



# ***IFRS for Boards and Audit Committees***

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**March 1, 2011**

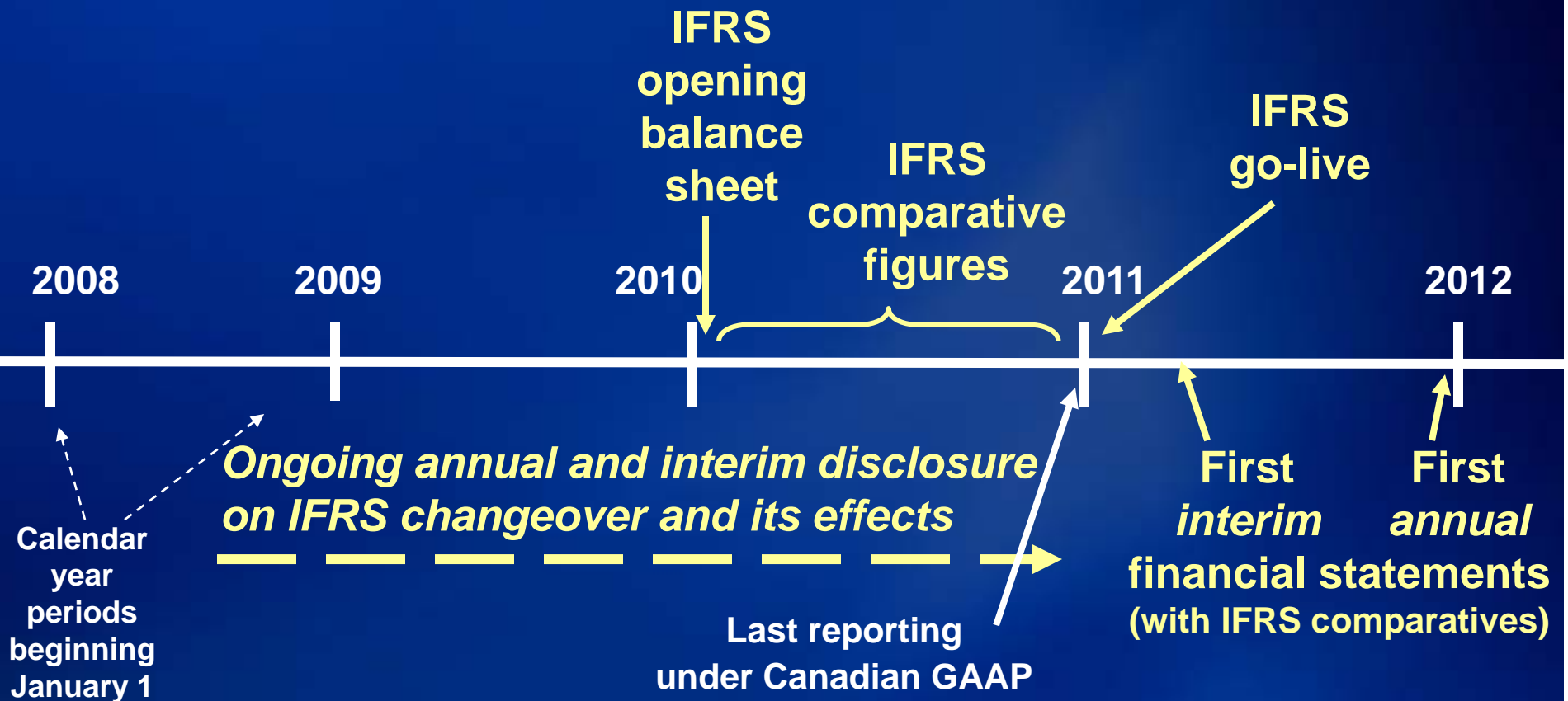


# ***IFRS – The Basics***

# Canada's transition to IFRS

- ◆ **Who is affected – “publicly accountable enterprises”**
- ◆ **To be adopted by**
  - All “profit-oriented” enterprises that have
    - securities issued to the public, or
    - hold assets in fiduciary capacity for a broad group of outsiders
  - Government business enterprises
- ◆ **Currently an SEC registrant could choose US GAAP**
- ◆ **Not-for-profits not required to adopt IFRS**

# Timeline for adopting IFRS



# IFRS will affect financial reporting

## *Implications for directors?*

- ◆ More accounting policy choices
- ◆ More professional judgment to be applied in applying standards and making estimates
- ◆ More fair value measures and approaches – either fair value through P&L or through equity or disclosure
- ◆ More disclosures in statement
- ◆ More earnings volatility

# IFRS versus Canadian GAAP – *Similarities*

- ◆ Comprehensive sets of principles-based standards
- ◆ Similar in structure and form
- ◆ Similar basic concepts and recognition / measurement principles
- ◆ Similar structure and content of financial statements
- ◆ Many standards in IFRS provide similar approach as Canadian GAAP
- ◆ More recent Canadian standards aligned with IFRS, not US GAAP

# IFRS versus Canadian GAAP – *Differences*

- ◆ Fewer bright lines and rules
- ◆ Some standards in IFRS differ *considerably* from Canadian GAAP – e.g. impairments, provisions
- ◆ More accounting policy choices and less interpretative guidance

*Applying IFRS requires more professional judgement and results in greater volume of disclosures*

