system vendor/provider at this stage. Given that the Leasing project has not been finalized, most major systems vendors are more than a year from releasing the software capable of handling the proposed new leasing model. For the time being, companies can at least review how they are managing, tracking and storing their lease accounting data so that when software becomes available, they are better prepared to make informed decisions.

Estimating lease liability

How much analysis has been done to date to estimate the adoption date lease liability?



Companies appear to be in a holding pattern as they await the finalization of the project. In fact, only 13% had calculated an estimate of the lease liability. Some 39% of respondents had done nothing to date to estimate the adoption date lease liability, while 29% had done some but not detailed calculations. This is in contrast to the U.S. survey's findings, which revealed that 53% of U.S. respondents had started to address the question of what impact the proposed new leasing guidance might cost.

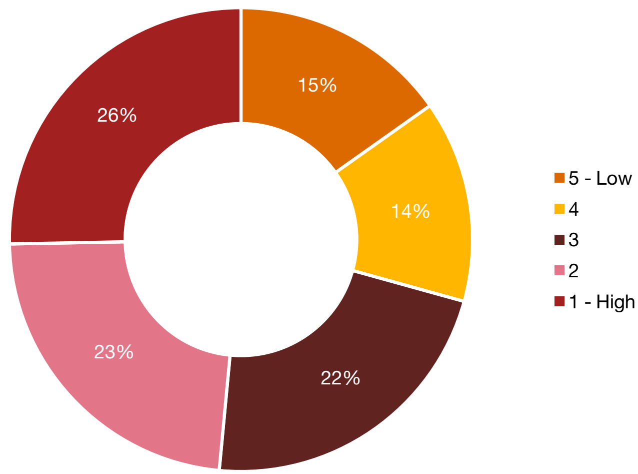
Interestingly, 53% of the Canadian respondents that had estimated their lease liability indicated the estimate was higher than originally expected. 47% said their estimate was in line with their expectations. But none said it was lower than expected. On the one hand, this could be a concern for companies that have not yet begun to estimate their date lease liability. It's also possible that given that some of the proposed changes are softening in the re-deliberation process, the actual impact may come back a bit more in line with expectations.

Concern over implementation

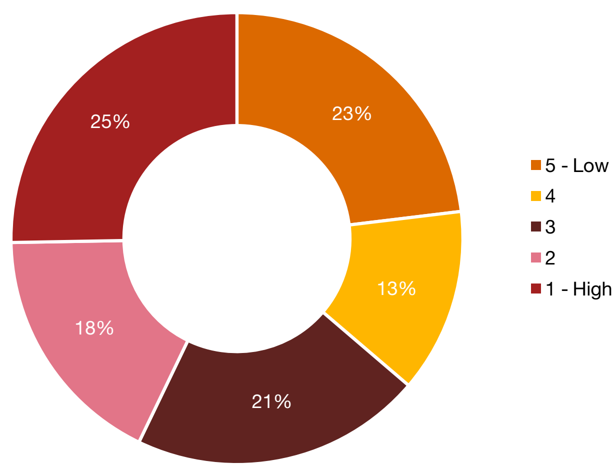
We asked respondents how concerned they were about the difficulty of implementation in five specific categories, and the majority (61%) reported they have a moderate to high level of concern overall. They were most concerned about resources (71%) and the fact that there will be no grandfathering of existing leases (64%).

Please indicate your level of concern for the following potential impacts of the leasing exposure draft.

