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Keeping your head above water

Recent issues in financial reporting

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In this issue

A change is coming in Canadian public company financial reporting – a veritable sea change, if we dare to use that awful phrase. Having spent more than a decade rebuilding standards, the IASB has changed focus. The objective now is to better the communications value of IFRS financial statements. In part that's a natural evolution – after all, sooner or later you've got to start cleaning up the construction site and making the roads passable – but it also represents a response to the increasing use of non-GAAP reporting. The IASB very much feels the need to make IFRS more useful to investors, lest it eventually wind up like the dog food manufacturer who transformed its product into something no dog would eat.

Of course, the era of building up GAAP isn't quite over – for most companies there are major new IFRS on revenue, financial instruments and leasing to worry about. Deadlines are looming. For revenue and financial instruments, 2017 is the last chance companies have to finish their preparations. If our latest survey on the status of implementation of revenue is any indication, it'll be the year in which a fair number of companies will be starting preparations too. Regulators around the globe have been busy setting expectations for what companies and audit committees need to be doing, not only in terms of their implementation of the standards, but the disclosures they should be making about their effects in periods leading up to their adoption. You may be surprised.

IFRS financial reporting isn't the only thing standard setters have targeted. There's auditor reporting too. Auditors' opinions on financial statements have long been criticized as not being terribly useful, so much so that international auditing standards now require auditors to add a commentary on the key audit issues they faced during an audit – the stuff that kept them awake at night. The Canadian Auditing and Assurance Standards Board has hung back a bit from introducing them into Canada, waiting to see what happens in the US. It may take a while.

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The Future of Global GAAP

Sadness: "Wait, Joy, you'll get lost in there."
Joy: "Think positive."
Sadness: "Ok, I'm positive you will get lost in there."

– Inside Out

The possibility of having the US eventually adopting IFRS finally died late last year. Only a few bothered to attend the funeral.

Death came at the hands of the newly appointed Chief Accountant of the SEC, Wesley Bricker, who announced that, in his view, US GAAP would continue to be the basis for US public company reporting for at least the foreseeable future. IFRS authorities would have greeted that announcement with shock and outrage ten, or even five, years ago, but the US has bobbed and weaved around this issue for so long now that their only reaction on hearing the news was mild surprise that the patient wasn't already dead.

Whether by accident or design, Bricker's announcement came only a short time after the IFRS Trustees rejected recommendations from some constituents (mainly from Europe and Asia) to make further US participation on the IASB's governing bodies and the Board contingent on providing more financial support and committing to IFRS. Instead, the Trustees decided to rebalance the geographical distribution of its members so that anyone not funding or using IFRS isn't "over represented". And so, to the disappointment of some, the US will continue to have some influence over the setting of international accounting standards.

Consistent with the SEC's long standing position, Bricker encouraged the FASB and IASB to work together to eliminate differences in standards when it's in the best of the capital markets. With that end in mind, the FASB announced that in addition to its regular attendance at IASB sponsored gatherings of national standard setters, it will continue meeting regularly, one on one, with other national standard setters, including Canada, to discuss issues in the hope of finding common ground. The IASB is less enthusiastic. Convergence is barely mentioned in its new five year work plan (see the next page), and then only in the context of maintaining the convergence that has already been achieved, not extending it. "If the FASB comes up with good ideas before we do, then we will steal them as quickly as possible", said Hans Hoogervorst, the Chair of the IASB. A joke, of course, but it reinforces the point that the Board is not demonstrating much interest in further collaborations.

PwC observation. Globalization has lost its cachet and, unlike what happened during the financial crisis, there's no political pressure on the Boards to work together. It'll take a lot more than positive noises from the SEC and FASB for the IASB to find its way back to the convergence table.

The Future of IFRS

"I went to the museum where they had all the heads and arms from the statutes that are in all the other museums."

