IFRS news

Latest leasing re-deliberations

In this issue:

1 **IASB leasing update**

3 **Cannon Street Press**
Accounting for government loans

3 **Interpretation on stripping costs**

5 **Board members**
Who's who at the IASB

7 **Transition issues**
Canada

9 **Contacts**

The boards met last month to discuss:

- Lessor accounting;
- Lease receivables held for sale;
- Transition; and
- Presentation issues.

The boards' target publication date for the exposure draft is the first half of 2012. A number of key tentative decisions were made during the October meeting. One of the decisions reached on how lessors should account for multiple use assets has led some to question the tentative decisions made earlier on the lessee model. If this issue were to be re-opened, it could put pressure on the boards' timetable.

Lessor accounting – multiple leases of physically distinct portions of an underlying asset

The boards agreed at an earlier meeting that a physically distinct portion of an asset could be subject to a lease. This month, the boards debated the issues faced by lessors when applying the proposed 'receivable and residual' model to multiple leases of physically distinct portions of an underlying asset, such as shopping centres and telecommunication towers. It was tentatively decided that all assets that meet the definition of an investment property in IAS 40, 'Investment property', will be excluded from the scope of the leasing standard. This decision broadens the previously agreed scope exemption to include those investment properties measured at cost as well as those at fair value. The IASB board members also briefly discussed a consequential amendment to IAS 40 that could broaden the definition of an investment property.

Certain FASB board members stated that their reason for allowing the above exemption for investment properties was a belief that there is more than one type of lease. As a result of the tentative decision made for lessors, the majority of FASB board members voted to revisit the debate about whether there is more than one type of lease for lessees. They have agreed to have this discussion offline; however, if this issue is re-opened, it could further extend the timeframe before an exposure draft is published.

Lessor accounting – measurement issues

The boards agreed to amend their July decision as to how the components would

Lost property – in search of the revenue ED

The IASB and FASB are due to publish the new exposure draft on revenue from contracts with customers. We delayed publication of *IFRS news* this month in the hope of bringing you confirmation of the new proposals. However, release has now been pushed back to 14 November. We hope that, as with all good things in life, it'll be worth the wait. To see our guidance on the new ED once it is released, visit 'Straight away updates' on our website pwc.com/ifrs under 'IFRS publications'.

be measured under the 'receivable and residual' model. They agreed to remove their previous requirement that a day-one profit should be recognised in the income statement only if it passes a 'reasonably assured' test.

Under the revised model, a lessor will derecognise the underlying asset subject to the lease and instead recognise a lease receivable, measured at the present value of lease payments, and a gross residual asset, which would be calculated by estimating the present value of the expected future fair value of the residual asset.

The total profit is calculated by comparing the fair value and cost of the underlying asset subject to the lease. The total profit is then allocated between the receivable and gross residual asset. While the profit related to the lease receivable is recognised in the income statement on day-one, any profit related to the residual asset is deferred throughout the lease term. This deferred profit is only realised at the end of the lease term, either upon sale or re-lease of the underlying asset.

Consistent with the July decision, the receivable and gross residual asset will be subsequently accreted using the rate the lessor charges the lessee. However, the deferred profit relating to the residual asset is not re-measured.

It was also agreed that when the rate the lessor charges the lessee reflects an expectation of variable lease payments (such as usage-based rental of a motor vehicle), the lessor should adjust the residual asset by recognising a portion of its cost as an expense when the variable lease payments are recognised as income.

Lessor accounting – lease receivables held for sale

It was tentatively agreed that a lessor should not measure a lease receivable at fair value, even if part or all of that receivable is held for the purposes of sale. Instead, a lessor should apply the existing derecognition requirements in IFRS 9, 'Financial instruments'. It was also agreed that lessors should apply the disclosure requirements in IFRS 7, 'Financial instruments: Disclosures', to lease receivables held for sale.

Transition

It was agreed that lessees and lessors should have the option of applying either a modified or a full retrospective approach to transition. Under the modified approach, the lessee's incremental borrowing rate on the effective date is used for measuring the lease liability. Acknowledging the expense front-loading issue that many commentators referred to in response to the 2010 exposure draft, the boards agreed that the right-of-use asset should be calculated as the amount that would have arisen if the lessee had always applied the discount rate used at transition. For example, if a lessee applies the new standard in the fourth year of a 10-year lease, annual payments of C1,000 and a discount rate at the effective date of 5.7%, it would calculate a lease liability of C4,967. Applying the same discount rate, the lease liability at the beginning of the lease term would have been C7,472. The right-of-use asset is then determined to be C4,483, which is the amount derived after four years of hypothetical depreciation.