Resources required to gather data and continually re-assess estimates

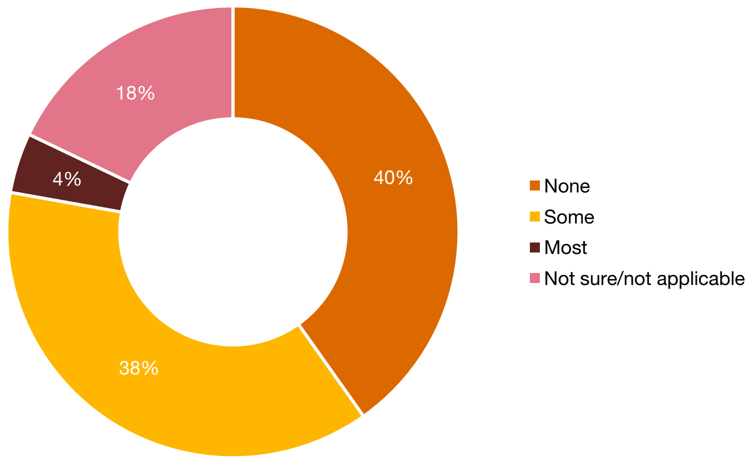


No grandfathering of existing leases



Stakeholder awareness

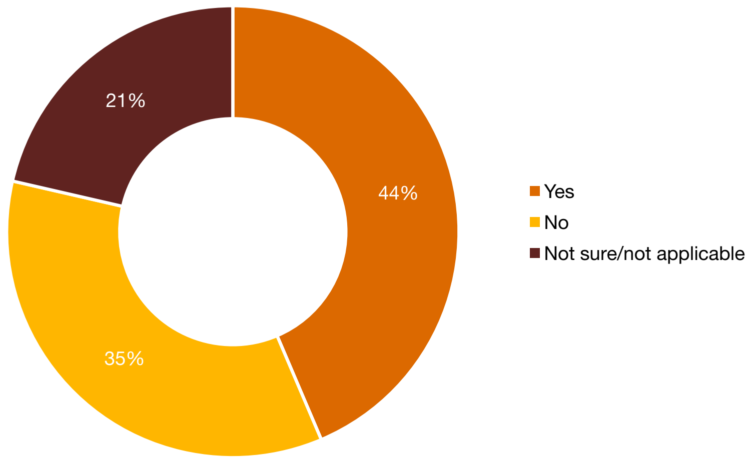
To what extent have stakeholders outside of the finance/accounting department been educated on the proposed leasing standard (e.g. board/audit committee, senior management, treasury, tax, real estate, investor relations)?



Eventually, it will be necessary for all stakeholders, including those outside the accounting and finance departments, to be made aware of the changes to lease accounting under the IFRS Leasing project. These stakeholders may include corporate real estate, treasury, operations, information/technology and legal. When respondents were asked about the extent to which the organizations had educated these stakeholders, 42% said that some or most had been educated. Many respondents, 40%, reported they had not talked to stakeholders outside of finance about the leasing project. The strategic thought behind this is sound. The fact is you have to strike the right balance about what to communicate and when. Once you start sharing information with people outside of finance, they will want to know how changes will impact them and what they need to do, and those answers are not yet available. Companies that start this education process too early, risk frustrating and then losing the interest of these stakeholders so that when the time does come to engage them, they may not be so willing to offer meaningful feedback. That said, it's important to keep key internal stakeholders such as senior management and audit committees in the loop as the convergence projects and related impacts unfold.

Inventorying the lease portfolio

Have you performed an inventory of your lease portfolio—for example, understanding what types of assets are leased and where the data resides?



Some, 44% of companies surveyed, have taken at least a preliminary look at what types of leases exist in their portfolio and where the data resides, while 35% have not. The latter group may be missing an opportunity to trouble shoot and to begin the necessary process to create an informed implementation roadmap. The reality is the proposed leasing changes will have a significant impact on many companies. For many companies, the sooner they start preparing and identifying the gaps when the standard is in its final stage, the smoother the implementation will be once it goes live.

Revenue Recognition

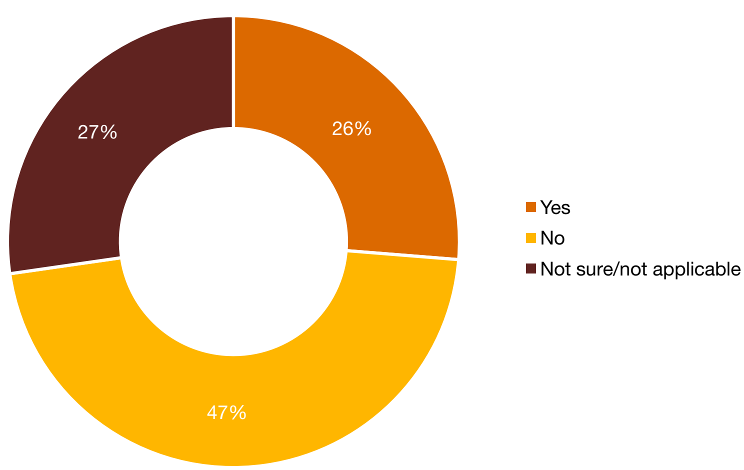
Of the three priority convergence projects, Revenue Recognition was rated third as far as anticipated impact. But, at the time the FASB and IASB released their exposure draft in 2010, there was obviously much concern given they received hundreds of comments. The primary concerns focused on the lack of clarity around the transfer of control for services, challenges in identifying and separating performance obligations, the accounting of warranties and the model proposed for licenses of intellectual property. As well, some pointed to issues with the practicality of full retrospective applications (recasting financial information to prior periods). After extended re-deliberation the Boards reached decisions around issues about concerns raised through the comment letters by the public. The final standard is expected in 2012 and the likely effective date will be no earlier than 2015.

Amount and timing of revenue recognition

Almost half of respondents, 47%, didn't expect the proposed standards to have an impact on their companies. As the majority of the respondents are in industries that will not be affected by the changes, this is not surprising.