– Steven Wright

After a year or so of public consultation, the IASB has formally approved its work plan for the next five years. It comes with a motto – "Better communication in financial statements". The old one was, well, there wasn't one, but if there had been, it would have been something like "Continuing to rebuild IFRS, brick by brick, in the wake of the financial crisis and the hope of becoming the world's sole purveyor of global accounting standards".

A key element of the Board's new strategy is finishing its Disclosure Initiative, a series of inter-linked projects whose common objective is to sweep away the irrelevancies and redundancies in existing disclosures, and, what's often overlooked, add more relevant information. Also, the Board has begun researching whether it should be improving the organization and structure of its primary financial statements – the balance sheet, income statement and so forth. A major objective, says Hans Hoogervorst, is to enable companies to better tell their story through the financial statements in a way that's clear, objective and consistent. The reorganization initiative has got the potential to be every bit as significant as the Disclosure Initiative, perhaps more so. We'll talk more about the most important part of this project – disaggregating the income statement – a little later. Bet you just can't wait.

In response to demands from stakeholders, grown weary after a decade or more of constant change, the IASB has promised to go easy on projects affecting the way you recognize and measure things in the statements. Not that it will stop completely, of course. It's researching the following.

- Business combinations of entities under common control (accounting for internal restructurings and reorganizations).
- Dynamic risk management (hedging for banks).
- Financial instruments with characteristics of equity (eliminating some of the absurdities of existing IFRS).
- Goodwill and impairment (whether the current rules, set only nine years ago, need to be revisited, including reinstating goodwill amortization).
- Discount rates (assessing the impact of any IFRS internal inconsistencies for discounting cash flows).

The Board also will be working to finish updating its Conceptual Framework (closing the barn door after most of the horses have already fled, grumble some), and also, perhaps, completing its project on Rate Regulation (something near and dear to Canadian hearts, but perhaps not anyone else's). The only other thing left on the Board's standard setting plate from its old work plan, other than the dry crumbs of some narrow technical amendments, is the insurance project. After almost 20 years in the making, the end is in sight – really. See our separate discussion a few pages on.

PwC observation. The IASB's new focus on better communication is understandable. Research shows that investors now rely more on customized, entity specific, non-GAAP reporting in press releases and elsewhere than GAAP financial statements. "Press releases" observed a participant at a recent meeting of the US PCAOB Investor Advisory Committee on non-GAAP reporting, "are the market moving engine of the train, and annual financial statements are just the caboose, the numbers that analysts use to validate their models". Will the IASB's new strategy be the catalyst that moves IFRS up investors' value chain? We don't know. What we do know is that cabooses these days are relics more often found in railroad museums than on trains.

Non-GAAP Measures

"Depend upon it, Sir, when a man knows he is to be hanged in a fortnight, it concentrates his mind wonderfully."

– Samuel Johnson

Not that non-GAAP reporting isn't without its own set of challenges. Recall that last year, the SEC and OSC each began to investigate this reporting in response to studies showing that regulatory requirements governing its use were being bent out of shape, or worse, ignored altogether. As a result, the SEC has tightened its requirements, issued comment letters and threatened a few public hangings. In Canada, comment letters about non-GAAP reporting have increased in their frequency and severity, with Canadian securities commissions voicing the major concerns about practice in Canada. For example, the OSC has issued guidance warning about:

- Giving undue prominence to non-GAAP measures in press releases.
- Using an extensive number of non-GAAP measures to obscure results.
- Not reconciling non-GAAP measures to the most directly comparable GAAP measures.

The Alberta Securities Commission has also published a bulletin on non-GAAP measures commonly used by oil and gas companies and which may have implications for other resource companies.

