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Financial Accounting Standards Board
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28 January 2011

Dear Sirs,

Request for Views/Discussion Paper: Effective Dates and Transition Methods (the “consultation”)

We are pleased to respond to the invitation by the IASB and the FASB (“the boards”) to comment on the consultation. Following discussion with members of the PwC network of firms, this response summarises the views of those member firms who commented on the consultation. ‘PwC’ refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

The scale of the proposed changes in the new standards is unprecedented, with the exception of when a company transitions to IFRS. The new standards will affect most companies, large and small, public and private. Beyond the significant financial reporting impact, the new standards may change how companies operate and their negotiations with creditors, customers and suppliers. The new financial instruments guidance will trigger revisions to treasury and hedging strategies whilst the new revenue and leases guidance may prompt changes in the structure of these contracts. As the impact on each company will be different, no single effective date, transition method or sequence will be ideal for all companies. Investors will derive the most benefit from the new standards if companies are given sufficient time to implement the changes in a quality manner. Most companies will need several years to develop the necessary software, systems and processes.

With these considerations in mind, we believe a single effective date approach should be adopted with an unrestricted early adoption option of any or all of the standards available to all companies. This is especially important for first-time adopters of IFRS. Based on our discussions with clients that are most affected and assuming final standards on the priority projects are issued by June 2011, we believe the effective date should be no earlier than periods beginning 1 January 2015. This date would allow companies sufficient lead time to implement the new standards correctly the first time, reduce costs, improve operations and minimise risk.

We acknowledge that some preparers, including smaller companies, prefer a sequential approach. The difference in views is a reflection of the diverse impact that the new standards will have on each company; views which are influenced by factors such as transition costs, adequacy of existing resources and adaptability of current systems. The concerns of sequential date proponents would be

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addressed by an unrestricted early adoption option providing the flexibility to determine the adoption sequence that is most appropriate for their circumstances.

We also acknowledge the concerns raised by some that lack of comparability between companies will increase for a period of time when early adoption is allowed. We believe that the impact on comparability can be reduced with appropriate transition disclosures in the financial statements, describing the impact of changes as they occur. Further, complying with the appropriate disclosure requirements under IFRS and US GAAP with respect to the expected impact of standards that have been issued but are not yet effective would also aid comparability. More importantly, we believe that companies are in the best position to determine the most cost-effective timeline for their particular situation that will also result in a quality implementation. Therefore, after weighing the benefits of early adoption, against the short period of non-comparability, we believe that allowing early adoption is the preferable approach for companies and investors.

In respect of transition methods, we acknowledge the theoretical merit of applying the proposed changes retrospectively to increase consistency across periods. It might not, however, be practicable to apply certain provisions included in the new standards retrospectively as we have highlighted previously to the boards.

Our answers to the specific questions in the consultation provide our underlying logic and more detail on the views expressed above and are attached in appendix A to this letter.

If you have any questions, please contact John Hitchins, PwC Global Chief Accountant (+44 207 804 2497), Peter Holgate (+44 207 213 5675), Paul Kepple, PwC US Chief Accountant (+1 973 236 5293), or Tim Corrigan (+1 973 236 5302).

Yours faithfully,

A handwritten signature in blue ink, which appears to read 'Peter Holgate'.



Appendix A: Responses to questions

In reviewing the questions posed by the boards in their respective consultation documents, we have noted some differences in the FASB and the IASB wording of certain questions that appear to address the same issue. While our response to both boards is the same for each of these questions, we have highlighted the more significant wording differences we have noted in square brackets or separately presented the text of each board's question for information.

Q1. Please describe the entity (or the individual) responding to this Request for Views [Discussion Paper]. For example:

- a) ***Please state whether you are primarily a preparer of financial statements, an auditor, or an investor, creditor or other user of financial statements (including regulators and standard-setters). Please also say whether you primarily prepare, use or audit financial information prepared in accordance with IFRSs, US GAAP or both.***
- b) ***If you are a preparer of financial statements, please describe your primary business or businesses, their size (in terms of the number of employees or other relevant measure), and whether you have securities registered on a securities exchange.***
- c) ***If you are an auditor, please indicate the size of your firm and whether your practice focuses primarily on public entities, private entities or both.***
- d) ***If you are an investor, creditor or other user of financial statements, please describe your job function (buy side/sell side/regulator/credit analyst/lending officer/standard-setter), your investment perspective (long, long/short, equity, or fixed income), and the industries or sectors you specialise in, if any.***
- e) ***Please describe the degree to which each of the proposed new IFRSs [standards] is likely to affect you and the factors driving that effect (for example, preparers of financial statements might explain the frequency or materiality of the transactions to their business and investors and creditors might explain the significance of the transactions to the particular industries or sectors they follow).***

a) We are responding to this consultation primarily in our capacity as auditors of financial statements prepared in accordance with IFRS and US GAAP.

c) We are one of the world's largest providers of assurance services with firms located in 154 countries. Our practice focuses on both public and private entities.

e) The new standards' impact on us will ultimately be driven by the impact on our clients. Given the diversity of our client base, on balance, we expect all of the proposed new standards to have a significant impact on a notable proportion of our clients. We have previously highlighted any concerns in this regard to the boards in our comment letters on the relevant projects. For convenience, we have included copies of the relevant parts of our comment letters in appendix B to this letter and refer to these comments in our response to questions raised in this consultation.



IASB

Q2. Focusing only on those projects included in the table in paragraph 18 above:

- a) **Which of the proposals are likely to require more time to learn about the proposal, train personnel, plan for, and implement or otherwise adapt?**
- b) **What are the types of costs you expect to incur in planning for and adapting to the new requirements and what are the primary drivers of those costs? What is the relative significance of each cost component?**

FASB

Q2. Focusing only on those proposals that have been published as Exposure Drafts (accounting for financial instruments, other comprehensive income, revenue recognition, and leases):

- a) **How much time will you need to learn about each proposal, appropriately train personnel, plan for, and implement or otherwise adapt to each the new standard?**
- b) **What are the types of costs you expect to incur in planning for and adapting to the new requirements and what are the primary drivers of those costs? What is the relative significance of each cost component?**

We have spoken to people in a large number of companies and have summarised the numerous challenges that they highlighted in our response to question 3. The impact on each company's financial reporting and business will vary depending on the level of resources available to them and the complexity of their operations, products and services. Given the impact of these proposals will be felt most by preparers of financial statements, we believe the boards should pay particular attention to feedback received from these constituents.