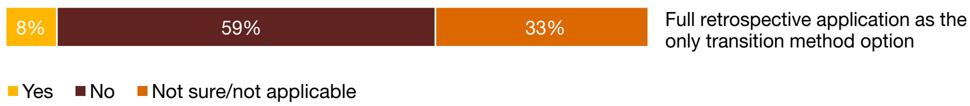
In the minority, 26% of respondents believed the proposed standard will lead to a significant shift in how revenue is recognized. The truth is, the new standard moves away from specific measurement and recognition thresholds and leaves room for interpretation.

Do you expect the proposed standard to impact the amount or timing of revenue recognition for your company?



Full retrospective application

Do you agree with the following aspect of the revenue exposure draft?

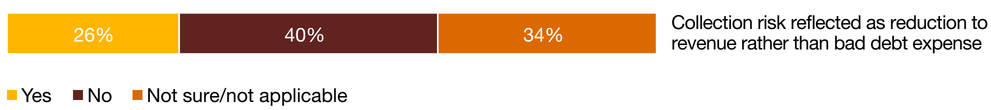


When it came to the Revenue Recognition Exposure draft, respondents in both the Canadian and US surveys expressed the greatest level of disagreement and attributed the greatest significance to full retrospective application—recasting prior period financials. Even those who agreed with full retrospective application noted that implementing the standard would require significant resources.

While there is a case to be made to applying the proposed requirements retrospectively to achieve consistency and comparability across periods presented, retrospective application may be difficult to apply in a number of situations. As well, the costs may outweigh the benefits and could require significant incremental efforts and resources in restating historical information. Companies are well advised to closely monitor this requirement.

Collection risk

Do you feel the tentative decisions (as at March 31, 2011) on current re-deliberations are an improvement from the revenue exposure draft?



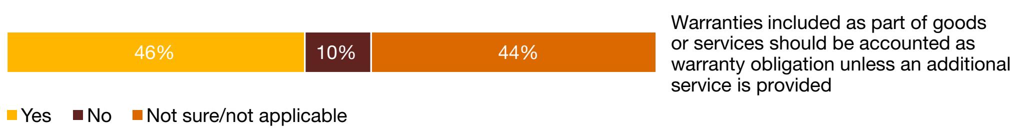
Collection risk reflected as a deduction to revenue came in second in terms of disagreement. Almost half (49%)of respondents disagreed with the Exposure Draft that credit risk should be recorded as a reduction of revenue, with subsequent changes in the assessment included in other income or expenses. Even though the IASB and FASB changed the proposal that collection risk should be part of revenue measurement to accounting for collection risk as a contra to revenue, almost 40% of the respondents still disagreed with this tentative decision around the treatment of collection, only slightly down from the 49%.

Warranties as a deferral of revenue

Do you agree with the following aspect of the revenue exposure draft?

Many respondents strongly disagreed with the Exposure Draft proposal that warranties be treated as a deferral of revenue rather than as a liability. The Boards received similar feedback and as a result have decided to change this aspect of the proposed model. Instead, the tentative proposal as of March 31, 2011, is that an entity should account for some warranties as a warranty obligation (a cost accrual).

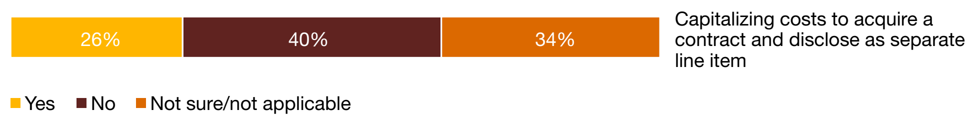
Do you feel the tentative decisions (as at March 31, 2011) on current re-deliberations are an improvement from the revenue exposure draft?



Respondents reacted positively to the re-deliberation process of the Boards on this issue. Some 46% believed it was an improvement.

Capitalization of contract cost

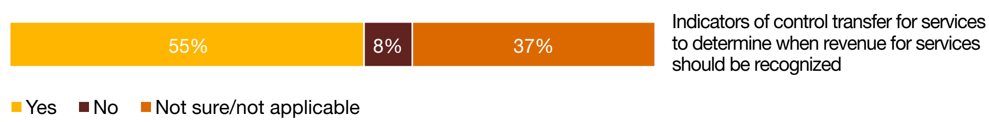
Do you feel the tentative decisions (as at March 31, 2011) on current re-deliberations are an improvement from the revenue exposure draft?



Another area where the respondents disagreed with the Boards' tentative decision is around the capitalization costs to acquire a contract. In the Exposure Draft, the Boards' proposed to expense these cost through the profit and loss statements, a decision that was supported by more than 45% of the respondents. But in the re-deliberation process the Boards' decided that these costs should be capitalized as a separate line item. Almost 40% of the respondents did not agree with this tentative decision.

Indicators of control transfer for services

Do you agree with the following aspects of the revenue exposure draft?