In the US, companies appear to have moved quickly to amend their ways. According to an Audit Analytics survey published in the Wall Street Journal, for example, more than 80% of S&P companies presented their GAAP results first in last year's third quarter reports, up from just over half in the prior quarter. Although SEC staff has announced that US non-GAAP reporting has improved, Chief Accountant Bricker says there's more progress for companies to make, for example, in evaluating the appropriateness of measures and their prominence, as well as the effectiveness of disclosure controls used to develop them. It's worth noting, for example, that in comment letters the SEC is now requesting companies to reconcile their GAAP numbers to their non-GAAP numbers, not the other way around. In Canada, the OSC has announced it will be monitoring non-GAAP reporting in 2017. It's threatening to set up its own set of gallows if it continues to see stuff it doesn't like.

As might be expected, both the OSC and SEC are urging audit committees to play an active role in overseeing companies' reporting. Audit committees, said Bricker, should be seeking to understand management's judgments in the design, preparation, and presentation of non-GAAP measures, and how those measures might differ from approaches followed by other companies.

PwC observation. Although most of the focus is on how quickly companies are responding to regulators' demands for compliance with existing requirements on non-GAAP reporting, public debate is now beginning to surface on whether more fundamental reforms are necessary. Ideas being tossed about include that measures should be limited in number, strictly defined, the subject of self-regulation by industry organizations, and even audited. The common thread linking all of these proposals is the view that this reporting needs to be more transparent, more consistent and more comparable. There is, of course, one other solution, which we explore on the following page.

GAAP Measures of Performance

Igor: "Wait Master, it might be dangerous... you go first."

– Young Frankenstein

Hans Hoogervorst doesn't have much time for non-GAAP reporting, often describing it as a sugar coated realm that almost always paints a rosier picture than reality. Audit and remuneration committees, he said, should be concerned about the increasing use of non-GAAP measures, pointing out that management usually develops them on their own (a not so subtle suggestion, perhaps, that the fox is minding the hen house). There's safety in using GAAP numbers, he said, because they're rigorous and based on sound economic principles.

Having said this, Hoogervorst admits that IFRS is partly to blame for the proliferation of alternative reporting, by not providing much guidance on the presentation of income statement performance measures beyond sales and net earnings. Right now, all that IFRS says is that additional performance measures should be provided when necessary to understand the entity's performance. How this principle applies is one of the mysteries of the universe, right up there with quantum gravity.

This may all change. Expanding and standardizing performance measures in IFRS income statements is one of the main objectives of the IASB's new Primary Financial Statements project. The objective is to establish a grand, overarching principle of disaggregation from which subtotals would naturally flow – a kind of magic Harry Potter type key that once turned will automatically unlock the mysteries of the income statement. The project almost certainly will include looking at establishing more subtotals, such as operating income, or EBIT, or both, and removing some presentation options that now exist (e.g., choice over the location of net interest cost on pensions). It might even, in the delicate words of Hoogervorst, consider creating a more "disciplined manner" for companies to report non-recurring, unusual or infrequently occurring items. The Board also will look at doing something to give more visibility to that poor lost soul of accounting – other comprehensive income.

PwC observation. If history is any guide, developing operational income statement disaggregation principles will be a challenge because of the inherent conflict in reporting objectives between the IASB and preparers. On the one hand the IASB is looking for consistency and comparability among companies and industries; on the other hand, management is looking for enough flexibility to tell its story its own way. Finding a proper balance between the two will be a delicate task. More than a decade or so ago, the IASB proposed an approach to unbundling the income statement, albeit on a different basis than it's considering now. That one was ridden out of town on a rail, followed by jeering crowds carrying torches and yelling "And never come back". That the Board has dared to return to this topic is an indication of the importance it's now placing on the issue.

OSC Financial Reporting

"He has Van Gogh's ear for music."
– Billy Wilder

The tradition continues. A few months ago, as a kind of pre-holiday treat, the Office of the Chief Accountant of the OSC issued a special bulletin on financial reporting. Staff's objective is to communicate its perspectives on disclosure effectiveness, discuss recent areas of focus, and set out its expectations for companies' implementation of new accounting standards.

On disclosure effectiveness, staff has picked up on the IASB's "better communications" theme, but applied it to companies' preparation of financial statements. Consider financial reports as communications documents, not compliance exercises, says the staff, pointing to recent changes to IFRS disclosure requirements, where an important objective is to exclude information that provides little or no value.