With respect to the impact on our network, we believe that the majority of the costs we will likely incur in preparing for the new standards will relate to investment in training of our staff.

Q3. Do you foresee other effects on the broader financial reporting system arising from these new IFRSs? For example, will the new financial reporting requirements conflict with other regulatory or tax reporting requirements? Will they give rise to a need for changes in auditing standards?

The boards have previously asked constituents for views on the impact of proposals within individual exposure drafts. We refer the boards to our previous comment letters on these projects for specific observations, extracts from which are included in appendix B. Our response to this question builds on those observations in the context of this consultation.

Our discussions with preparers show that the new revenue, leases, and financial instruments standards will have the most significant impact on companies. The proposed changes will affect how senior management, boards, analysts and investors consider a company's performance through its financial results. In particular, companies will need to carefully consider investor communications to ensure the effect of these changes is clearly conveyed. The impact of these changes on the financial results of companies may also require terms of employee compensation plans to be reconsidered to maintain the original intent of the arrangements. Beyond the significant financial reporting impact, the new standards may change how companies operate and their negotiations with creditors,



customers and suppliers. The new financial instruments guidance will trigger revisions to treasury and hedging strategies whilst the new revenue and leases guidance may prompt changes in the structure of these contracts.

The new revenue recognition and leases standards will require many companies to develop systems that are capable of processing a large number of contracts and transactions. In many cases, software that can handle the specific requirements of these standards will not be developed until after the final standards are issued.

In addition to the impact on systems, companies will need to interpret the new standards, develop appropriate accounting policies and procedures, and train employees. There is an increased level of estimation and judgement required in applying many of the new standards such as revenue and leases. Considering the use of this judgement within the context of internal controls and processes will be challenging for many companies.

Given the level of financial reporting change, we expect that many tax authorities will need to undertake a comprehensive assessment of their tax regulations to determine any necessary changes required. Resulting changes to tax regulations will also impact companies who will need to amend their tax reporting processes to align with these changes. Further, tax provision and tax compliance systems may need to be updated to conform with the changes to the financial reporting systems.

From the perspective of auditors, the principal challenge will be where the new standards require management to make new estimates. The audit of these estimates will depend on preparers having developed robust estimation processes and the latter will require sufficient lead time to achieve. Although, in many cases, the final accounting requirements have not yet been decided, we do not believe they will necessitate new auditing standards.

In isolation, a single system change can be particularly demanding for any company. When combined with changing multiple systems, business processes and internal controls as well as adapting to guidance in the new standards, the level of change becomes even more challenging. As we note in our response to question 5 of this consultation, these challenges should be borne in mind when determining the effective dates of each standard.

IASB

Q4. Do you agree with the transition method as proposed for each project, when considered in the context of a broad implementation plan covering all the new requirements? If not, what changes would you recommend, and why? In particular, please explain the primary advantages of your recommended changes and their effect on the cost of adapting to the new reporting requirements.

FASB

Q4. In the context of a broad implementation plan covering all the new requirements, do you agree with the transition method as proposed for each project? If not, what changes would you recommend and why? In particular, please explain the primary advantages of your recommended changes and their affect on the cost of adapting to the new reporting requirements.



The boards have previously asked constituents for views on transition methods within individual exposure drafts. We refer the boards to our previous comment letters on these projects for more specific observations, extracts from which are included in appendix B. Our response to this question summarises our key observations in the context of this consultation.

We acknowledge the theoretical merit of applying the proposed changes retrospectively to increase consistency across periods. It might not, however, be practicable to apply certain provisions included in the new standards retrospectively.

For revenue, factors such as the existence of long-term contracts, multiple performance obligations, variable consideration, or other matters that require a significant degree of estimation will make retrospective application difficult or possibly impractical. For insurance contracts under IFRS, the complexities of applying the new accounting policy may also render full retrospective application impracticable. In both cases, we support full retrospective application of the guidance with an impracticability exception to address these issues.

For leases, we agree that a simplified approach to transition is necessary but do not believe the approach is as simplified as it should be, nor necessarily the best presentation in all cases. While a simplified approach may be appropriate and cost-effective for many, we do not believe that a full retrospective approach should be precluded, as it would represent a more faithful comparative presentation of the economics for those willing to undertake the exercise.

In the case of the IASB proposals on fair value measurement and hedging, we agree with prospective application of this guidance in principle. However, we believe the transition guidance for fair value measurement requires clarification as to how prospective application would affect assets and liabilities in existence prior to adoption of the standard. For hedging, we believe that limited retrospective application of the guidance may be acceptable in certain circumstances. We refer the boards to our future comment letter on the hedging proposals for further detail.

For the US proposal on financial instruments, we agree with the approach to require a cumulative effect adjustment to the statement of financial position for the reporting period that immediately precedes the effective date. However, even under this approach, the proposed changes do not provide sufficient transition guidance, such as how a company that previously applied the short cut method should account for the cumulative ineffectiveness that may exist in the hedging relationship. Further transition guidance should be provided in this and other areas as described in our financial instruments comment letter.

We believe that all standards should be available for early adoption with no restrictions around applying standards in groups. For some sequences of adoption that companies may choose, there will be an absence of guidance in how to deal with conflicts between standards. This matter should be addressed by the boards as we have noted in our response to question 6.