- ◆ *Many differences in application/interpretation*

**BE CAREFUL – *The devil is in the detail!***

# IFRS accounting policies

## IFRS has a “hierarchy” for selecting accounting policies

1. Apply the specific IFRS standard / interpretation; consider any relevant implementation guidance
2. Refer to other IFRS standards / interpretations dealing with similar issues
3. Use the IFRS Framework
4. Consider pronouncements of other standard-setting bodies (with similar conceptual framework)
  - US GAAP *may* be appropriate when IFRS is silent, but often inconsistent with either Framework or IFRSs  
– *Use caution!*

***Selection of IFRS policies will have a national flavour!***



# ***Significant IFRS – Canadian GAAP Differences***

# IFRS compared with Canadian GAAP

## *Standards with more significant differences*

- ◆ Property, plant and equipment
- ◆ Leases
- ◆ Investment property
- ◆ Impairment of assets ☆
- ◆ Provisions (incl. asset retirement obligations)
- ◆ Financial instruments and hedging
- ◆ Pensions & employee benefits
- ◆ Securitizations ☆
- ◆ Stock-based compensation
- ◆ Revenue recognition
- ◆ Business combinations
- ◆ Accounting for income taxes and tax uncertainties
- ◆ Consolidations, SPEs, investments, JVs
- ◆ Rate-regulated operations ☆
- ◆ Industry-specific issues – insurance, extractive industries

The background of the slide is a photograph of a modern building's interior or exterior structure, featuring a complex grid of glass panels and steel beams. The lighting is bright, creating a high-contrast, blue-tinted scene. The perspective is looking up at a curved, vaulted ceiling or a large window structure.

# **Property, Plant & Equipment and Investment Property (IAS 16, IAS 40)**

# PP&E – *Recognition and measurement*

- ◆ **Major spare parts – *must be treated as PP&E***
- ◆ **Components approach – *more rigorously applied and broader than under Canadian GAAP***
  - On initial recognition, allocate cost to significant parts of the asset (including non-physical components such as major overhaul/inspection)

## PP&E – *Recognition and measurement* (cont'd)

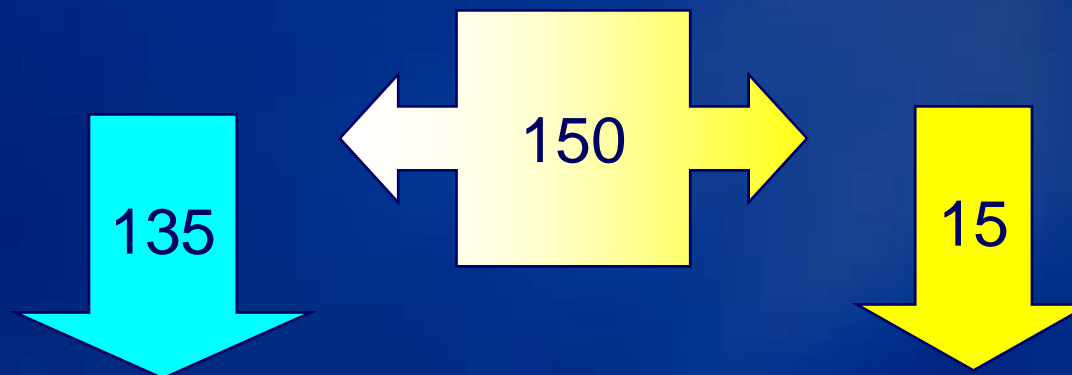
- ◆ **Borrowing costs directly attributable to construction or production of “qualifying” assets – *must be capitalized / extensive guidance provided***
- ◆ **Subsequent measurement options for PP&E**
  - Cost model or revaluation model
  - Apply to all items in a category of PP&E

# Components approach – *an illustration*

Boiler costs \$150

Useful life – 10 years

Major overhaul / inspection after three years –  
estimated overhaul cost \$15



Depreciate over 10 years

- a) Depreciate over three years
- b) Capitalize subsequent overhaul costs when incurred

# Borrowing Costs

- ◆ **Where entity previously expensed interest under Canadian GAAP**
  - Can elect under IFRS 1 to prospectively capitalize borrowing costs for **qualifying assets** for which commencement date for capitalization is after IFRS transition date (or an elected earlier date); or
  - Retrospectively capitalize IFRS borrowing costs

# Investment property – Two options

Property held for rental or capital appreciation

## ◆ Fair value model

- Initially measure at cost
- Adjust carrying value to fair value
- Do not deduct disposal costs in arriving at FV
- Recognize changes in FV in P&L, not equity
- No depreciation or impairment losses