The bulletin also discusses staff's initiatives relating to going concern disclosure, fair value measurement and non-GAAP reporting. On the first, staff has been evaluating disclosure in high risk industries (including whether disclosure is being made when a close call was made that going concern wasn't an issue). The conclusion is that companies are providing only generic and boilerplate information. On fair value measurement, staff is looking for more consistency and depth in the quality of disclosures, highlighting issues in the real estate and investment funds industries in particular. As to non-GAAP reporting, see our comments a few pages back.

We'll discuss staff's views on the implementation of new accounting standards in a bit.

PwC observation. Disclosure effectiveness is the overarching issue. Over the years, the OSC has consistently called for companies to improve disclosure by getting rid of boilerplate and providing more entity specific information. Whether it'll have any better luck by appealing to recent changes in IFRS disclosure requirements remains to be seen. Companies often take the view that disclosing pretty much everything specified by IFRS is the safest and easiest way to address disclosure and may be loath to change their ways, notwithstanding the cautions in the new requirements. Furthermore, the issue of what to do about overload isn't going to get any easier given the extensive new disclosures being specified in IFRS for its new standards on revenue, financial instruments, and leases. Once these standards take effect, even a diligent process of revision might mean that the best you can do is to keep the size of your footnotes to what it is now. Of course, deciding what disclosures are appropriate in a particular set of circumstances is like appreciating fine music. It takes a discriminating ear.

The Upcoming Standards

"He has no enemies, but is intensely disliked by his friends."
– Oscar Wilde

New accounting standards on revenue, financial instruments and leases are effective in the next few years. Here, more as a reminder than an education, and as a background to our discussions on the next few pages about the implementation of the standards, is a brief summary of the major changes they introduce. Our advice? Let the standards be your friend, or at least not your enemy.

Revenue	Introduces a five-step model for recognizing and measuring revenue that applies to all industries: • Identify customer contracts. • Distinguish the unique performance obligations of a contract. • Determine the transaction price. • Allocate the transaction price to performance obligations. • Recognize revenue when or as the entity satisfies the performance obligation. The standard also sets new requirements for capitalizing related costs. **PwC observation**. Some companies not using specialized industry GAAP have leapt to the conclusion that the standard won't have much, if any, impact because they already do something like these steps under existing IFRS. That may or may not be so. All of the issues are really in the fine print.
Financial instruments	Establishes new requirements for: • Fair value versus cost – there are new criteria for determining the measurement basis of loans and receivables, and if it's fair value, whether to put changes in profit or loss or other comprehensive income. Everything now depends on how plain vanilla your assets are and your business model for realizing their cash flows. • Allowances for doubtful accounts on loans and receivables – we've now got the so-called "expected credit loss model", under which allowances are booked based on the risk that default will happen, not waiting until there's incontrovertible evidence that it will. • Portfolio investments in equity securities – these continue to be measured at fair value but the new rule is that changes go to profit and loss, not other comprehensive income. There's an exception, but you might not like it. • Hedging – the rules for its use are more liberal and purport to be simpler (but not necessarily simple). **PwC observation**. Companies that aren't financial institutions generally love the new hedging rules and have leaped to early adopt the standard, shouting hallelujah all the while. Others are less effusive in their praise, including non-financial institutions that don't expect the standard will change what they're doing now much, but are grumpy about having to prove it – if they can. Banks and other financial institutions? They're something else again – more on this later.
Leases	A new standard that requires lessees to recognize all leases, other than minor ones, to be put on the balance sheet as depreciable assets and interest-bearing liabilities. No more operating leases. **PwC observation**. The changes won't affect the total expense to be recognized over the term of the lease but will cause a greater proportion to be recognized in earlier periods. Operating cash flow and EBITDA, however, usually will both go up. If you only see black clouds in the leasing standard, you might think this is one silver lining. Or not.