Q5. In thinking about an overall implementation plan covering all of the standards that are the subject of this Request for Views [Discussion Paper]:

- a. Do you prefer the single date approach or the sequential approach? Why? What are the advantages and disadvantages of your preferred approach? How would your preferred approach minimise the cost of implementation or bring other benefits? Please describe the sources of those benefits (for example, economies of scale, minimising disruption, or other synergistic benefits).***



- b. Under a single date approach [and assuming the projects noted in the introduction are completed by June 2011], what should the mandatory effective date be and why?**
- c. Under the sequential approach, how should the new IFRSs [standards] be sequenced (or grouped) and what should the mandatory effective dates for each group be? Please explain the primary factors that drive your recommended adoption sequence, such as the impact of interdependencies among the new IFRSs [standards].**
- d. Do you think another approach would be viable and preferable? If so, please describe that approach and its advantages.**

After considering the complexity and the pervasiveness of the proposed changes, and recognising the different needs of each preparer, we believe a single date approach should be adopted with an unrestricted option for early adoption of any or all of the standards available to all companies, especially first-time adopters of IFRS. Based on our discussions with companies that are most affected and assuming final standards on the priority projects are issued by June 2011, we believe this effective date should be no earlier than periods beginning 1 January 2015 to allow sufficient lead time to prepare for the change. We acknowledge that some preparers, including smaller companies, prefer a sequential approach. The concerns of sequential date proponents would be addressed by an unrestricted early adoption option providing the flexibility to determine the adoption sequence that is most appropriate for their circumstances. In this regard, we urge the boards not to prevent early adoption, particularly, under IFRS, for first-time adopters.

We also acknowledge the concerns raised by some that lack of comparability between companies will increase for a period of time when early adoption is allowed. We believe that the impact on comparability can be reduced with appropriate transition disclosures in the financial statements, describing the impact of changes as they occur. Further, complying with the appropriate disclosure requirements under IFRS and US GAAP with respect to the expected impact of standards that have been issued but are not yet effective would also aid comparability. More importantly, we believe that companies are in the best position to determine the most cost-effective timeline for their particular situation that will also result in a quality implementation. Therefore, after weighing the benefits of early adoption, against the short period of non-comparability, we believe that allowing early adoption is the preferable approach for companies and investors.

In addition, we believe a forced sequential date approach is not preferable because no single predetermined grouping of the standards can properly consider the interactions between two or more new standards that would uniquely impact different industries. For example, while lessors may wish to adopt the revenue and leases standards together, certain financial institutions may wish to adopt the revenue standard together with financial instruments and fair value measurements. Further, the imposed timing and groupings under a forced sequential date approach may not be most cost-effective to a company. This approach would also lead to forced multiple restatements of comparative information over an extended period, which may be considered to be too costly by those companies who would prefer to adopt most, if not all standards on a single date.



While a single date approach is preferable, we do not believe that it is necessary for all projects within the scope of the consultation to be effective at the same date. For example, the amendments proposed to IAS 19, 'Employee benefits' and IAS 1, 'Presentation of financial statements' in relation to defined benefit plans and other comprehensive income respectively could be applied independently of other new standards. However, given the likely complexities involved for some companies in applying the consolidation and joint arrangement guidance, we believe there is merit in aligning the effective dates of these standards with those in the scope of this consultation.

- a) In addition to our discussion above, the advantages of a single date approach over a forced sequential date approach are as follows:
- i. Where entities have the sufficient level of resources, tackling implementation of all new standards at a single date might be most cost-effective and avoid disruption over an extended period. In such a case, the required system changes may also be easier to implement as part of single project as opposed to a piecemeal approach over a period of time.
 - ii. Both US GAAP and IFRS require an entity to present a balance sheet as at the beginning of the earliest comparative period presented in the event of a change in accounting policy that is applied retrospectively. Standards also require presentation of this additional comparative information in the related balance sheet notes. Where new standards have sequential effective dates and at least some degree of retrospective application, the result would be entities presenting this additional balance sheet and related notes for a number of periods. The single date approach with an early adoption option would eliminate this continual change to comparative information over an extended period of time unless companies specifically choose to early adopt standards sequentially.

The disadvantages of a single date approach without being accompanied by an unrestricted early adoption option are:

- iii. The volume of change reported in the period of application may present challenges to certain preparers in terms of communicating the impact of these changes to users of financial statements.
- iv. The single date approach may be less preferable for entities that have limited resources to deal with all new standards as part of a single implementation project.

We believe that the above disadvantages would be addressed by an unrestricted early adoption option and a reasonable lead time for preparation. This would allow preparers time to determine an adoption sequence that is most appropriate to their circumstances.

- b) Based on our discussions with companies that are most affected and assuming final standards are issued by June 2011, where a single effective date approach is followed, we believe this effective date should be no earlier than periods beginning 1 January 2015 to allow sufficient lead time to prepare for the change. This is mindful of the fact that certain jurisdictions, such as the US, require public companies to present two years' of comparative information resulting in a transition date to the new standards of 1 January 2013 for a calendar year company.



An effective date of 1 January 2015 would also provide the required lead time for countries that base their local GAAP on IFRS, such as Hong Kong and Australia, to embed these changes into local requirements as well as time for the necessary endorsement process in specific jurisdictions, for example, the EU.

Companies have told us that the revenue, leases and financial instruments standards could take up to three and a half years to fully implement. During the first 12 to 18 months, companies will be interpreting the new standards, identifying software needs, developing systems, and training staff. After software and systems have been developed, companies may need up to an additional two years to complete implementation. This period consists of collecting and processing data, testing systems, implementing internal controls and possibly renegotiating contracts. During this period, many companies will account for transactions in parallel under existing and new standards for comparative reporting purposes.

We note to the boards that the suggested effective date of 1 January 2015 is subject to certain factors. There have been no substantive field tests of the revenue and leasing proposals to date and field testing by the IASB for the insurance proposals is ongoing. In addition, as we note, the systems for certain standards, such as leasing, will need to be developed. As indicated, we believe 12 to 18 months would be a reasonable timeline, however, given these are entirely new systems, successful development within that time is not guaranteed. Therefore, the results of such field testing and the boards' assessment of the time necessary to develop these systems may impact the decision as to the appropriate effective date. Additionally, to accommodate those jurisdictions where two years' comparative information is required, for a calendar year company, these implementation challenges would need to be resolved by 1 January 2013. The boards should consider this fact when deciding on an appropriate final effective date.