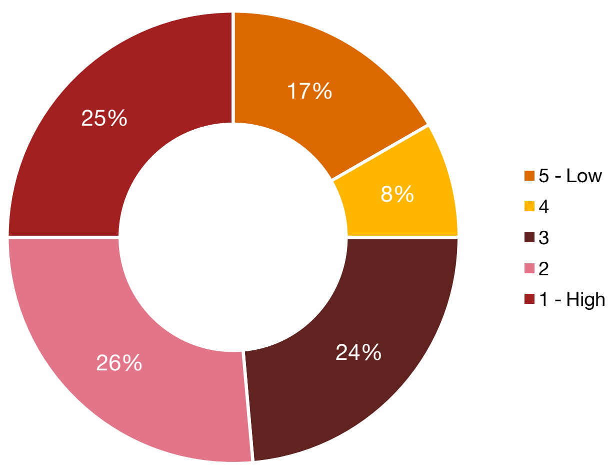
This is another area that illustrates theory and practice do not always mesh. A majority of respondents agreed with the concept, they found the guidance difficult to apply to service contracts. At the same time, almost half of respondents, 49%, anticipated these changes would have a significant impact on their business. The good news for these respondents is that during the re-deliberation process, the Boards tentatively agreed on new guidance for determining when to recognize revenue for services. The process is ongoing and companies are well advised to stay current on the changes and how they might impact their business.

Financial Instruments

On October 28, 2010, IASB re-issued IFRS 9 Financial Instruments, which incorporates new requirements on accounting for financial liabilities and carry over from IAS 39 the requirements for de-recognition of financial assets and financial liabilities. Recently, the IASB issued an exposure draft that proposes to delay the effective date of IFRS 9 Financial Instruments, to annual periods beginning on or after January 1, 2015. The original effective date was for annual periods beginning on or after January 1, 2013.

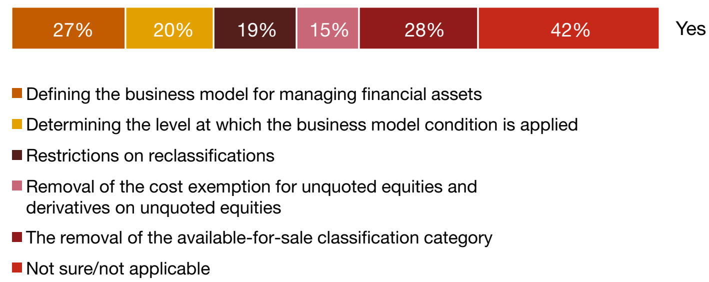
Impact on the business

In each of the following areas, please rate the likely impact the IASB Financial Instruments proposals will have on your business.



The majority of respondents (75%) indicated that the proposed changes in Financial Instruments will have a moderate to a high impact on financial reporting. Even so, only 32% believed they would need to bring in additional resources to deal with the changes, and 37% anticipated implementing new technology platforms.

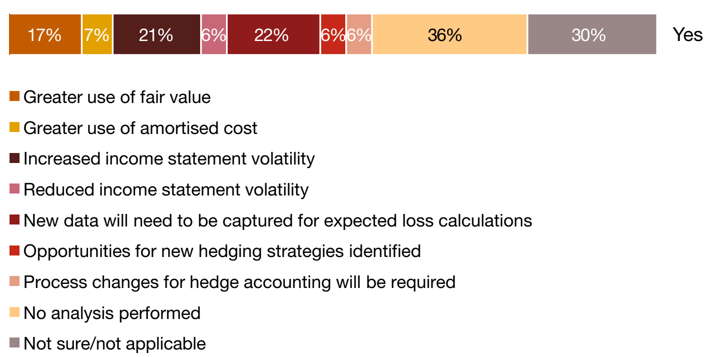
What areas of IFRS 9 do you think will have the largest impact on your business? (select all that apply)



A large group of the respondents reported they were not sure what the impacts of IFRS 9 would be, but, approximately 27% cited that “Defining the business model for managing financial assets” and “The removal of the available-to-sale classification category” would have an impact on their organization.

Analysis has been spotty

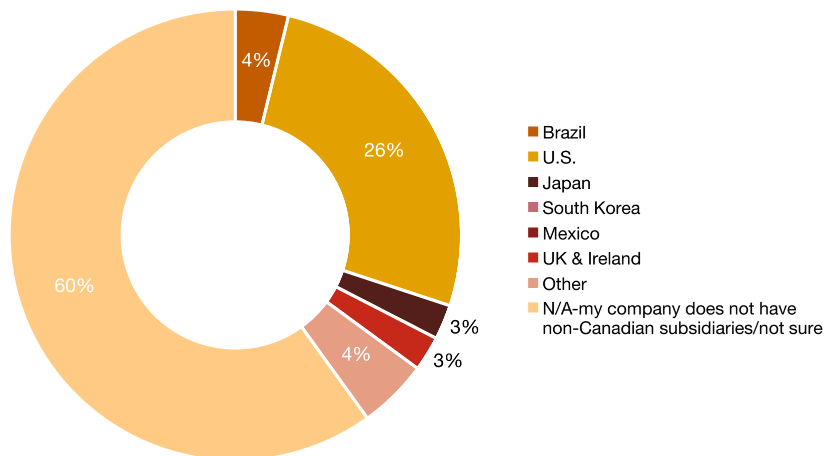
Has your organization performed any analysis of the likely impact of the Financial Instruments proposals and if so what do the results show? (select all that apply)