Implementing Upcoming IFRS

"If you don't know where you're going, you might end up somewhere else."
– Yogi Berra

What with companies having to adopt revenue and financial instruments in 2018, and leases a year later, securities regulators in Canada and the rest of the world have become like old-time town criers, wandering through the streets and ringing their bells about the importance of proper implementation. Those hitting the pavement include the OSC, the SEC, the European Securities and Markets Authority, and the International Organization of Securities Commissions. They're all saying pretty much the same thing. Here, distilled from the dry, careful language of their communications, are the key messages for senior management and audit committees:

- Start implementing now, if you haven't begun already (in other words, what are you waiting for?)
- Take the time to understand the changes the new standards introduce.
- Conduct (or, in the case of audit committees, aggressively oversee) an impact assessment. Make sure it considers all the angles – accounting, tax, financial reporting, financial planning and analysis, investor relations, treasury, IT, internal audit, human resources, systems, controls and processes, disclosure controls, etc., etc.
- Establish (or in the case of audit committees, aggressively oversee) an implementation project plan that sets milestones and considers things such as the timing for updates, the process of approving significant judgments, developing and approving accounting policies, reviewing and evaluating contracts, comparison to peers and competitors, socializing the organization, in house training, communications to investors, design, testing and documentation of internal controls relating to adoption and disclosure, adequacy of systems and manual processes, dealing with control deficiencies, etc., etc.
- Ensure that an appropriate tone has been set at the top, and adequate resources are being applied to the task (fit the resources to the implementation, not the other way round). If you need outside help, get it.
- Ask the auditors what they think of the company's planning and implementation as you go, not at the end.

PwC observation. The extent to which individual standards will affect companies will vary considerably. As a result, implementation in some cases will be substantially easier than in others. Nevertheless, you can be confident that every company will be impacted to some degree. It's not a question of whether, it's how much. The regulators' communications are a timely reminder that before you start traveling down the implementation road it's wise to map out where you're going first.

Disclosing the Estimated Impact of Upcoming IFRS

"A balanced diet is a cookie in each hand."

– Unknown

Regulators' bell ringing hasn't been restricted to implementation; it also extends to disclosing the estimated impact of the standards in IFRS annual and interim financial statements and MDA leading up to transition.

What constitutes appropriate disclosure? Well you might ask. Long-standing IFRS requirements generally provide that you have to disclose any known or reasonably estimable information relevant to assessing the possible impact on the financial statements at the date of transition. Ditto for the MDA, though broader disclosure is also necessary about the impact on the company. How much you disclose, say regulators, depends on how deep you've gotten into implementation, but the general presumption is that the closer to the date of adoption you get, the more detailed and entity specific it should be. Last fall, Cameron McInnis, the Chief Accountant of the OSC, provided a basic rule of thumb for deciding when enough is enough – disclosure should be extensive enough that there shouldn't be any surprises when the company actually crosses over to the new standards. OSC staff has also provided the following specific examples of the disclosures that might be necessary in respect of revenue:

- The status of transition, including significant milestones and anticipated timelines.
- Significant implementation matters still to be addressed.
- Expected changes in accounting policies.
- Revenue streams and reportable segments that are expected to be most significantly affected.
- Expected directional impact and quantitative impact (either dollar amount or range) on financial statement items.
- Potential implications on internal controls over financial reporting, data systems, information technology, as well as compensation and financing arrangements.
- Potential effects on business practices (e.g., sales).
- If the standard isn't expected to be material, a statement to this effect.

Note the emphasis on "potential" and "expected". Regulators are viewing these disclosures as estimates, not final results.

Don't be reluctant, says the OSC staff, to provide quantitative data about the impact of adoption as soon as you reasonably can. That perspective has been endorsed by the European Securities and Markets Authority. In the context of loan impairment, it emphasizes that you can't avoid disclosing impacts on the basis that actual outcomes depend on specific business and economic conditions prevailing at the transition date. If you've made reasonable estimates based on data as of an earlier date, you should be disclosing that.