- c) As outlined previously, we believe a sequential approach could be achieved within the single date approach by providing an option to permit early adoption of all standards. This would provide preparers the flexibility to determine the most appropriate adoption sequence for their circumstances.
- d) We have not identified an alternative approach that would be more viable or preferable.

Q6. Should the IASB [Board] give entities the option of adopting some or all of the new IFRSs [standards] before their mandatory effective date? Why or why not? Which ones? What restrictions, if any, should there be on early adoption (for example, are there related requirements that should be adopted at the same time)?

We believe there should be an option to early adopt all standards with no restrictions around applying standards in groups. Further, as indicated in our response to question 5, we believe there is merit in aligning the effective dates of the consolidation and joint arrangement guidance with the standards in the scope of this consultation. Equally, we believe the consolidation and joint arrangement standards should also contain the same unrestricted early adoption option. All new standards being issued by the boards are intended to be improvements in financial reporting and we believe preparers should be allowed to early adopt if they wish. As we have noted to the boards, the new standards present a significant amount of operational change for a number of companies. The option to early adopt new standards would afford companies the ability to avoid the costs of running old and new systems in parallel should these new systems be operational prior to the standards' effective date.

An unrestricted early adoption option would provide preparers the flexibility to determine the most appropriate adoption sequence for their circumstances. To illustrate, for some companies, certain new



standards may have limited impact while others may require more extensive changes. For example, some financial institutions may be greatly impacted by the new financial instruments and leases standards, but may not be affected significantly by the new revenue standard. An unrestricted early adoption option would afford the choice of applying the revenue standard first before focusing on the more complex application of financial instruments and leases.

As we note in our response to question 4, for some sequences of adoption that companies may choose, there will be an absence of guidance in how to deal with conflicts between standards. We believe the boards should develop transition guidance to address these situations. In our view this can be accomplished through the establishment of a simple principle rather than any detailed rules.

We urge the boards not to prevent early adoption. This is particularly important under IFRS for first-time adopters. We refer the IASB to our response to question 8 and note that an early adoption option is particularly vital for those transitioning to IFRS prior to the effective date(s) of the new standards.

Q7. [FASB: Q8.] Do you agree that the IASB and FASB should require the same effective dates and transition methods for their comparable standards? Why or why not?

We believe that the IASB and FASB should require the same effective date for comparable standards. Given the global economy in which companies operate today, a single effective date across IFRS and US GAAP would provide a single end date by which global comparability of financial statements would be achieved for these standards. Equally, we note that the requirement for SEC registrants to provide 2 years' comparative information may affect the FASB's selection of an effective date.

IASB only

Q8. Should the IASB permit different adoption dates and early adoption requirements for first-time adopters of IFRSs? Why, or why not? If yes, what should those different adoption requirements be, and why?

Over the next few years a number of territories will be transitioning to IFRS and at a time when the new standards in the scope of this consultation have been issued. To illustrate the impact on first-time adopters, assume the effective date for the new standards is 1 January 2015. For an entity that is significantly impacted by the new standards and applying IFRSs for the first time in calendar year 2013, requiring a further fundamental financial reporting change relatively close to the year of first-time adoption would seem unduly harsh.

To that end, we believe that unrestricted early adoption of all standards should be available to all entities including first-time adopters for the reasons set out in our response to question 6. If, contrary to our view, the IASB determines that early adoption is prohibited for existing IFRS preparers in relation to some or all of the new standards, we believe that early adoption should nevertheless be available to first-time adopters between issue of the standards and their effective dates to avoid unnecessary cost or effort in adopting the old versions of standards shortly before having to adopt new standards.

FASB only

Q7. For which standards, if any, should the Board provide particular types of entities a delayed effective date? How long should such a delay be and to which entities should it apply? What would be the primary advantages and disadvantages of the delay to each class of stakeholders (financial statement preparers, financial statement users, and



auditors)? Should companies eligible for a delayed effective date have the option of adopting the requirements as of an earlier date?

We believe that the FASB should allow private companies an additional year to adopt all of the new standards. Implementation by private companies may have additional challenges because they may not have the same depth of resources as most public companies. This means it may take longer to renegotiate contracts and implement the necessary systems and the accounting policy changes. Private companies can also benefit by learning from public companies adopting first. Further, similar to public companies, an early adoption option should be provided to private companies.



Appendix B: Extracts from comments letters

Relevant extracts relating to response to question 3

Extract from PwC comment letter: Exposure draft - Leases

Question 17

Paragraphs BC200–BC205 set out the boards’ assessment of the costs and benefits of the proposed requirements. Do you agree with the boards’ assessment that the benefits of the proposals would outweigh the costs? Why or why not?

With respect to lessors, as outlined in our response to question 2, we do not support the current proposed ‘hybrid approach’ in the exposure draft, as it fails to meet users’ needs and does not represent a significant enough improvement over the existing model to justify the costs of implementation.

With respect to lessees, as outlined in our response to question 1, we support the proposed right-of-use model for lessees. The existing leasing model in IAS 17/ASC 840 fails to meet the needs of users as it does not provide a faithful representation of leasing transactions. We therefore support the boards’ aim to develop a new approach to lease accounting that would ensure all assets and liabilities arising under leases are recognised in the statement of financial position.

We agree with the boards’ analysis of the benefits to users outlined in paragraph BC204. Recognising all leases on the statement of financial position will be viewed as an improvement by users who will no longer need to make adjustments to recognise assets and liabilities in respect of operating leases. This will make the reported information more useful for decision making and will increase comparability.

However, while we acknowledge that the proposals address the primary concern - that is, the recognition of assets and liabilities arising out of lease contracts - we understand from outreach that investment professionals use this information in different ways, and we believe they will continue to make adjustments to the numbers reported by an entity. We also understand that many investment professionals say it is ‘the journey not the final destination’ that is important. Therefore, they would rather have disclosure around the amount, timing and uncertainty of cash flows than a single number recognised in the financial statements on the basis of significant management estimates and judgements. Specifically, we are aware that many investment professionals are still proposing to make adjustments under the proposed model, both in relation to these estimates and judgements and to adjust for the front-loading issue outlined in our response to question 1(b).