For lessors applying the modified approach, the discount rate at transition should be the discount rate charged in the lease, determined at the lease's commencement.

As a further relief, it was agreed that, for leases classified as finance leases under IAS 17, lessees and lessors should use existing carrying amounts at transition, even for complex leases including options and contingent rentals.

Presentation issues

A number of lessor presentation issues were tentatively agreed. Consistent with the 2010 exposure draft, income and expense should be presented either as separate line items, or net in a single line item based on the lessor's business model. Accretion of the gross residual asset should be presented as part of interest income. It was agreed that presentation of income and expenses from leasing activities can be either in the income statement or disclosed in the notes to the financial statements.

Cannon Street Press

IASB proposes amendment to IFRS 1 on accounting for government loans

The IASB has published a proposed amendment to IFRS 1, 'First-time adoption of International Financial Reporting Standards', setting out how a first-time adopter would account for a government loan with a below-market rate of interest when they transition to IFRSs.

The amendment would provide the same relief to first-time adopters as is granted to existing preparers when applying IAS 20, 'Accounting for government grants and disclosure of government assistance'.

The exposure draft, 'Government loans – Proposed amendments to IFRS 1', is open for comment until 5 January 2012.

IFRS IC guidance on accounting for stripping costs

IFRIC 20, 'Stripping costs in the production phase of a surface mine', sets out the accounting for overburden waste removal (stripping) costs in the production phase of a mine. The interpretation may require mining entities reporting under IFRS to write off existing stripping assets to opening retained earnings if the assets cannot be attributed to an identifiable component of an ore body.

Objective and scope

Stripping costs incurred once a mine is in production often provide benefits for current production and access to future production. The challenge has always been how to allocate the benefits and then determine what period costs are versus an asset that will benefit future periods. The IFRIC was developed to address current diversity in practice. Some entities have judged all stripping costs as a cost of production, and some entities capitalise some or all stripping costs as an asset. IFRIC 20 applies only to stripping costs that are incurred in surface mining activity during the production phase of the mine. It does not address underground mining activity or oil and natural gas activity. Oil sands, where extraction activity is seen by many as closer to that of mining than traditional oil and gas extraction, are also outside the scope of the interpretation.

The transition requirements of the interpretation may have a significant impact on a mining entity that has been using a general capitalisation ratio to record deferred stripping. Existing asset balances that cannot be attributed to an identifiable component of the ore body will need to be written off to retained earnings.

Key provisions

IFRIC 20 addresses the following issues:

1. Is the definition of an asset met?

Stripping activity may create two types of benefit: (i) inventory produced and (ii) improved access to the ore. An entity should assess whether the benefits of the stripping activity fall within either of those categories. The benefit of improved access to the ore will qualify as a non-current asset only when:

(a) it is probable that the future economic benefit (improved access to the ore body) associated with the stripping activity will flow to the entity;
(b) the entity can identify the component of the ore body for which access has been improved; and
(c) the costs relating to the improved access to that component can be measured reliably.

2. When should the asset be recognised?

Stripping costs that relate to inventory produced should be accounted for as current production cost in accordance with IAS 2, 'Inventories'. Stripping costs that generate a benefit of improved access and meet the above definition of an asset should be accounted for as an addition to or enhancement of an existing asset (stripping activity asset); it is not an asset in its own right. The capitalised costs are classified as tangible or intangible according to the nature of the existing asset.

3. How should the stripping activity asset be measured initially?

The stripping activity asset should initially be measured at the direct costs incurred. These costs include haulage, waste transportation, materials consumed, costs of machinery employed, labour and fuel. An allocation of directly attributable overhead costs may also be made.

It may be difficult to separate the costs incurred that create the future benefit (stripping activity asset) and the costs related to current period inventory production. Entities will allocate total costs between the inventory produced and the stripping activity asset using a relevant production measure. The production measure is calculated for the identified component of the ore body and used to identify the extent to which the additional activity has created an asset. IFRIC 20 provides examples of such measures, including volumes of waste extracted compared with expected volumes for given production levels.

Entities currently using 'stripping ratios' may find the new requirements similar to their existing approach, although the basis of the ratio will be the identified component and not the full life-of-mine.

4. How should the stripping activity asset be measured subsequently?

The stripping activity asset is carried at cost or revalued amount (per IAS 16, 'Property, plant and equipment') less depreciation or amortisation and impairment losses. It is depreciated or amortised in a rational and systematic manner over the useful life of the relevant identified component of the ore body. This is expected to be shorter than the useful life of the mine in most cases. The units-of-production method is applied unless another method is more appropriate.