We'll leave the final word to the SEC, but it's one which every regulator will agree with – don't forget about controls over the disclosures themselves. Transition disclosure, says Chief Accountant Bricker, should be subject to effective internal controls over financial reporting and disclosure, and, as management completes a portion of its implementation plan and develops an assessment of its impact, those controls should ensure that the relevant disclosures are made.

PwC observation. The days are gone when it's possible to say only that, yes, there are some new standards, and yes, the company is currently evaluating their effects, with more or less the same boilerplate disclosure being repeated in the financial statements and MDA until the company actually adopts the standards. Regulators are looking for much more balanced, entity-specific disclosures.

Revenue – The Survey

"That's the secret to life... replace one worry with another."
– Charlie Brown, Peanuts

Revenue is often labelled as being the "standard of the decade" or "historic" in terms of its impact. Nevertheless, many companies don't appear to be giving its implementation more emphasis than the other new standards, and, if current expectations are any guide, its impact isn't nearly as pervasive as one would normally expect of a standard deserving of these accolades. Consider the results of our latest US survey, published late last year:

- 75% of respondents had yet to complete an assessment of how the standard will affect them. 8% hadn't even begun.
- 78% said that they hadn't attempted to quantify impacts, on things such as on sales of multiple goods or services, reward or loyalty programs, vendor incentives, rebates, warranties, licenses and royalties, variable compensation, costs to obtain or fulfill a contract, employee compensation plans, debt covenants, changes to tax accounting, and timelines.
- 52% hadn't decided whether they're going to apply the standard to comparative periods, or only to existing and future contracts at the transition date, even though that decision could have significant implications on what's reported now and in the future, timing, systems, resources and work flow.
- Only 17% had begun active implementation (i.e., changing systems, processes, controls, etc.).
- Almost 66% of respondents said that they expect that the standard won't have a material impact on the income statement or balance sheet.

On the other hand…

- Over 50% say the standard will have a moderate to high impact on accounting policies and procedures, the internal control environment, business processes and policies and IT systems.
- More than 60% rate as being somewhat to very difficult, issues such as identifying accounting differences across the organization, revising systems and associated controls, project management, quantifying adjustments, documenting the conversion process and associated auditability, developing and implementing new accounting policies, and contract reviews.

PwC observation. Companies' decisions as to the timing of implementation of revenue may have been affected by expectations that the standard will have a limited financial statement effect. Be careful about relying too much on these assessments. First of all, the work involved in implementing a new accounting standard isn't necessarily proportional to its financial statement effects. Second, our experience is that issues about how the standard applies often reveal themselves only when companies get their hands dirty by looking at their actual contracts. Disclosure is a sleeper too – you may have to arrange to get much more information from operating units than you did before. What can we say? It's just one worry after another.

Transition Resource Group on Revenue

"A child of five could understand this. Send someone to fetch a child of five."

– Groucho Marx

One of the issues companies become aware of as soon as they get serious about implementing revenue is that the specific requirements on how to apply the basic principles are much more complicated than the principles themselves. That's why the IASB and FASB set up a joint forum for the discussion of implementation issues, called, naturally enough, the Transition Resource Group. (There's a separate TRG for loan impairment, too, but that's mainly bank related.)

The Group has addressed 82 issues, one way or another, consuming vast forests in developing agenda papers and final minutes (95 if you include issues addressed solely by the US in 2016 after the IASB shut down its participation saying, for goodness sake, enough is enough). Examples of issues addressed include: gross versus net presentation, non-refundable fees, licenses, collectability, implicit price concessions, significant financing components, restocking fees, impairment of contract assets, variable consideration, etc., etc. You get the drift – the TRG addresses finer points that, although they are finer points, nevertheless could significantly impact when and how a company recognizes revenue and its related costs.