For the reasons outlined above, we believe the benefit to users is limited to the boards’ proposals to bring all leases on to the statement of financial position, supplemented by the suite of disclosures that will provide investment professionals with information about the amounts, timing and uncertainty of cash flows.

We recommend that the boards weigh up this benefit against the potentially extensive costs imposed on preparers of adopting and applying the proposed model. We believe if the boards were to adopt the proposals to modify the guidance in the exposure draft that we outline in this comment letter (most significantly those relating to extension options and contingent payments), the costs to preparers would be significantly reduced, while not reducing the benefits to the user community.



We agree with the boards' analysis of costs identified for preparers, but we do not believe the boards have captured all of the costs associated with the proposals. We have summarised the key areas in which we believe preparer costs will be significant.

Contracts with business partners

The proposed standard may trigger or even require the re-negotiation of contracts with suppliers, lenders, vendors and employees. Financing arrangements with lenders, credit arrangements with suppliers and other legal agreements containing financial covenants will need to be assessed to enable management to discuss potential changes in good time. The effect of the proposed standard on financial ratios and performance measures may also require revisions to agreements to redefine these targets.

Human capital

Employee compensation arrangements, such as bonuses and share-based payments based on existing performance measures, may need to be revised to be consistent with the spirit of originally expected performance levels.

Despite automated solutions for accounting for leases, resource requirements may increase to cope with the levels of judgement and documentation required by the proposed standard. The estimates required for renewal options, contingent rents and residual value guarantees, including periodic re-assessment, may strain an entity's existing resources. Additional training may also be required to ensure employees understand how to comply with new requirements, as well as changed processes and controls.

Accounting systems

Lease accounting systems in the marketplace are based on the existing risks and rewards concept; they will need to be modified to reflect the proposed right-of-use concept. Obviously, systems designed to meet entities' future needs in light of the proposed rules have not yet been created and need to be developed. New systems or upgrades will need to be implemented to ensure entities can capture and report new data or summarise existing data in new ways. Entities will need new information technology solutions that can capture data, continuously track individual lease agreements, support the process of developing and reassessing estimates for renewal options and contingent rents, and report certainly newly required disclosures.

Internal controls and processes

Many entities in the past have not needed robust processes and controls for leases as existing lease accounting models (absent a modification or exercise of an extension) did not require leases to be periodically revisited. Initial recording and periodic reassessment of lease terms and payment estimates may require significant and complex changes to existing processes and internal controls, including support for significant management assumptions. This will require new or updated documentation of processes and internal controls.

Information gathering

The proposed model does not permit grandfathering of existing leases. Management will need to catalogue existing leases and gather data about lease terms, renewal options, contingent payments and guarantees in order to measure the amounts to be included in the statement of financial position. If an entity has a significant number of leases, locating and reviewing agreements that were negotiated decades ago and obtaining the relevant lease documentation could be challenging and time-consuming. Gathering and analysing the information could take considerable time and effort, depending on the number of leases, inception dates and records available.



Tax impact

The proposed model might have a broad impact on the tax treatment of leasing transactions, as tax accounting for leases is often based on accounting principles. Given that there is no uniform leasing concept for tax purposes, the effect of the proposed lease accounting model will vary significantly, depending on the jurisdiction, and could result in the need to change local tax law.

Stakeholder communication

As outlined above, the proposals may impact an entity's relationship with its business partners. The investment community is likely to rely on entities to explain the effects on key financial ratios and performance measures. Timely and clear communication will help avoid any misunderstanding by users of financial statements.

Capital requirements for regulated financial institutions

Lessors and lessees that are regulated banks and investment firms will need to look again at the proposed models' regulatory capital implications. For the lessors, the impact of the changes could be limited, as the existing capital treatment (set by the Basel Committee of global banking supervisors) is independent of the accounting. For lessees, however, the impact could be more difficult; the new model increases balance sheet assets, with the likelihood that the regulators will require more capital to be set aside. Banks are particularly concerned that if the assets are treated literally as 'intangible' assets, regulators might treat them in a similar way to other intangibles as a deduction of capital. This would have severe repercussions for the banking sector. Alternatively, and perhaps more likely, the regulators might treat the assets in the same way as other tangible fixed assets, with a risk-weighting of 100%, which would still have an impact on bank's capital requirements, but not to the same degree.

At the same time as the new accounting approach is developed and implemented, the regulators are developing 'Basel 3', the new global regime of regulation to reflect the lessons of the last two years. This could impact the capital treatment of leases in some cases, but that is not the main focus - other factors will come into play as well. In particular, the regulators are likely to introduce a 'leverage ratio' that limits the gross size of a bank's balance sheet total as a multiple of capital. An 'on-balance sheet' treatment for leases could significantly increase the size of some banks' statements of financial position (particularly lessees) and trigger bank-wide leverage ratio concerns (although this can be addressed in the calibration of the leverage ratio).

There are also various proposals for levies to be raised on banks. Where such a levy is based on balance sheet assets or liabilities, the proposals could significantly increase the impact. We believe that users and preparers will factor this into their cost-benefit analysis of the proposals.

Extract from PwC comment letter: Exposure draft - Insurance contracts

Extract from cover letter

Timetable and field testing

The proposed standard will bring about pervasive changes to the way insurers measure insurance contracts, for example unbundling components of an insurance contract, the use of risk free discount rates with an illiquidity adjustment, the calculation of an explicit risk adjustment and amortisation of the residual or composite margin, as well as changes to some investment contracts with discretionary participating features. The current field testing being undertaken by the Board has a very tight timeline and this could impede the ability of the participants to fully test the proposals on a wide range of products. The European insurance industry has already had experience with such testing in the context of the Quantitative Impact Studies carried out to support the development of the Solvency II



regulations. This testing demonstrated that field testing can enhance the understanding of the proposals and identify problems of interpretation and implementation of the measurement and disclosure requirements. In addition, it has also highlighted the amount of time that is required by the industry to implement extensive changes to systems and processes that are likely to be required. We recommend that the Board work closely with the insurance industry to comprehensively test the proposals with real data before finalising the proposed standard to ensure the finalised model will produce information that is relevant to the decision-making needs of users and on balance cost beneficial to produce. The Board should also take the results of the field testing into consideration when setting the effective date for the proposed standard.