The majority, 66%, of respondents had not analyzed the financial impact of their business or were not sure of the impact. As with the other priority convergence projects, uncertainty because the final standards have not yet been released is colouring companies’ choices. On the other hand, about one-third of respondents had performed an analysis of the likely impact of the proposed Financial Instruments standards. The themes they identified in their analysis are consistent with our expectations: 22% said they will need to capture new data for expected loss calculations; 21% said increased income statement volatility; and 17% identified greater use of fair value.

Adoption of IFRS around the globe

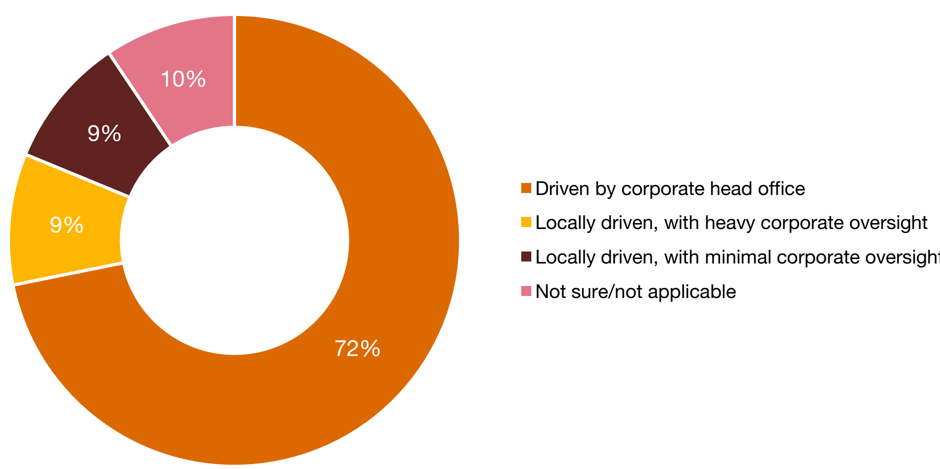
IFRS adoption and convergence is continuing around the globe (e.g. UK, Brazil, US, Japan). Of the following countries, where are you focusing your greatest efforts with regards to IFRS and the convergence?



As expected, given the geographic proximity of the US to Canada and our deeply connected economies, the majority of respondents are focusing their convergence efforts outside of Canada, in the US.

How are you approaching these non-Canadian adoption efforts?

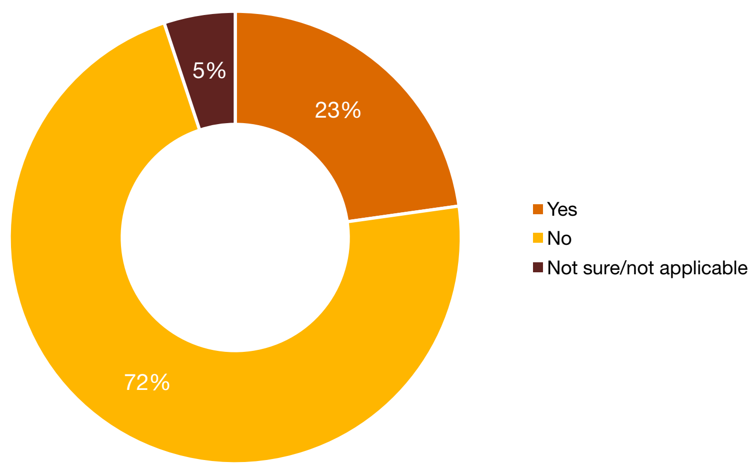
The majority, 81%, of respondents' company efforts were driven or had heavy involvement by corporate head office. This is positive news as we believe significant head office involvement is important for successful IFRS adoption.