The question is, considering that TRG findings are non-authoritative, and haven't been subject to due process, do companies have to consider and apply them? Or can you just use your own judgment? Although we suspect that regulators would dearly love to mandate the former, they can't. Nevertheless:

- Canadian securities commissions are encouraging companies to consider and apply TRG findings for the period when the TRG was sponsored jointly by the IASB and FASB; and
- The SEC has announced that it "expects" registrants (including IFRS ones) to consider TRG discussions to inform their selection and implementation of reasonable accounting policies, and "strongly encourages" them to come and talk before they decide not to apply any relevant finding.

But it's up to you. Right?

PwC observation. TRGs summarize the views of experts on complex transition issues. If a TRG is on point and provides an unambiguous answer, we expect it will be difficult to convince a regulator that any other solution is the better way, or even acceptable. If you are a foreign private issuer, you should heed the SEC's advice and discuss with them any proposed accounting that doesn't conform to the TRG's findings.

Loan Impairment for Banks

"I love deadlines. I love the whooshing noise they make as they go by."
– Douglas Adams, *The Salmon of Doubt*

For banks, the issue isn't revenue, it's all about implementing the new loan impairment "expected credit loss" requirements. "Expected credit losses" aren't necessarily "expected" nor "losses", at least as those terms are commonly understood; instead, they represent provisions for the risk that a loan will default in the future. These provisions represent the average of the losses a lender estimates that it would incur under various default scenarios weighted by the probability of their occurrence. Because every loan has some probability of defaulting, every loan has an expected loss associated with it – from the moment a loan is made. There are rather complex provisions governing the recognition of expected losses over a loan's life.

In recent months, a few answers are starting to emerge on certain key questions about the new requirements:

- The EU finally (!) endorsed the financial instruments standard, late last year, with the result that European banks will have to adopt the standard in 2018, on the same basis as other IFRS jurisdictions. Announcement of the decision was greeted with general relief in other parts of the world, if not necessarily by European banks themselves.
- While banks have yet to make disclosures about the impact of the impairment requirements, despite prompting from the regulators (see our earlier discussion), a study by the European Banking Authority indicates that average increases to loss allowances for European banks may be in the range of between 25 and 35 percent. One shouldn't be leaping to generalize this finding, however, as the impact will depend on each institution's specific portfolio, past reserving practices, judgments and estimates applied under the new model. It all depends.
- A significant area of concern about the requirements has been their impact on capital. Global (Basel) banking regulators have issued a consultation paper proposing that banks would not have to reflect any increase to loss allowances as an immediate hit in capital adequacy calculations, but rather spoon feed it in over time.

PwC observation. Unlike revenue, banks need no further encouragement to get busy with implementation. All signs are that they'll need every moment to meet reporting deadlines, given the once-in-a-generation level changes to systems, processes, methodologies, policies and controls that the standard requires.

Insurance

"What does it mean to pre-board? Do you get on before you get on?"
– George Carlin

In a rare burst of confidence that's surprising, perhaps, for a project that's now in its 20th year of development, the IASB announced late last year that the effective date of its upcoming insurance standard will be 2021, and that the standard itself will be out sometime in 2017.

The trouble with the 2021 effective date is that it's not 2018, when the financial instruments standard is effective. That's a problem because insurance and financial instruments are like bread and jam; it's possible to eat them separately, sure, but they taste so much better together. However, the Board has done the next best thing – giving insurers special transition options to mitigate the anomalies that can arise from their separate application:

- *The overlay approach* – adopting financial instruments in 2018, the same as everyone else, but putting changes in fair value on qualifying insurance assets that the standard says should go to profit and loss in other comprehensive income instead. The idea here is to allow insurers to continue to calculate net earnings and EPS following old IFRS for financial instruments, but account for the balance sheet and other financial statements under new IFRS. Like hedging, you've got to call your shots; i.e., designate the assets to which you're applying the option before recognizing anything in OCI.
- *The deferral approach* – for companies whose activities are predominately connected with insurance, deferring adoption of the financial instruments standard until you adopt insurance. Whether you qualify for this involves comparing insurance liabilities to total liabilities at a specified date. If the former is 90% or more of the total, the deferral is available automatically. If it's between 80% and 90%, another test has to be met – considering the relative significance of other activities. If the ratio is less than 80%, you're out of luck.