Extract from appendix

Question 19

Do you agree with the Board's assessment of the benefits and costs of the proposed accounting for insurance contracts? Why or why not? If feasible, please estimate the benefits and costs associated with the proposals.

As noted in our cover letter, we believe the development of a comprehensive standard for insurance contracts is essential because of the current lack of transparency and comparability of insurer's financial statements. The current accounting for insurance contracts lacks a consistent measurement approach which users of financial statements demand.

The proposed standard will bring about pervasive changes to the way insurers measure insurance contracts and the current field testing being undertaken by the Board will be paramount to enhance the understanding of the Board's proposals and to identify solutions to potential problems of interpretation and implementation of the measurement and disclosure requirements. We recommend that the Board work closely with the insurance industry to ensure the finalised model will produce information that is relevant to the decision-making needs of users of insurers' financial statements.

Extract from PwC comment letter: Exposure draft – Financial instruments: Amortised cost and impairment

Extract from cover letter

Operational Issues

While the IASB proposed model has conceptual merit, it does have a number of serious operational issues many of which have been discussed at the Expert Advisory Panel (EAP). The more significant concerns raised by the EAP include:

- Most financial institutions manage interest income and credit risk separately. Interest is determined from the loan accounting systems and credit losses are determined via the credit systems. These systems are generally not integrated and, therefore, in their current form, cannot provide EIR net of credit losses.
- Expected cash flows are generally not stored in any systems. Most entities would calculate an expected loss rate for a specific period (e.g. 12 months as required by Basel), but would not record expected cash flows. It will be operationally challenging to turn this loss rate into an annual charge that takes account of the impact on credit loss of both timing and amount will be operationally challenging. It will also be challenging to develop credit expectations over the full life of the asset.



- Most portfolios are open rather than closed. This means that new loans are constantly being added to the portfolio. This substantially increases the complexity in tracking changes in estimates. The expected loss rates for these portfolios are point in time estimates which change as the portfolios change. However, current systems do not track whether the change in the expected loss rate arises from a new loan (i.e. impacts initial loss expectation) or an old loan (i.e. arises from a change in estimate). This makes it operationally challenging to correctly identify and account for changes in original estimates.
- When a credit loss occurs early in the life of a portfolio and the related loans are written off in accordance with the Exposure Draft, this can lead to an inadequate allowance for the loans remaining in the portfolio or in some circumstances to a negative (debit) allowance. This is due to the fact that the charge off is debited to the allowance account before all the expected losses are credited to this account. Negative provisions will not be widely understood by users or regulators.

The EAP has identified several potential solutions to some of these issues such as de-coupling interest income and expected loss estimates and differentiating between a good book (e.g. performing loans) and a bad book (e.g. non-performing loans). We believe these are good suggestions and support their further development. The solutions the EAP has developed to date focus on determining credit losses for amortised cost measurement from expected loss data derived from credit systems rather than expected cash flows which are not currently captured by credit systems. While the expected cash flow model is arguably a more conceptually pure expected loss approach, it is not the only way to apply it. We therefore believe it may be beneficial for the Board to revise the Exposure Draft to focus on an expected loss approach as the governing principle that may be met through an expected cash flow model or another method(s), such as those suggested by the EAP.

Furthermore, as the Board evaluates possible solutions, we believe it is very important to allow entities the ability to establish an overall framework for estimating expected losses that is reflective of their circumstances. Entities should have the flexibility to estimate losses over a reasonable forward period that is appropriate given their systems, financial products and economic environment and to assume a long-term average loss rate for the remaining term. This will help alleviate concerns over estimating the effect of economic cycles over a long term, as well as enable the model to be responsive to the unique nature of each entity.

However, the operational challenges are very significant. Therefore we cannot support the IASB proposed model until it can be demonstrated that the model can practically be applied on a basis consistent with the fundamental principles of an expected loss approach. We encourage the IASB to continue working with the EAP as the Board re-deliberates the model and considers solutions to the various operational issues. We believe that it is very important that the Board sufficiently field tests these solutions to ensure the model is operational. The operational issues will not necessarily be the same for all entities. Therefore, it is important that the Board incorporates into its operational assessment:

- both small and large entities,
- those from advanced economies and developing economies,
- both financial and non-financial institutions, and
- an appropriate cross section of industries.

Transition

The operational issues noted above apply equally to transition. We conceptually support the IASB proposal that the standard should be retrospective and believe the Board's approach for determining the transition adjustment is practical provided the operational issues are resolved. However, the Board should not underestimate the complexity of retrospective application. Many entities will need a minimum of 3 years after the above operational issues have been resolved to determine the transition



adjustment and restate the comparative period. Therefore, if entities wish to adopt the standard earlier they should receive the same relief from restating comparative information as provided by the current IFRS 9.

Extract from appendix

Question 3

Do you agree with the way that the exposure draft is drafted, which emphasises measurement principles accompanied by application guidance but which does not include implementation guidance or illustrative examples? If not, why? How would you prefer the standard to be drafted instead, and why?

We support a principle-based approach to standard setting and believe that the principles should be supplemented with implementation guidance to the extent necessary depending on the nature and complexity of the area. As noted in our cover letter, the EAP has raised a number of operational issues with the proposed model and identified several potential solutions, such as de-coupling interest income and expected loss estimates and differentiating between a good book and a bad book. We believe these are good suggestions and support their further development. Furthermore, we believe it is very important that the Board allows entities the ability to establish an overall framework for estimating expected losses that is reflective of their circumstances. Entities should have the flexibility to estimate losses over a reasonable forward period that is appropriate given their systems, financial products and economic environment and to assume a long-term average loss rate for the remaining term. Given the significance of the operational challenges and the nature of the suggested solutions, we believe that the Board should consider incorporating an appropriate amount of implementation guidance and illustrative examples in the final standard. However it should be clear that such guidance is illustrative and not necessarily prescriptive of the only approach to be used.