## ◆ Cost model

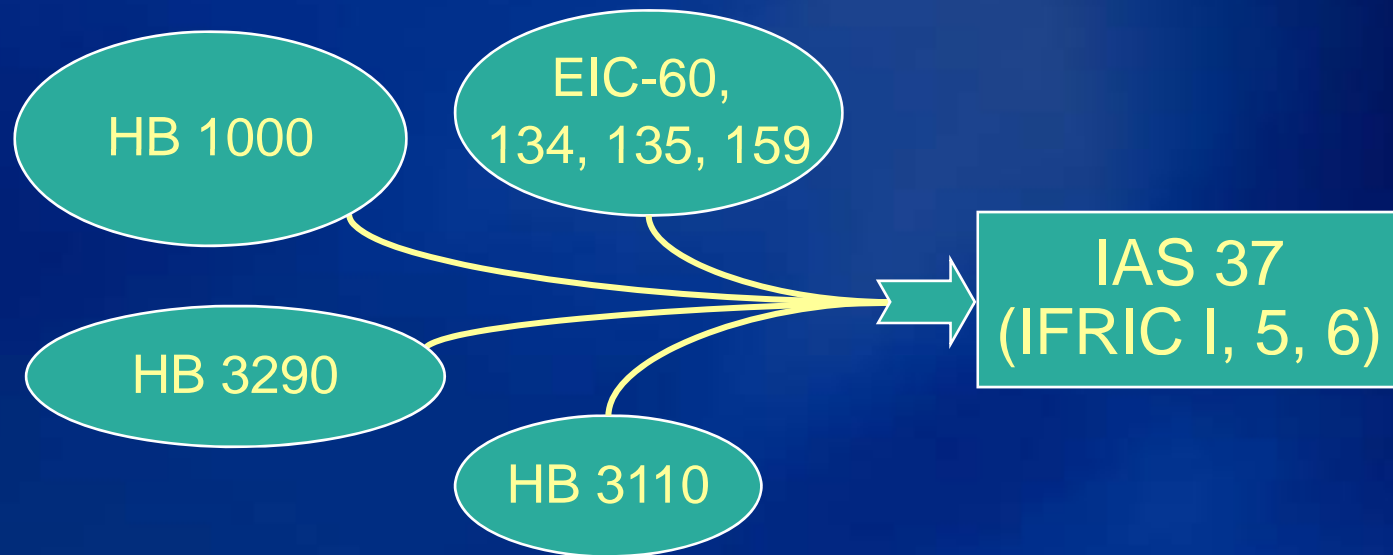
- Initially measure at cost
- Depreciate
- Impairment losses
- Determine and disclose fair value

*Apply accounting policy choice to all investment property*

# Provisions (IAS 37)

# Scope of IAS 37 – Provisions

- ◆ Applies to all enterprises in accounting for provisions, contingent liabilities and contingent assets, except
  - those covered by another IFRS (e.g. financial instruments, insurance contracts, employee benefit obligations)



*Provisions – liabilities of uncertain timing or amount*


# Provisions – *Recognition and measurement*

- ◆ Recognize if probable a liability has been incurred
- ◆ Recognize on basis of legal OR constructive obligation
- ◆ Probable = “More likely than not” rather than “likely”
- ◆ Measure at “best estimate” – *may be one of*
  - *most likely outcome* – single best estimate
  - *expected value* – probability weighted expected value
  - *midpoint* – where a range of probable estimates
- ◆ Discounting required when effect is material

*More items to be recognized...measurement may differ*

# Measurement—IFRS vs. Canadian GAAP

	<b>IFRS</b>	<b>Canadian GAAP</b>
<b>Provisions</b>	<b>Best estimate</b> -most likely outcome -expected value -mid-point of range	<b>Best estimate</b> -most likely outcome -expected value -low end of range
<b>Loss contingencies</b>	<b>Best estimate</b> -most likely outcome -mid-point of range	<b>Reasonable estimate</b> most likely outcome of ultimate loss (or low end of range if no estimate more likely than any other)
<b>Asset retirement obligations and restructuring liabilities</b>	<b>Best estimate</b> -most likely outcome	<b>Fair value</b> (amount liability could be settled for in a current transaction by willing parties)

The background of the slide is a photograph of a large, circular dome structure, likely a skylight or a part of a building's architecture. The dome is composed of a grid of metal or concrete ribs that converge towards a central circular opening at the top. The lighting is bright, creating a high-contrast scene with deep shadows and bright highlights. The overall color palette is dominated by various shades of blue, from light sky blue to deep navy blue.

# **Pension and Post Employment Benefits (IAS 19)**

# Defined benefit pension plans and OPEBs

## IFRS

- ◆ Measure plan assets and liabilities as of balance sheet date
- ◆ Must use fair value to measure plan assets and calculate expected return on plan assets

## Canadian GAAP

- ◆ Measure plan assets and liabilities at balance sheet date *or* not more than three months prior to balance sheet date
- ◆ Must use fair value to measure plan assets, but can use either fair value or market-related value to calculate expected return on plan assets

# Defined benefit pension plans and OPEBs

## – *Asset ceilings*

### IFRS

- ◆ Calculation of ceiling does not factor in unamortized transitional asset / liability
- Certain limitations on immediate recognition in P&L of changes in valuation allowance arising from actuarial losses in current year

### Canadian GAAP

- ◆ Calculation of ceiling factors in unamortized transitional asset/ liability
- ◆ No limitations on P&L recognition of changes in valuation allowance

# Defined benefit pension plans and OPEBs

## – *Past service costs*

### IFRS

- ◆ Recognize past year service cost on straight-line basis over average remaining vesting period
- ◆ To the extent that benefits are *already vested* at the time of plan amendment, recognize past year service costs *immediately*

### Canadian GAAP

- ◆ Recognize on straight-line basis over expected future years of service of active participants
- ◆ Use average remaining life expectancy when almost all employees are inactive
- ◆ No accelerated recognition for vested benefits