Am I affected?

All surface mining companies applying IFRS will be affected by the interpretation. The interpretation applies to all stripping activity as of the effective date of 1 January 2013, with early application permitted if disclosed. An entity that has been expensing all production period stripping will begin capitalising from the date of adoption of the interpretation.

Any existing stripping cost asset balances at the date of transition are written off to opening retained earnings unless they relate to an identifiable component of the ore body.

IFRC 20 also amends IFRS 1, 'First-time adoption of IFRS'. First-time adopters would be allowed to apply the transition provisions with effective date at the later of 1 January 2013 or the transition date.

What do I need to do?

IFRIC 20 is applicable for annual periods beginning on or after 1 January 2013. Existing IFRS preparers may be most interested in the transition provisions in the interpretation.

All aboard

Against the backdrop of a changing landscape, the IASB continues to renew its membership. This year, it is particularly significant with the appointment of a new chairman and vice-chairman, and the departure of the last three founding members of the IASC. Here is how the membership currently looks.

Name	***Former posts***
New members this year	
Hans Hoogervorst (chairman) **Term began/expires**: July 2011/June 2016	• Chairman of executive board of the Netherlands Authority for the Financial Markets (AFM). • Chairman of the IOSCO technical committee. Chairman of the Monitoring Board of the IFRS Foundation. • Dutch minister of finance, health, welfare and sport, and state secretary for social affairs. • Officer for the National Bank of Washington.
Ian Mackintosh (vice-chairman) **Term began/expires**: July 2011/June 2016	• Chairman of the UK Accounting Standards Board. • Chief Accountant of the Australian Securities and Investment Commission. • Manager, Financial Management, South Asia at the World Bank. • Deputy Chairman of the Australian Accounting Standards Board.
Takatsugu Ochi **Term began/expires:** July 2011/June 2016	• General Manager, Financial Resources Management Group of Sumitomo Corporation. • Member of the IFRS Interpretations Committee. • Secretary-General of the Nippon Keidanren (Japan Business Federation) Taskforce for early adoption of IFRS. • Adviser to the Accounting Standards Board of Japan.
Members potentially up for reappointment	
Stephen Cooper **Term began/expires**: July 2007/June 2012	• Managing Director in the Equities business of UBS Investment Bank in London. • Member of the European and Global investment recommendations committees and the investment committee of the UBS pension fund in the UK. • Member of IASB's advisory group for share based payments. • Member of joint IASB-FASB working group on financial statement presentation. • Member of the Analyst Representative Group, the IASB's consultative group for analysts and investors. • Member of the financial reporting committee of the Institute of Chartered Accountants in England and Wales and the pensions accounting advisory group of the UK ASB.

Paul Pacter **Term began/expires**: July 2010/June 2012	• Director of Standards for SMEs at the IASB. • Director in the Global IFRS Office of Deloitte Touche Tohmatsu, Hong Kong. • FASB's Deputy Director of Research. • Executive Director of the Financial Accounting Foundation. • Commissioner of Finance of the City of Stamford, Connecticut. • Professor of Accounting at the University of Connecticut's Evening MBA Program. • Vice Chairman of the Advisory Council to the US Governmental Accounting Standards Board. • Member of GASB's pensions task force and FASB consolidations task force.
Zhang Wei-Guo **Term began/expires**: July 2007/June 2012	• Chief Accountant and Director General of the Department of International Affairs at the China Securities Regulatory Commission. • Member of the China Accounting Standards Committee and the China Auditing Standards Committee. • Head of the Department of Accounting at Shanghai University of Finance & Economics (SUFE). • PhD supervisor at SUFE and Tsinghua University.
Members leaving next year after two terms	
John Smith **Term began/expires:** September 2002/ June 2012	• Audit partner, Deloitte & Touche. • Represented D&T on the Emerging Issues Task Force of the US FASB. • Member of the FASB's Derivatives Implementation Group and Financial Instruments Task Force. • Member of IFRIC and founding member of the predecessor body, the Standing Interpretations Committee. • Member of the Steering Committee for the development of IAS 39 and chairman of the IAS 39 Implementation Guidance Committee. • Leader of Financial Instruments Research Group, New York.

Others

Philippe Danjou
Term began/expires:
July 2006/June 2016

Amaro Luiz de Oliveira Gomes
Term began/expires:
July 2009/June 2014

Patricia McConnell
Term began/expires:
July 2009/June 2014

Jan Engström
Term began/expires:
May 2004/ June 2014

Prabhakar Kalavacherla
Term began/expires:
January 2009/June 2013

Darrel Scott
Term began/expires:
Oct 2010/Oct 2015

Patrick Finnegan
Term began/expires:
July 2009/June 2014

Elke König
Term began/expires:
July 2010/June 2015

Transition issues from around the world – Canada

This is the latest article in the series about issues affecting countries that are moving to IFRS. Scott Bandura, partner in PwC's Accounting Consulting Services in Canada, looks at the challenges around adopting IFRS in an interim reporting period.