Relevant extracts relating to response to question 4

Extract from PwC comment letter: Exposure draft – Fair value measurement

Question 13

Do you have any other comments on the proposals in the exposure draft?

We believe that the transition guidance is not sufficiently clear. The guidance calls for prospective application, but it is not clear what this means for assets and liabilities in existence prior to adoption of the standard. Should all measurement adjustments resulting from the application of the new guidance be recognised in profit and loss in the first post-application period? We ask that the Board clarify the meaning of prospective application of the proposed guidance as it applies to assets and liabilities in existence

Extract from PwC comment letter: Exposure draft – Financial instruments: Amortised cost and impairment

Extract from appendix

Question 8

Would a mandatory effective date of about three years after the date of issue of the IFRS allow sufficient lead-time for implementing the proposed requirements? If not, what would be an appropriate lead-time and why?



It is very difficult to conclude on the adequacy of the implementation lead time until solutions are found for the various operational issues and appropriate field tests are performed. However, it may be worth noting that many financial institutions required 2 to 3 years to install the necessary systems and procedures for applying the current incurred loss model when they transitioned to IFRS. We expect that the lead time for applying the proposed expected cash flow model should be at least this long and therefore believe a minimum of a 3 year lead-time is needed.

Question 9

- a. **Do you agree with the proposed transition requirements? If not, why? What transition approach would you propose instead and why?**
- b. **Would you prefer the alternative transition approach (described above in the summary of the transition requirements)? If so, why?**
- c. **Do you agree that comparative information should be restated to reflect the proposed requirements? If not, what would you prefer instead and why? If you believe that the requirement to restate comparative information would affect the lead-time (see Question 8) please describe why and to what extent.**

The operational issues we noted in our response to Question 3 and our cover letter apply equally to transition. We conceptually support the Board's proposal that the standard should be applied retrospectively. While the alternative transition approach of applying the EIR as determined under IAS 39 may be operationally easier, we would not favour such an approach as it would mean interest income and impairment would be determined in a different manner for assets pre-transition and those originated post-transition. We believe it is more appropriate for entities to estimate the EIR, net of credit losses, for the pre-transition assets and consider the Board's approach to be practical provided the operational issues are resolved.

We agree that comparative information should be restated to reflect the new requirements in all circumstances except where the new impairment model is adopted before its mandatory effective date. The difficulty of retrospectively adopting the proposed standard should not be underestimated however. Many entities will likely need the full lead time of 3 years, after the operational issues are resolved, to determine the transition adjustment and restate the comparative period. Entities that wish to adopt the new standard early should receive the same relief from restatement of comparative information as is available in transition requirements in current IFRS 9.

The Board recently announced that it intends to issue a document soliciting stakeholder input regarding the effective date and transition methods for major Memorandum of Understanding projects. We support this plan and believe that a coordinated consideration of the most appropriate transition to all of the new accounting standards will be well received by the Board's constituents. We strongly encourage the Board to move quickly on this so the benefits of the input can be applied to this project prior to its completion.

Question 10

Do you agree with the proposed disclosure requirements in relation to transition? If not, what would you propose instead and why?

We support the proposed disclosure requirements in relation to transition.



Extract from PwC comment letter: Exposure draft – Revenue

Extract from appendix

Question 13

Do you agree that an entity should apply the proposed requirements retrospectively (i.e., as if the entity had always applied the proposed requirements to all contracts in existence during any reporting periods presented)? If not, why?

Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it's better.

We understand the theoretical merit of applying the proposed requirements retrospectively to increase consistency across periods presented. It might not, however, be practical to apply the effects of the change in accounting principle retrospectively for a number of entities. Factors such as the existence of long-term contracts, contracts with multiple performance obligations, variable consideration, a significant number of contracts, or other items that require a significant degree of estimation will make retrospective application difficult and impractical. Retrospective application could require an entity to recreate information that it did not capture at the time the transaction was entered into, causing management to make subjective estimates about conditions that existed at that date and increasing the potential for the inappropriate use of hindsight. These estimates could reduce the relevance and reliability of the financial statements. The cost of retrospective application also might outweigh the benefits to users.

We suggest that, as a practical expedient, the final standard include language that would allow preparers to apply the impracticability exception in a wider range of situations. We also recommend that appropriate lead-time be provided to enable entities that can apply the standard retrospectively sufficient time to put in place the necessary systems to capture information.

The boards have proposed that entities not be permitted to early adopt the revenue standard before the mandatory adoption date. We suggest the boards permit early adoption for all entities. If the boards decide nevertheless to prohibit early adoption, we recommend that IFRS first time adopters, entities doing initial public offerings, and entities emerging from bankruptcy be permitted to early adopt the final standard to avoid another change in revenue accounting policies in a relatively short timeframe.

We are also concerned about the timing of adoption of the revenue standard in conjunction with the other new standards the boards are currently developing. The revenue standard requires that a contract that is partially within the scope of the revenue standard and partially within the scope of other standards be accounted for by first applying the separation and/or measurement requirements of the other standard. The boards should address the interaction between standards when the standards might be effective at different times or do not consistently require retrospective application.

Extract from PwC comment letter: Exposure draft – Insurance contracts

Extract from cover letter

Transition

We support the Board's proposal that the proposed standard should be applied retrospectively. However, we do not support the Board's proposals to not recognise any residual margin for contracts in existence on transition to the new standard. Such an approach would distort an insurer's reported income for years into the future. Therefore, we would support full retrospective application of the



proposed model in line with the requirements in IAS 8 to determine the residual margins at transition date as if the new accounting policy had always been applied. This treatment will allow future earnings to properly reflect profit emergence from all contracts (pre- and post-transition) on a consistent basis.