# Defined benefit plans - *Actuarial gains and losses*

## IFRS

- ◆ Choice of recognition
  - Corridor approach
    - Using fair value to calculate expected return on plan assets
  - Another systematic approach to recognize faster in P&L
  - Immediately in equity
- ◆ Policy must be applied consistently to all DB plans

## Canadian GAAP

- ◆ Choice of recognition
  - Using the corridor method
    - Use fair value or market related value to calculate expected return on plan assets
  - Another systematic approach to recognize faster in P&L
- ◆ Not required to apply accounting policy for all actuarial gains and losses consistently from plan to plan

# Defined benefit plans - *Curtailments & settlements*

## IFRS

- ◆ Measurement of gain / loss includes full recognition of unamortized actuarial gain / loss, unamortized past service costs and a related portion of any transitional liability
- ◆ Recognize curtailment gains and losses when entity is demonstrably committed to plan
- ◆ Recognize settlement gains and losses when event occurs

## Canadian GAAP

- ◆ Complex rules can lead to only partial recognition of certain unamortized amounts
- ◆ Record curtailment gains when event occurs, and curtailment losses when probable and measurable - probable may differ
- ◆ Recognize settlement gains and losses when event occurs

# Defined benefit plans - *Multi-employer plans and group plans*

## IFRS

- ◆ Account for participation in a multi-employer plan (ME plan) as a defined contribution plan *if*
  - specific identification of plan assets/liabilities not possible and
  - insufficient information is available to calculate the defined benefit cost
- ◆ *Recognize asset/liability for ME plan if contractual agreement for allocation of surplus/deficit*
  - even if P&L uses DC approach
- ◆ Net periodic pension cost for group plans = that under cost sharing agreement
  - Otherwise expense contributions

## Canadian GAAP

- ◆ Presumes insufficient information is available to account for ME plan as DB plan
  - account for multi-employer defined benefit plan similarly to a defined contribution plan
- ◆ No recognition of an asset or liability for ME plan
  - Even if contractual agreement determines how surplus would be distributed or deficit funded
- ◆ Group plan – DC accounting in sub's f/s and no adjustment for cost sharing agreement

# Income Taxes (IAS 12)

# Future income taxes

## – *Recognition and measurement differences*

### ◆ **Business combinations**

- Subsequent realization of unrecognized future taxes of acquiree
  - recorded in P&L as tax recovery
  - goodwill also adjusted and write-down recognized in P&L
- Change in deferred tax positions of the acquirer due to acquisition is recognized in P&L

# Future income taxes

## – *Recognition/measurement differences (cont'd)*

### ◆ **Intraperiod allocations**

- Backward tracing required under IFRS
  - record future taxes in equity, not P&L, when future taxes recognized in periods *after* initial recognition of transaction in equity

### ◆ **Classification**

- Always present as long-term

### ◆ **Recognition exemption**

- Exempt from recognizing tax effect of temporary difference arising on initial recognition of an asset or liability that
  - is not a business combination
  - affects neither accounting nor taxable profits

# Accounting for tax uncertainties

	<b>IFRS</b>	<b>Canadian practice</b>
<b>Initial recognition</b>	<b>Always recognize</b> ("probability-weighted estimate")	<b>Likely – 70%</b> ("all or nothing")
<b>Subsequent recognition</b>	<b>Adjust estimate</b>	<b>Probable threshold met; Tax matter resolved; Statute barred</b>
<b>Derecognition / tax exposures</b>	<b>Adjust estimate</b>	<b>Probable threshold</b> (below 30% level of assurance) <b>100% derecognition <u>or</u> "more likely than not" threshold</b> (below 50% level of assurance) <b>Probability-weighted estimate</b>

