

IFRS Advisory Committee
Report on Public Meeting
January 29, 2009

The IFRS Advisory Committee (IAC) met in Toronto on January 29, 2009. The Chair and AcSB staff provided an update on recent activities of the IASB and the AcSB.

The Chair noted that the Accounting Standards Oversight Council (AcSOC) and the AcSB have reconfirmed that nothing in the current economic environment has influenced them to change the date for Canada's changeover to IFRS of January 1, 2011. In fact, some of the reasons for changing to IFRSs, such as greater access to capital markets around the world for Canadian companies and strong investor support for a common set of accounting standards are even more apparent than before. To minimize changes leading up to Canada's transition to IFRSs, recent decisions by the AcSB have often meant not adopting changes issued by the US Financial Accounting Standards Board (FASB) and delaying the effective dates of some standards issued by the IASB to 2011. Therefore, the Chair noted that if there was a change in the 2011 date, current Canadian GAAP would require some challenging updates. Also, a delay could result in the Canadian changeover occurring at a time when changes to IFRSs themselves are less manageable. Furthermore, many enterprises are proceeding well with their preparation for the changeover on the understanding that the date will not change.

The Chair reviewed advice given to the AcSB resulting from the last meeting of the IAC. In particular, he noted that:

- a forthcoming second omnibus Exposure Draft, "Adopting IFRSs in Canada II," will contain clarifications to the definition of a publicly accountable enterprise [issued March 12, 2009];
- the Public Sector Accounting Board plans to issue an Invitation to Comment on the application of IFRSs by certain entities in the public sector [issued February 24, 2009]; and
- the CICA Performance Reporting Board has issued its publication, "Pre-2011 Communications about IFRS Conversion."

Observations on IFRS Implementation

IAC members commented on progress that organizations are making in their preparations for transition to IFRSs. The following matters were noted.

- Stage of preparation — Many enterprises are well into their preparations for the changeover. As they reach more advanced stages of preparation, more questions about application of particular standards are arising. Fewer smaller listed companies are starting their preparations, which is of some concern. Efforts will be necessary to encourage smaller enterprises to start planning.
- Current economic environment — The current economic environment has posed a challenge by taking the focus away from the planning and execution of plans for

transitioning to IFRSs. It is also putting pressure on enterprises to transition to IFRSs in the most cost-efficient way, which may not result in a company making the best choices for its financial reporting issues.

- MD&A disclosure requirements — Preparers are reluctant to disclose too much in case it raises expectations that are not met in the future. Also, enterprises may not disclose the quantitative effect of new IFRS policies because of their reluctance to restate previously disclosed financial information should decisions about policy selection change. Regulators expect to scrutinize carefully the MD&A disclosures in 2008 annual financial reports.
- Errors — Some concern was expressed that the process of adopting IFRSs might reveal errors in the application of prior Canadian GAAP. It was noted that such circumstances would need to be evaluated on their merits. However, disclosures required by the Canadian Securities Administrators' CSA Staff Notice 52-320 are directed to user's understanding of the effects of transition to IFRSs, not to identifying past problems.
- IFRS 1, *First-time Adoption of IFRSs* — Enterprises have been disappointed by the limitations of the proposed amendment to IFRS 1 that allows lease contracts to not be reassessed on transition to IFRSs if that lease was previously assessed under IFRIC 4, *Determining whether an Arrangement Contains a Lease*, or an identical requirement, but at a date other than that required by IFRIC 4. For Canadian constituents, this does not provide relief for many lease contracts because EIC-150 on this topic had a different transitional provision from IFRIC 4. The Chair responded that the IASB understood the limitations of the proposed amendment, but was only willing to allow an exemption for contracts assessed under identical previous requirements.
- IAS 12, *Income Taxes*, and royalties — The resource sector, in particular the oil and gas industry, is struggling to decide how to account for royalties and other revenue-sharing arrangements under IFRSs. The Australians found diversity in practice, including accounting in accordance with IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, IAS 2, *Inventories*, and IAS 12. In March 2006, IFRIC decided not to take on a project to clarify which taxes qualified under IAS 12, but in their agenda decision they “noted that IAS 12 applies to all taxes which are taxes that are based on taxable profit” and the “IFRIC observed that any taxes that are not in the scope of IAS 12 are in the scope of IAS 37.” Subsequently, the Australian Accounting Standards Board issued an interpretation addressing the treatment of the Australian Petroleum Resource Rent Tax (that is based on taxable profit), an arrangement considered similar to many in Canada.
- IAS 16, *Property Plant and Equipment*, and depreciation of components — Members indicated that people are still having problems determining their approach to the allocation of components of an asset for the purposes of amortization. It was noted that the discussion of components and the meeting notes from the April 10, 2008 meeting of the IAC were a help, but there are still problems. Members were reminded that IAS 16 allows components to be separated on a prospective basis if they were not separated on initial recognition. A number of IAC members were in