Of course, you don't have to follow either approach, just adopt the financial instruments standard like everybody else has to (unless you are a qualifying life insurer where OSFI is intending to mandate deferral of adoption until 2021). Some may like their toast plain.

PwC observation. We reckon the Board thinks that giving special transition relief to insurance companies is a small price to pay. Even though some might have to pre-board when it comes to adopting financial instruments, and others can delay until the last possible minute, sooner or later they'll be on the same plane and flying in the same direction (unless you're US GAAP bound, where the FASB is still flying its own route). Lest you have forgotten what a world without commonly applied standards looks like, said Hans Hoogervorst, just look at the accounting anarchy that is insurance, where just about every country does its own thing and gets to call it IFRS.

Auditor Reporting

"If you're going to do something tonight that you'll be sorry for tomorrow morning, sleep late."

– Henny Youngman

Never count your standard's before they're hatched.

The Canadian Auditing and Assurance Standards Board announced last summer that it expected to adopt new international standards on auditor reporting for Canada sometime in the last half of 2016. Now, it's decided to hold off for a bit.

You'll remember that these standards revamp the traditional auditor's opinion – the one that goes in the annual report – with the most notable change being that the auditor now has to discuss key audit matters – the stuff which up to now auditors review only with senior management and the audit committee. This reporting is mandatory in England, most of Europe and many other parts of the world, but not the US, at least not yet. As we went to press, the Public Company Accounting Oversight Board was scheduled to approve similar reporting, but final approval rests with the SEC and no date has been set for that. The fact that the US hasn't finalized its standard is the thing that has given the AASB pause.

The earliest it now expects to give its blessing is the spring of this year. It's also reconsidering the scope of the requirements. While the Board still anticipates requiring key audit matter reporting for all TSX listed companies – big and small, it has rethought its position on applying the requirements to entities listed on other exchanges. It's now going to make a decision on this only after considering the TSX experience.

The earliest TSX reporting will happen is for audits for periods ending on or after December 15, 2018 (e.g., an auditor's 2019 report on a company's 2018 annual financial statements, assuming it has a calendar year end).

PwC observation. We believe that it's important to have similar auditor reporting standards in Canada and the US, and so we agree with the Board's decision to delay. The PCAOB's latest proposals haven't provoked the same outrage an earlier iteration did a few years ago, but it's always difficult to make predictions about what may or may not happen in the US regulatory environment after an election year. Especially last year's. The Board will be in a bit of a pickle if the SEC decides to trump whatever the PCAOB might come up with. That decision could take a while – the Chair of the Commission is being replaced and there are other vacancies to fill as well.

For more information

This newsletter has been prepared for the clients and friends of PwC by National Accounting Consulting Services. For further information on any of the matters discussed, please feel free to contact any member of ACS, or your PwC engagement leader. This newsletter is available from the PwC Canada web site, which is located at www.pwc.com/ca/financialreportingrelease.

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- Assistance with offering documents
- Support in responding to regulatory comments and requests
- Advice on alternatives

GAAP / IFRS Interpretation and Conversions

- Diagnostic summary of key impacts on transition
- Evaluation and development of accounting policies
- Training development
- Support in analyzing and documenting technical accounting issues

Accounting Standard Adoption

- Adoption of new standards under IFRS, U.S. GAAP and Canadian GAAP for Private Enterprises
- Diagnostic summary of key impacts on adoption
- Evaluation and development of accounting policies
- Training development and implementation
- Support in analyzing and documenting technical accounting issues

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- Tax Accounting Services
- Comperio
- Automated Disclosure Checklists
- PwC IFRS Manual of Accounting

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