# Accounting for tax uncertainties (Cont'd)

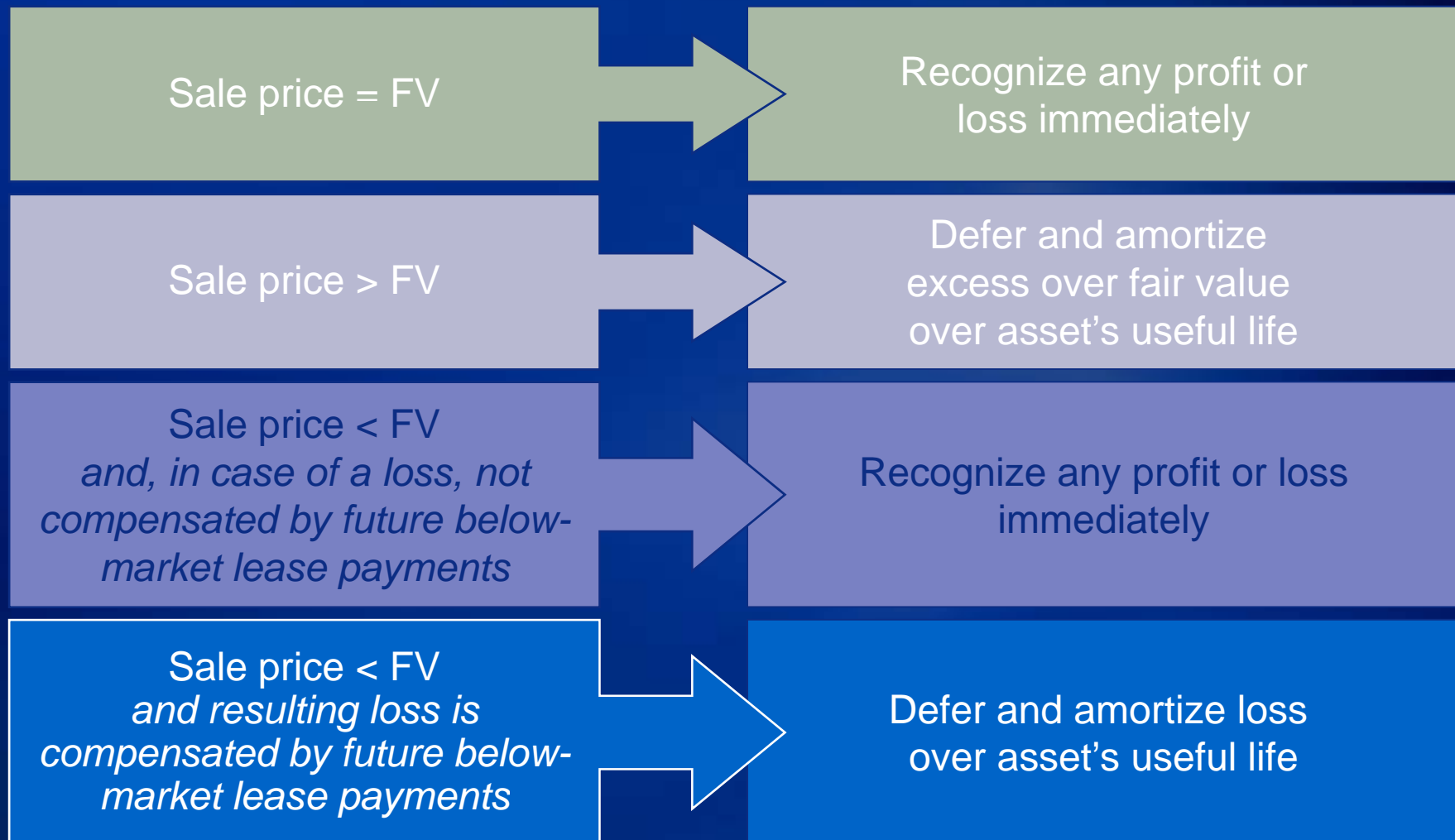
	<b>IFRS</b>	<b>Canadian practice</b>
<b>Changes in judgment</b>	<b>Recognize in period in which change occurs</b>	<b>Recognize in period in which change occurs</b>
<b>Interest and penalties</b>	<b>Charge “best estimate” to income <i>only if probable that the expenditure will be incurred</i></b>	<b>Charge to income over period interest “deemed to be incurred”</b>

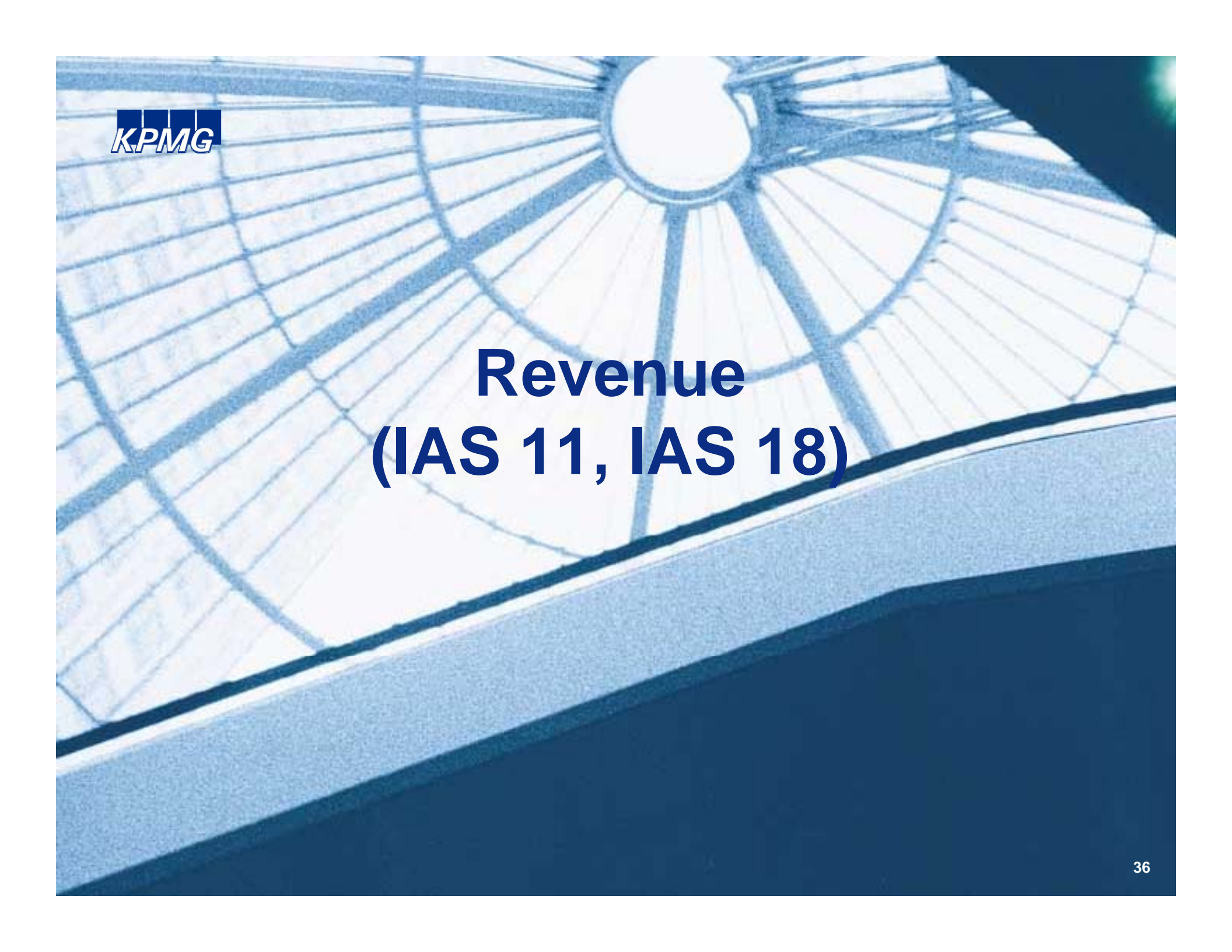
# Leases (IAS 17)