Scott Bandura

Challenges of adopting IFRS for an interim reporting period

The Canadian Accounting Standards Board (AcSB), in its transition guidance, mandated the adoption of IFRS for 'interim and annual periods' beginning on or after 1 January 2011. Interim financial statements must comply with IAS 34, 'Interim financial reporting'. With the benefit of hindsight we recommend that territories proposing to transition to IFRS in an interim period should carefully consider whether the benefits outweigh the costs.

Public companies in Canada are generally traded on the Toronto Stock Exchange or TSX Venture Exchange (smaller, junior issuers). All public companies are required to file quarterly financial statements. The first reporting period under IFRS for calendar year public companies was therefore 31 March 2011.

Companies listed on the TSXV normally have 60 days after the end of a quarter to file their interim financial statements, and TSX issuers have 45 days in which to file – a much shorter timeframe than for annual financial reporting. So, one of the challenges of adopting IFRS in an interim period was the tighter timeline.

The securities commissions therefore allowed a one-off extension of 30 days for the filing of the first interim financial statements. However, larger companies generally did not take advantage of the extension because they had begun preparing for the transition to IFRS well in advance of the first quarter. In some cases, this included having the auditors prepare an assurance report on the opening 1 January 2010 balance sheet or accounting policies. Smaller TSX venture companies were more likely to take the filing extension as their resources related to the transition were more constrained.

The average length of first-quarter IFRS financial statements had grown from an average of 16 pages to 35 pages, according to a PwC survey of energy companies in Canada. Much of this increase is

Local background

- The Canadian Accounting Standards Board (AcSB) adopted a strategic plan in 2006, which called for the adoption of IFRS in Canada. Prior to the 2006 decision, Canadian GAAP was more closely aligned with US GAAP.
- The AcSB mandated IFRS for publicly accountable entities, starting with interim and annual financial statements for annual periods beginning on or after 1 January 2011.
- More than just traditional 'public' companies are scoped into the transition. Publicly accountable entities are entities that have issued (or are in the process of issuing) debt and equity traded in a public market or those that 'hold assets in a fiduciary capacity for a broad group of outsiders'.
- Non-publicly accountable entities have the option to transition to IFRS or use a simplified version of former Canadian GAAP called 'Accounting Standards for Private Enterprises'.
- The Canadian Institute of Chartered Accountants Handbook was amended to incorporate IFRS. For legal reasons, Canadian companies will be allowed to assert compliance with both Canadian GAAP and IFRS. Canadian GAAP for publicly accountable entities is now IFRS.
- The original intent of the AcSB was for all 'publicly accountable' enterprises to transition to IFRS in 2011. However, the AcSB granted a one-year extension to entities with rate-regulated activities (some of which have since decided to transition to US GAAP); and a two-year extension for investment companies to allow for the completion of the IASB's consolidation project relating to investment entities.

attributable to the additional information required when adopting IFRS in an interim period in addition to what would normally be included in such filings. We address some of the additional requirements for disclosure and related challenges below.

Communicating compliance

The first challenge that companies face in adopting IFRS within an interim period is communication. Management would often have liked to assert unreserved compliance with IFRS in their first quarter financial statements. However, IAS 34 requires interim financial statements not to make such an unreserved statement of compliance unless they comply with all the requirements of IFRS. IAS 34 contains reduced disclosure requirements and some special measurement guidance (for example, for income taxes). Management would not generally be in a position to say that they 'complied with all the requirements of IFRS'. Most companies therefore made the disclosure that the financial statements complied with 'IFRS applicable to the preparation of interim financial statements, including IAS 34 and IFRS 1'.

Accounting policies

The second challenge is assessing which accounting policies to use. IFRS 1 requires the policies in an entity's first IFRS financial statements to 'comply with each IFRS effective at the end of its first IFRS reporting period'; an entity's first IFRS reporting period is defined by reference to an annual reporting period. If the IASB releases a new standard with a mandatory adoption date for annual periods during the transition period, this new standard would have to be applied retrospectively. Most companies made clear disclosure of the potential for accounting policies to change, as follows:

The policies applied in these condensed interim consolidated financial statements are based on IFRS issued and outstanding as of {date}, the date the Board of Directors approved the statements. Any subsequent changes to IFRS that are given effect in the company's annual consolidated financial statements for the year ending December 31, 2011 could result in restatement of these interim consolidated financial statements, including the transition adjustments recognized on change-over to IFRS.