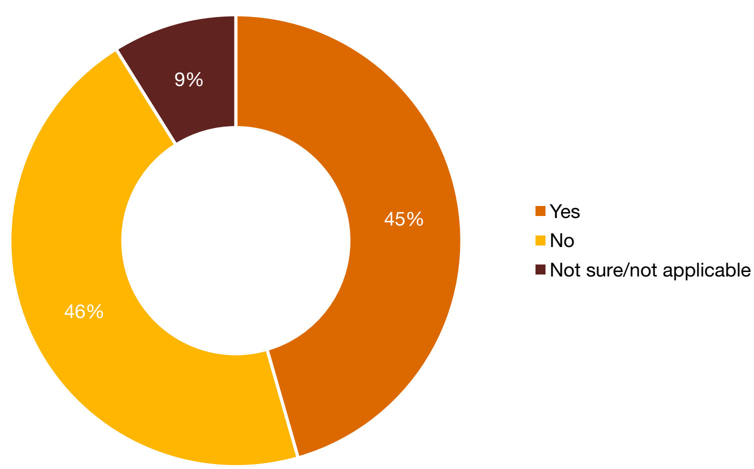
Systems upgrade

The implementation of the new IFRS will require far more than simply accounting changes. Both changeover and convergence are expected to significantly impact data requirements and their capture. Spreadsheets may not suffice and may introduce risk into the financial reporting process. Even so, results show that the respondents (72%) have not yet implemented upgrades or new systems due to IFRS conversion. Respondents were evenly split when it came to whether they believed their systems would need an upgrade or not.

Have you currently undergone a system upgrade or implementation due to IFRS conversion?



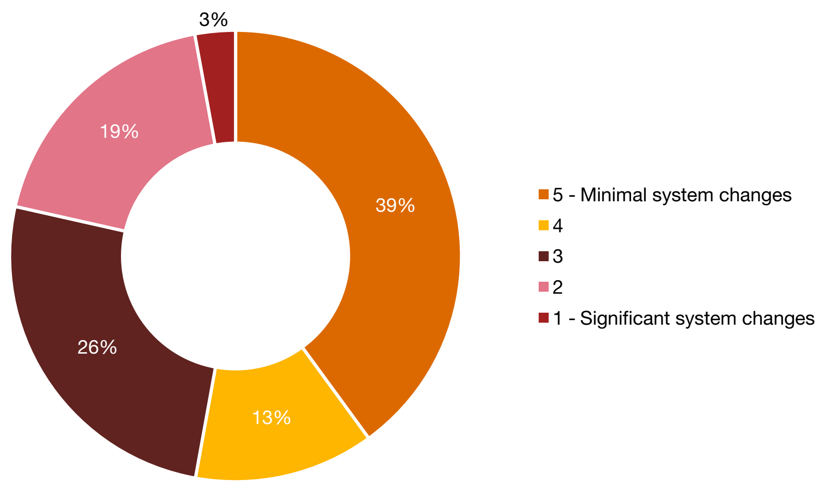
Do you believe your systems will need further updating for the proposed IFRS improvements mentioned above?



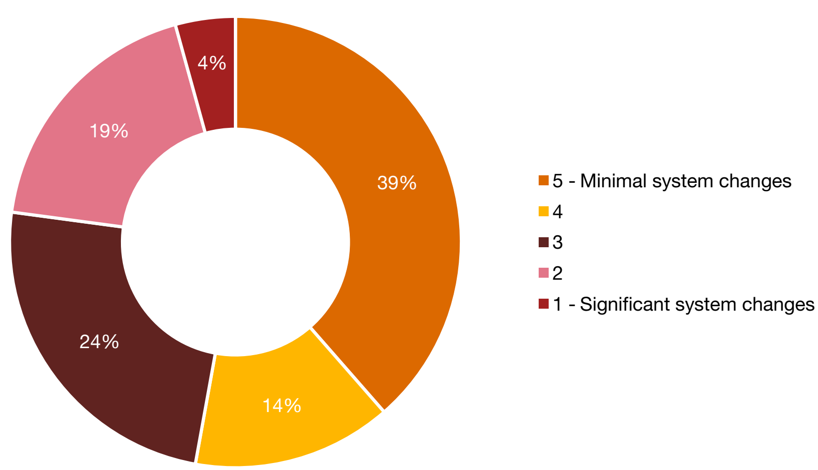
The table below shows how the respondents rate the proposed IFRS changes from 1 to 5 in terms of anticipated systems changes and new data requirements.

Rate the proposals in the areas below from 1 to 5 of impact on your organization's systems, if approved in current form.

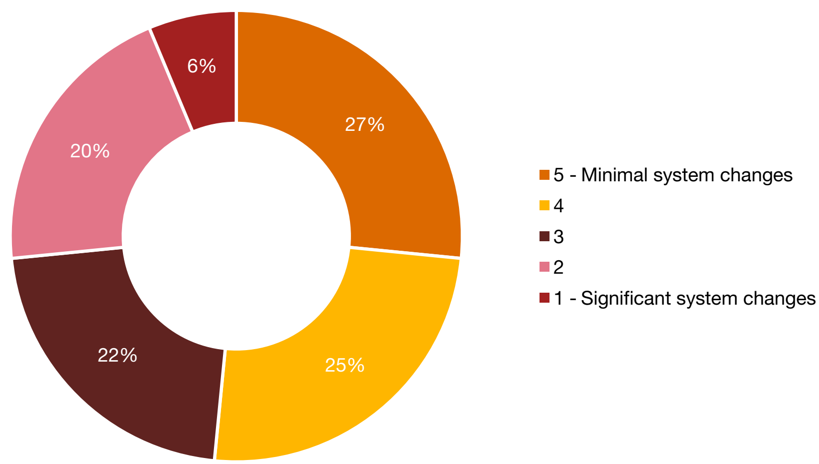
Classification and measurement of financial assets