# Lease classification

- ◆ IFRS provides guidelines for determining lease classification – *not interpreted as “bright lines”*
- ◆ IFRS contains additional indicators of a finance lease (beyond criteria under Canadian GAAP)
  - Lease asset is specialized
  - Cancellation losses borne by lessee
  - Changes in fair value of residual borne by lessee
  - Bargain lease renewal option
- ◆ Differences – types of costs included from minimum lease payments and discount rate used

# Sale and operating leaseback



The background of the slide is a photograph of a large, white, ribbed dome structure, likely the interior of a modern building. The dome is composed of many thin, white ribs that converge towards a central circular opening at the top. The lighting is bright, creating a high-contrast scene with deep shadows and bright highlights. The overall color palette is dominated by white and light blue tones.

# Revenue (IAS 11, IAS 18)

# IAS 18: Sale of goods

## – IFRS versus Canadian GAAP

### IAS 18

- ◆ Probable future economic benefits
- ◆ Revenue can be measured reliably
- ◆ Costs can be measured reliably
- ◆ Significant risks and rewards of ownership transferred
- ◆ Do not retain managerial involvement to degree of ownership nor retain effective control

### EIC 141

- ◆ Persuasive evidence of an arrangement
- ◆ Collectibility reasonably assured
- ◆ Price fixed or determinable
- ◆ Delivery occurred / services rendered



# Revenue recognition

## ◆ Similarities

- Right of return
- Barter transactions
- Agent vs. principal

## ◆ Differences

- Non-cash rebate/discount (e.g. “free” product or service)
  - Classified as a reduction in revenue
- Volume rebates
  - Difference in measurement of liability, when cannot reliably estimate total volume

# IFRIC 13, Customer Loyalty Programs

- ◆ **Cost of providing the award must be accrued**
- ◆ **Fair value of the consideration received must be allocated between the fair value of the goods/service provided and the fair value of the award credit**
  - Relative fair value
  - Residual approach
- ◆ **Timing of revenue recognition is dependent on whether the entity itself or a third party supplies the award**
- ◆ **Estimates are adjusted for prospectively**

# Multiple-element arrangements

IAS 18 applies to multiple-element arrangements

## *Conflicting guidance*

### Paragraph 13 (Multiple Element)

Revenue recognition criteria are applied to identifiable elements within the transaction; revenue recognised as services performed on each element.

### Paragraph 19 (Single Element)

Revenue fully recognised at time of sale with liability for accompanying commitments (undelivered elements).

# Multiple-element arrangements (cont'd)

- ◆ **Analyze substance of each arrangement/consider:**
  - Ability to identify separately each component
  - Significance of after-sales service components, in terms of value, to the whole contract
  - If right of return exists, is delivery of service probable and substantially in control of vendor
- ◆ **If the component is not significant to the contract, recognize revenue at the time of sale and accrue for any additional costs**
- ◆ **Allocating consideration to elements of arrangement**
  - Relative fair values method; or
  - Cost plus a reasonable profit margin; or
  - Residual method

# Software Revenue Recognition

- ◆ **No specific guidance; general revenue criteria applied to each component:**
  - if sale of software products, apply sale of goods guidance
  - if services, recognize services as provided
  - if customized software, apply % of completion
  - if license arrangement, recognize in accordance with substance of license
- ◆ **Consider substance of transaction to determine whether various components are linked**

IAS 18 vs. SOP 97-2

# IAS 18 – Services rendered

*Recognize revenue when*

- ◆ Probable future economic benefits
- ◆ Can reliably measure
  - revenue
  - costs incurred / to be incurred
  - stage of completion based on
    - services to total services,
    - costs to total costs, or
    - work surveys

# IAS 11 – Construction contracts

## IFRS

- ◆ Revenue recognition using either percentage of completion (POC) or zero-profit methods for long-term construction projects
- ◆ Must combine or segment contracts if meet certain criteria

## Canadian GAAP

- ◆ Revenue recognition using either POC or completed-contract methods for long-term construction projects
- ◆ No specific guidance on combining or segmenting contracts

*IAS 11 does not permit the completed contract method*

# Stock-Based Compensation (IFRS 2)

# Transactions with employees

## – *Recognition and measurement differences*

### ◆ Graded vesting

- Must account for each instalment as a separate award
- *Depending on policy choice, could differ from Canadian GAAP*