agreement with the approach to components but indicated that, in their opinion, problems can arise when auditors take a tougher line than do advisors.

- IAS 19, *Employee Benefits* — The current project by the IASB to revise IAS 19 proposes to eliminate the deferral of actuarial gains and losses. IFRS 1 currently allows a company, on transition, to choose to write off any deferred actuarial gains and losses, but the pending proposals in the IAS 19 project could result in this being a mandatory write-off when Canadian companies transition to IFRSs.
- IFRIC 14, *IAS 19 — The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* — This is likely to have a significant effect in Canada as economic circumstances affect the limit on a defined benefit asset.
- IAS 21, *The Effects of Changes in Foreign Exchange Rates*, and functional currency — Some entities have been surprised that IAS 21 has resulted in them determining that they have a different functional currency.
- IAS 32, *Financial Instruments: Presentation* — Organizations are reviewing and revising their governance documents to avoid undesired results resulting from different liability versus equity classification on transition to IFRSs. However, some do not like the result of applying the recent changes to accounting for puttable instruments in IAS 32, especially to real estate investment trusts and mutual funds.
- IAS 36, *Impairment of Assets*, and cash generating units — Under IAS 36, impairment is tested at the cash generating unit level, which is the smallest group of assets that generates cash inflows, while under Canadian GAAP, impairment is tested at the asset group, which is the lowest level for which there are identifiable net cash flows. This is causing some re-evaluation of the level at which impairment testing is performed.

Rate-regulated Activities

Accounting Standards Board staff informed IAC members that the IASB had added a project to its agenda in December 2008, to review whether rate regulation can create an asset or a liability under certain circumstances. Canadian entities with operations subject to rate regulation were cautioned that in spite of the IASB's project, they should continue their plans to convert to IFRSs as the standards are currently written. Further, they should not assume that, even if the IASB decides it is sometimes appropriate to recognize an asset or liability as a result of rate regulation, all assets and liabilities they have recognized in the past will qualify; (this is unlikely when such an item has been recognized in advance of obtaining regulatory approval). The project schedule calls for an exposure draft by mid-2009 that will provide Canadians an indication of the IASB's thinking on the subject. It is expected that the proposals will focus on the form of regulation, which can differ by country and industry, and that they will still require the exercise of professional judgment.

IAC members discussed the recent proposal for IFRS 1 that would provide some relief for enterprises affected by rate regulated activities. The proposal would amend IFRS 1 to include an exemption that would allow operations subject to rate regulation to choose to use the carrying amount of items of property, plant and equipment containing amounts

that do not qualify for capitalization under IFRSs as their deemed cost at the date of transition to IFRSs. However, the ability to use the exemption would only be available if both retrospective restatement and the use of fair value as deemed cost is impracticable. It was clear that many are concerned about this condition of impracticable that the IASB is proposing be attached to this exemption. Other exemptions in IFRS 1 have no such condition. The Chair noted that the IASB had received 90 comment letters on the IFRS 1 amendments with many voicing their concern about the impracticability hurdle.

Auditing and Assurance Matters

The Auditing and Assurance Standards Board (AASB) has established a task force to develop non-authoritative guidance for auditors on the assurance implications on the transition from Canadian GAAP to IFRSs. Representatives of this task force provided the IAC members with a list of issues they had identified. The IAC was asked to review the list and provide comments and suggestions on whether there were other issues that should be included in the list and whether the issues in the list were appropriate. IAC members suggested some clarification on the terminology used in the list, but they were generally in agreement with the issues listed.