Thankfully, the IASB has not so far released any standards subsequent to the first quarter that would be required for adoption in 2011.

The ability to change accounting policies prior to the release of the annual financial statements could also be an advantage: it might allow companies to harmonise accounting policies with their peers prior to filing the annual financial statements without the constraints for changing accounting policies normally imposed by IAS 8, 'Accounting policies, changes in accounting estimates and errors'. However, we have not seen significant voluntary changes in accounting policies so far.

The third challenge that companies face is deciding what accounting policies to disclose. An entity is not required to repeat its accounting policies if they have not changed from the previous annual financial statements. However, there are no annual IFRS financial statements to refer to when adopting IFRS in an interim set of financial statements. Many IFRS accounting policies would be different from the prior Canadian GAAP policies. Companies had to include significant additional accounting policy disclosures (and related disclosures about judgements and estimates) in their first quarter financial statements. In some cases, management reduced the volume of disclosure in the second and third quarter by referencing the accounting policies disclosed in the first quarter filings.

Opening balance sheet and reconciliations

IFRS 1 requires the first set of IFRS financial statements to contain an opening balance sheet. Calendar-year Canadian public companies adopting IFRS therefore included a 1 January 2010 opening balance sheet in their first interim financial statements. Companies not changing any accounting policies in the second and third quarter were eligible to drop this opening balance sheet in those quarterly financial

statements. However, many found it easier to repeat the opening balance sheet each quarter, as the opening balance sheet must appear again in the 2011 annual financial statements.

IFRS 1 sets out the reconciliations required in an interim set of financial statements. The required reconciliations in the first quarter included a reconciliation of equity for 1 January 2010, 31 March 2010 and 31 December 2010; and a reconciliation of comprehensive income for the three months ended 31 March 2010 and the year ended 31 December 2010.

The conciliation requirements were complex. Companies could drop the opening balance sheet and annual reconciliations; they could instead refer back to the first quarter statements where there had not been any change in accounting policies during those quarters. Many companies found it easier to repeat the annual reconciliations, as they would need to appear again in the 2011 annual financial statements even if dropped in the second and third quarter.

The large number of reconciliations required in transitioning to IFRS in an interim period partially explains the increased number of pages in the first quarter financial statements.

Almost all Canadian public companies met the extended filing deadlines for the first quarter financial statements despite the significant amount of effort needed to adopt IFRS during an interim period. Many larger companies had already prepared IFRS reconciliations and policy disclosures during 2010 in anticipation of the tight deadline for first-quarter reporting. With the first quarter now behind them, the level of work for annual financial statements will be less than if adoption took place in an annual period. Nevertheless, territories proposing to transition to IFRS in an interim period should carefully consider whether the benefits of requiring adoption in an interim period outweigh the costs of doing so.

'Illustrative financial statements for 2011 year-ends now available

The financial statements of a fictional company have been updated to illustrate the disclosure and presentation requirements of the IFRS standards and interpretations for financial years beginning on or after 1 January 2011.

The entity is an existing preparer of IFRS financial statements. There is an appendix illustrating disclosures for first-time adopters; and on IFRS 9, 'Financial instruments', IFRS 10, 'Consolidated financial statements', IFRS 11, 'Joint arrangements', IFRS 12, 'Disclosure of interests in other entities', and IFRS 13, 'Fair value measurement', for early adopters.

Visit pwc.com/ifrs to view the PDF or click here to order hard copies.

For further help on IFRS technical issues contact:

Business combinations and adoption of IFRS
mary.dolson@uk.pwc.com: Tel: + 44 (0)20 7804 2930
caroline.woodward@uk.pwc.com: Tel: +44 (0)20 7804 7392

Liabilities, revenue recognition and other areas
tony.m.debell@uk.pwc.com: Tel: +44 (0)20 7213 5336

Financial instruments and financial services
john.althoff@uk.pwc.com: Tel: + 44 (0)20 7213 1175
jessica.taurae@uk.pwc.com: Tel: + 44 (0)20 7212 5700

IFRS news editor
joanna.c.malvern@uk.pwc.com: Tel: +44 (0)20 7804 9377

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. It does not take into account any objectives, financial situation or needs of any recipient; any recipient should not act upon the information contained in this publication without obtaining independent professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PricewaterhouseCoopers LLP, its members, employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

© 2011 PricewaterhouseCoopers. All rights reserved. PricewaterhouseCoopers refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.