### ◆ Forfeitures

- Must estimate forfeitures up-front and adjust to actual (unless forfeiture due to market-based conditions)
- *Depending on policy choice, could differ from Canadian GAAP*

### ◆ Determining vesting period

- When grant date follows service commencement date
  - base expense during period prior to grant date on estimated fair value
  - subsequently adjust to actual grant date fair value

# Transactions with employees – *Recognition and measurement differences* (cont'd)

## ◆ Cash-settled awards

- Recognize initially at fair value at grant date
- Re-measure each period at fair value – *not intrinsic value*

## ◆ Employee share purchase plans

- Must recognize *any* discount as expense in P&L

## ◆ Employee choice of cash or share settlement

- Treat as a compound instrument
- Separately account for liability and equity components – *rather than being accounted for as liability award and measured at intrinsic value*

# Transactions with non-employees

## – *Recognition and measurement*

- ◆ Rebuttable presumption that fair value of goods or services received should be used to measure award
- ◆ Measure fair value when goods or services are rendered
  - can lead to multiple measurement dates

# **First-Time Adoption of IFRS (IFRS 1)**

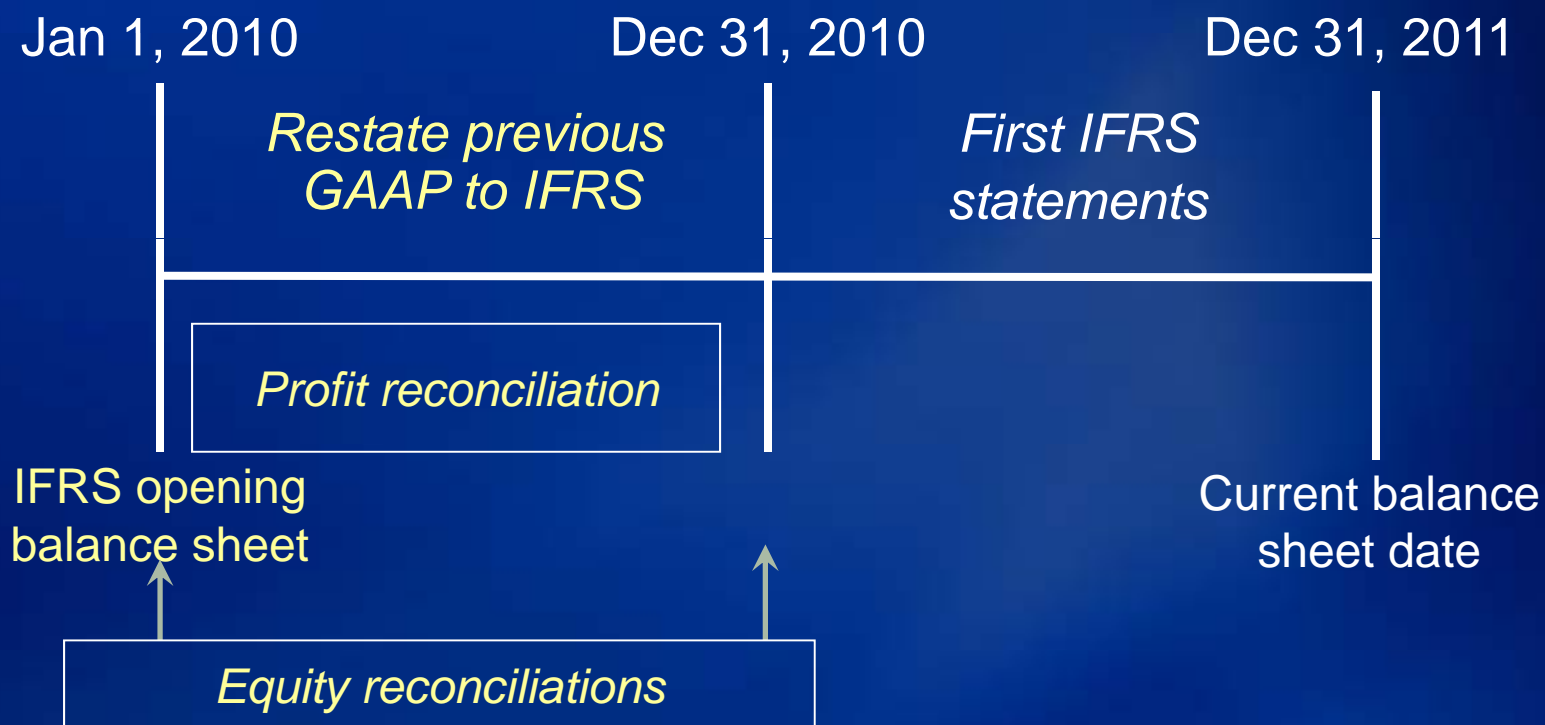
# IFRS 1 – *First-time adoption of IFRS*

- ◆ General principle is retrospective application  
– *restate as though always applied IFRS*
- ◆ Provides some relief the first time an entity fully adopts IFRS
- ◆ Requires certain disclosures and reconciliations on adoption
- ◆ Contains mandatory exemptions and certain elective exemptions on applying the new basis of accounting

*Evaluate available exemptions –  
both the impact on conversion effort and  
impact on post-changeover reported earnings*