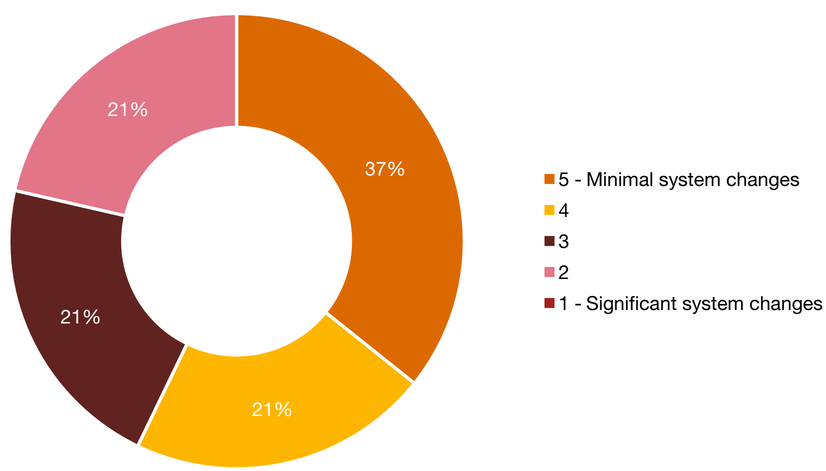
Classification and measurement of financial liabilities



Impairment

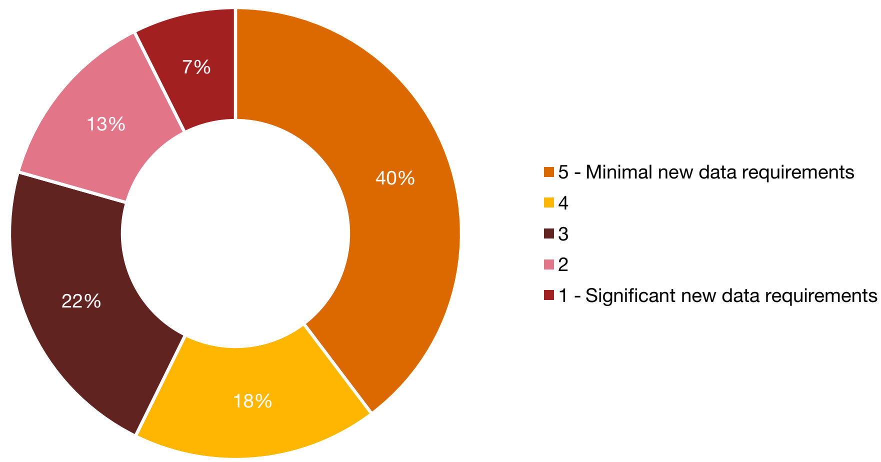


Derivatives and hedging activities

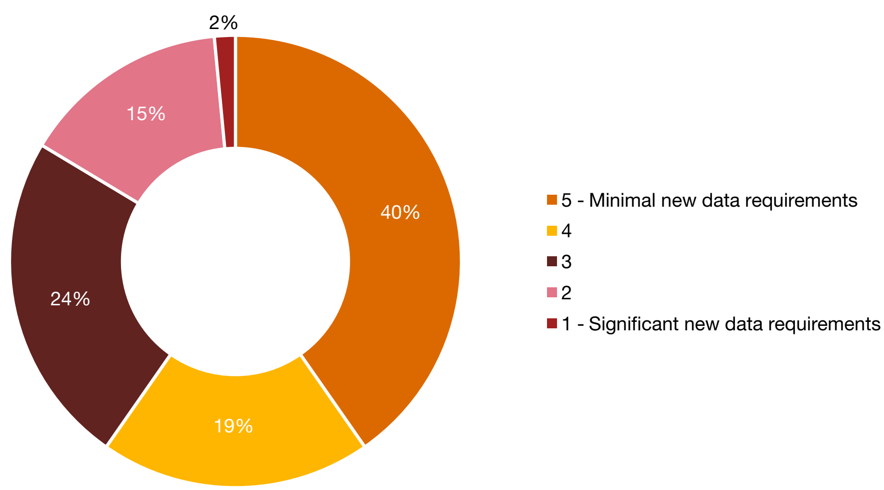


Rate the proposals in the areas below from 1 to 5 of new data requirements for your organization, if approved in current form.