Interim Financial Statements

While discussing auditing and assurance matters, the IAC noted that there is some lack of clarity as to how IFRSs should be applied to interim financial statements in the first year of adoption. The AcSB has stated that it intends IFRSs to be adopted for interim and annual financial statements relating to years beginning on or after January 1, 2011. However, many people are not clear as to what needs to be included in the first interim financial statements, what basis of reporting will be required and what the consequences are for selection and changes in accounting policies during the first year of adoption. IAC members encouraged the AcSB and regulators to provide greater clarity in this regard.

Consolidation

The IASB issued an Exposure Draft, “Consolidated Financial Statements,” in response to some of the problems identified as weaknesses through the credit crisis. The Exposure Draft proposes a single model for determining whether a reporting entity has control of another entity. IAC members were asked to consider the application of the proposed control principle to structures used in North America and to comment on the decision-usefulness and practicability of the disclosures proposed about a reporting entity’s involvement with structured entities that is does not control.

The preliminary impression of members, who expressed a view, was that the proposed control principle did not raise any significant issues and would improve consistency over the different approaches currently in IAS 27, *Consolidated and Separate Financial Statements*, and SIC 12, *Consolidation — Special Purpose Entities*. However, concerns were expressed over the amount of judgment required to assess control through holding less than a majority of voting rights, and that the proposals regarding options and convertible instruments when assessing control of an entity are not clear. Members also expressed a desire for more guidance on judging the relative significance of the factors

listed in the Exposure Draft to evaluate structured entities. It was also noted that entities will need internal controls to enable them to continuously assess which entities they control.

It was noted, also, that the change from existing North American accounting for variable interest entities would likely be greater than that for entities presently using SIC 12. The proposals are more specific than those of SIC 12. Some are concerned that this project creates a “moving target” for planning purposes in Canada. It can take a long time to go through an entity’s investments to determine where control exists, so a change to the requirements just as Canada transitions to IFRSs would be challenging.

Revenue Recognition

The IAC discussed the IASB’s and FASB’s joint Discussion Paper, “Preliminary Views on Revenue Recognition in Contracts with Customers.” The Discussion Paper proposes a single contract-based revenue recognition model. Members questioned why the IASB was moving away from current models and some indicated it would have been helpful if the Discussion Paper had explained why the IASB and FASB had selected the model they did over the others. A member pointed out that there is some risk that Canadian enterprises applying IFRSs would undergo two rounds of change in a short period of time since current Canadian GAAP for revenue is not fully converged with current IFRSs.

The proposed model only recognizes revenue from increases in an entity’s net position in a contract with a customer. It was noted that this could be a fundamental change in revenue recognition for some, such as construction businesses and those that provide bundles of goods and services. Members discussed the effect of assessing the satisfaction of a performance obligation when the satisfaction of a performance obligation is based on the customer obtaining control of the asset and control is a legal concept. This could result in the same contracts in different jurisdictions being recognized differently. Generally, members considered that the Discussion Paper contained insufficient analysis in many areas. In particular, it was noted that costs are not addressed. Concern was also expressed as to whether the model would work for financial products, such as those entered into by financial institutions, insurance companies and leasing organizations. While it seems desirable to develop a single model, it might be satisfactory to develop a few models, together with guidance as to when each would be used. This would be an improvement on the myriad of models presently used.

Financial Statement Presentation

The IAC was asked for input on the IASB’s and FASB’s joint Discussion Paper, “Preliminary Views on Financial Statement Presentation.” The Discussion Paper proposes significant changes to the format of financial statements, including the classification of information in financial statements using a management approach and the separation of information into business activities and financing activities. The separate presentation would be carried across all financial statements in an effort to organize financial statements in a manner that clearly communicates an integrated financial picture of the entity. IAC members expressed reservations about the allocations

between the proposed categories of business and financing, since the allocation will vary depending on the type of business and the increased reliance on managements' assessment for those allocations.

The paper also proposes that a schedule reconciling the statement of cash flows to the statement of comprehensive income be included in the notes to the financial statements. A number of IAC members commented on the complexity of the reconciliation and wondered whether it added value. The Chair noted that the IASB had done extensive canvassing of users to determine what information they wanted.

Future meeting dates

Future meeting dates were confirmed as follows:

April 30, 2009

July 22, 2009