# Reconciliations and transition date

## – *First IFRS financial statements*



Opening balance sheet – create at *start of earliest period* for which entity presents full comparative information under IFRS

# General requirements

## Step 1 - Select IFRS accounting policies

- ◆ Apply latest version of standards only
- ◆ Adoption of IFRS does not represent a change in accounting policy
- ◆ Apply selected IFRS policies consistently on a retrospective basis, with few exceptions
- ◆ Ignore transition rules embedded in standards

# General requirements (cont'd)

## Step 1 - Select IFRS accounting policies (cont'd)

- ◆ **Consider implications on opening and future IFRS financial statements**
  - Consider policies selected by peers in Canada and comparables elsewhere
  - More accounting policy choices under IFRS (both explicit and implicit)
  - Take the time to carefully consider their accounting policy choices and the impact on their conversion efforts

# General requirements (cont'd)

Step 2 - Recognize / derecognize as appropriate

## Liabilities

- Constructive obligations
- Onerous contracts
- Deferred revenue

## Assets

- Securitizations

# General requirements (cont'd)

## Step 3 – Reclassify

- ◆ Between captions or classification
  - PP&E to investment property
  - Accretion on asset retirement obligations as interest expense
  - Assets held for sale / discontinued operations

# General requirements (cont'd)

## Step 4 - Remeasure

- Where measurement basis has changed
- Where discounting is required / prohibited
- Revise estimates for errors only, not new information
- For impairments, where required, reassess and re-measure under IAS 36 or IAS 39
- Reversal of past impairment charges, other than goodwill

# Types of exemptions

Two types of exemptions from  
“general rule” of retrospective application



Retrospective application  
prohibited

Hedge accounting  
Estimates

Elective exemptions include  
Deemed cost  
Employee benefits  
Cumulative translation differences  
Decommissioning liabilities  
Share-based payment transactions

Can pick and choose elective exemptions!

# Optional exemption

## *Deemed cost*

- ◆ Can elect to use fair value or revaluation as deemed cost at date of transition for PP&E, investment property and in very limited cases, intangible assets
- ◆ Election available on an asset-by-asset basis
- ◆ FV or revaluations becomes deemed cost for subsequent depreciation/amortization
- ◆ Election is separate from ongoing policy choice to measure long-lived assets at cost or fair value

### *Why would you elect to use?*

- *Trade off higher future depreciation charges with additional effort of addressing restatement of PP&E*

# Optional exemption

## *Actuarial gains / losses exemption*

- ◆ Can elect to recognize all cumulative actuarial gains / losses in equity at date of transition
- ◆ Exemption independent of
  - Accounting policy under previous GAAP
  - Selection of accounting policy under IFRS
- ◆ No exemption for unrecognized unvested past service costs

### *Why would you decide to use the election?*

- *Avoid the reconstruction of unamortized pools of actuarial gains and losses from inception of plan*
- *If in a position of cumulative unamortized losses, can avoid their subsequent recognition through the P&L*

Must be applied consistently to all DB plans!

# Optional exemption

## *Cumulative translation differences*

- ◆ Can elect to reset CTA to zero at transition date with offsetting adjustment to retained earnings
- ◆ Must be applied consistently to all foreign operations (subs, joint venture's and associates)
- ◆ ***Why would you elect to use the exemption?***
  - *If cumulative FX losses, avoids their subsequent realization through the P&L*
  - *Avoids assessing if CTA was relieved in circumstances where no drawdown permitted under IFRS*



# ***Presentation of IFRS Financial Statements***

# Income statement differences

## ◆ Clarification of expenses: by nature or function

- *Nature*: purchase, depreciation, staff costs, advertising costs
- *Function*: cost of sales, distribution, or administration
- Consider industry, nature of entity

***European  
Commission  
Report –  
52% function  
47% nature***

## ◆ If by function, all costs should be allocated

- No “one-line” charges for impairments or restructurings

## Income statement differences (cont'd)

- ◆ No extraordinary items
- ◆ “Exceptional” or “unusual” items of income or expense are not addressed in IAS 1
- ◆ Unwinding the discount is presented as finance cost

# Specific disclosure requirements

- ◆ Disclosure of fair value measures / assumptions
- ◆ Continuity schedules for long-lived assets
- ◆ Investment property at fair value
- ◆ Continuity schedules for each type of provision
- ◆ Pro-forma disclosures for business combinations

# First IFRS financial statements

## *IFRS 1 disclosures and reconciliations*

- ◆ IFRS 1 provides no relief from disclosures within other IFRS standards, but adds incremental required disclosures
- ◆ Disclosures and reconciliations required in order to form a link between previous GAAP and IFRS financial statements
- ◆ Requirements for first interim IFRS statements are onerous and need to be carefully planned for

# IFRS 1 Reconciliations

## *Interim financial statements*

	Q1	Q2	Q3
Reconciliation of Canadian GAAP equity to IFRS as at transition date <i>and</i> end of comparative annual period	✓ ✓	--	--
Reconciliation of Canadian GAAP equity to IFRS equity as at comparative interim balance sheet date	✓	✓	✓
Reconciliation of Canadian GAAP comprehensive income (CI) to IFRS CI for the comparative quarter <i>and</i> year to date	✓ ✗	✓ ✓	✓ ✓
Reconciliation of Canadian GAAP CI to IFRS CI for comparative annual period	✓	--	--