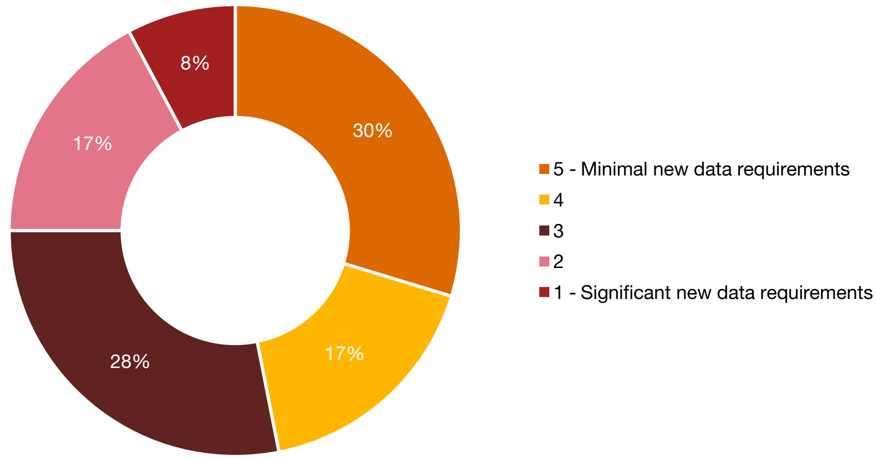
Classification and measurement of financial assets



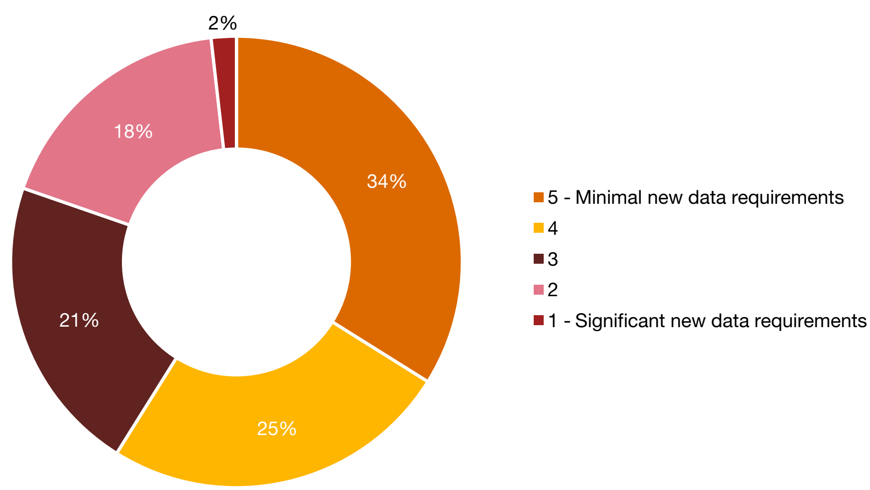
Classification and measurement of financial liabilities



Impairment



Derivatives and hedging activities



As we can see, the majority of the respondents thought the impact on their organization's systems and the requirements for new data would be minimal. With regards to the system changes for the proposed revisions on impairment this could be surprising. As the model for impairment is significantly changing from the current model many would expect that this will result in a need for changes in the organizations' current systems and new data requirements.

Moving forward

The goal of undertaking this survey was to provide an opportunity for all organizations and practitioners dealing with IFRS, to see how others are preparing for the new standards and what their thoughts are on some of the detailed issues.

It is obvious from the survey responses that many Canadian finance executives have a high level of general awareness of convergence-related changes to lease accounting, financial instruments and revenue recognition. While these priority convergence projects are still in the developmental stages, some of the most significant elements could be mandatory as early as 2013 or 2014 (as comparative periods). Given the level of change and the impact on comparative reporting periods, companies across industries may want to start assessing what the potential impacts are likely to be for their organizations. From the survey responses we perceive that a large group of respondents have already performed a high-level assessment of the potential implications or have deployed resources and have already begun to actively plan for implementation. Respondents believe the greatest impact will come in the area of lease accounting, followed by financial instruments and revenue recognition. The majority also believe implementation of the new standards will take less than a year.

As the Boards' are still in the re-deliberation process there are still uncertainties about what the final standards will be, but what we do know for sure is that the Boards are willing to listen and are receptive to suggestions. In this survey of Canadian companies, we asked organizations if they had commented on the Exposure Drafts. The number of companies that had not, ranged from 76% to more than 80%. That said, the majority believe the IASB should re-expose the proposed standards prior to issuance, which would give an opportunity for all those who have concerns or are interested in improving financial reporting standards across the world to speak up and get involved.

Who to call

IFRS

Diane Kazarian
Partner, National Leader
416 365 8228
diane.a.kazarian@ca.pwc.com

Capital Markets Group

Geoff Leverton
National Leader
416 815 5053
geoff.m.leverton@ca.pwc.com

Financial Services

Jason Boggs
Partner
416 941 8311
jason.boggs@ca.pwc.com

Accounting Consulting Services

Michael Walke
Partner
416 815 5011
michael.walke@ca.pwc.com