However, the Board should not underestimate the complexity of retrospective application. If it is impracticable to determine the cumulative effect by applying the new accounting policy to all prior periods at the transition date, we believe the insurer should apply the Board's proposals to measure the insurance contracts at the present value of the fulfilment cash flows. We believe that using previous measurement policies to determine the future profits would distort an insurer's reported profit for years into the future and we do not support such a transition method.

Extract from appendix

Question 17

- a) Do you agree with the proposed transition requirements? Why or why not? If not, what would you recommend and why?**
- b) If the Board were to adopt the composite margin approach favoured by the FASB, would you agree with the FASB's tentative decision on transition (see the appendix to the Basis for Conclusions)?**
- c) Is it necessary for the effective date of the IFRS on insurance contracts to be aligned with that of IFRS 9? Why or why not?**
- d) Please provide an estimate of how long insurers would require to adopt the proposed requirements.**

- (a) We do not agree with the proposed transition requirements. We support a full retrospective application of the full building blocks model with the IAS 8 impracticability exception. If full retrospective application is impracticable, we agree with excluding any residual margin on contracts in existence on transition to the new standard as proposed in the exposure draft.

We are concerned that the Board's proposal results in the elimination of all future earnings, except for the release of the risk adjustment, from the insurance business in force at the transition date. For long term contracts this could be a significant amount of future profit. This treatment will result in disproportional earnings from existing contracts compared to new business written after the implementation of the new standard and such an approach would distort an insurer's reported income for years into the future. We understand that the disproportionate earnings between existing contracts and new contracts was one of the reasons why the Board did not support recognising the difference between the existing measurement basis and the fulfilment cash flows as the residual margin on transition.

We believe insurers should be allowed to reclassify financial assets designated at fair value through profit and loss to amortised cost if account balances are unbundled from insurance contracts. This would also be necessary if an insurer is able to apply a locked in discount rate as proposed by us.

The transition arrangements should provide guidance for past business combinations where the present value of fulfilment cash flows exceeds the fair value of the insurance contract liability. We recommend that the positive difference between the fair value and the fulfilment value on past acquisitions should be treated as an adjustment to goodwill.

The requirement to present claims development tables for at least 5 years at transition is problematic due to the requirement to reconcile the claims in the development table to the



carrying amounts of the insurance liability recognised in the statement of financial position. This will not be possible for the period before adopting the new standard and the transition provisions should provide relief to only provide this information from the transition date.

- (b) If the Board was to adopt the composite margin approach, we believe to require a risk adjustment to be calculated for transition purposes only but not for subsequent measurement would not be cost beneficial. Consistent with our proposal for transition, we would support the full retrospective application of the building blocks model with the IAS 8 impracticability exception. If impracticable, we agree with the proposed composite margin transition model.
- (c) We believe it is very important that the effective dates of this proposed standard and IFRS 9 are aligned. Both standards will result in a significant change to the recognised amounts in the financial statements and to have an insurer make significant restatements of comparative information in successive years would not be helpful to the users of the accounts and would make comparison of results difficult. Simultaneous implementation of both standards will also eliminate the need for any exceptions for insurers to the transition provisions and eliminate the need to change previous fair value option elections on adoption of IFRS 9.

We support the plan to solicit input on effective date for all Memorandum of Understanding projects. We believe that a coordinated consideration of the most appropriate transition for all of the new accounting standards, including insurance, will be well received by the Board's constituents.

- (d) As noted in the covering letter, insurers will need sufficient time to implement the proposals in the final standard. Insurers will have to change the data they capture to be able to comply with the proposed measurement model. The requirement for insurers to develop systems to model expected future cash flows scenarios should not be underestimated and sufficient time should be allowed to ensure these measurement models will provide reliable information.

Extract from PwC comment letter: Exposure draft – Leases

Question 16

(a) The exposure draft proposes that lessees and lessors should recognise and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186– BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?

We agree that a simplified approach to transition is necessary. However, we do not believe the proposed simplified retrospective approach is as simplified as it should be, nor necessarily the best presentation in all cases.

We agree with many of the points articulated by Stephen Cooper in his alternative view (paragraphs AV9 and 10). We have concerns about the misleading reduction in lessees' profits on transition. The expense front-loading issue outlined in question 1 is further exacerbated by applying the simplified retrospective approach in transition. For further discussion, see our response to question 16(b) below.

(b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?

Yes. We believe there should be the option to use the full retrospective approach to transition. While the application of a right-of-use model creates a front-loading of expenses viewed on an individual



lease basis, over a larger portfolio of leases in varying stages of their life cycle, the effects would be more normalised (for example, some leases in the portfolio with higher relative expense in their early phases and others in lower relative expenses in their later phases). The simplified retrospective approach effectively treats the lease portfolio at the initial date of application as if the entire portfolio were new leases at that date, with this entire group in a higher relative expense level. For longer dated average lease portfolios, the number of periods until 'normalisation' occurs may be extreme. While we believe that the simplified retrospective approach may be appropriate and cost effective for many, we do not believe that a full retrospective approach should be precluded, as it would represent a more faithful comparative presentation of the economics for those willing to undertake the exercise.

(c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

The proposed leasing standard provides no transition guidance for transactions that were previously 'failed sales' where neither the sale nor the leaseback are recognised as sales or leases. Similarly, if the exposure draft were applied as it now stands, for qualified sale and leaseback transactions that were consummated before the initial adoption, many are concerned that the deferred gains resulting from sales currently being recognised over the lease term will just be reflected in a transition adjustment to equity (that is, they will never go through the income statement). As we observe in our response to question 11, we do not believe that the gain associated with the portion of the proceeds relating to the period of use retained should be recognised; rather, it should be reflected as part of the right-of-use asset.

In addition, there are other areas where we believe that the boards should provide transition guidance, such as in-substance purchases and sales. If the boards continue with their 'hybrid model' for lessors, consideration of which approach to lessor accounting should be adopted. In each of these cases, the proposals require judgements at lease inception in respect of information that may be unavailable or difficult to obtain at the transition date.

Because we believe that for lessees the new guidance would be an improvement in financial reporting, we believe that preparers should be allowed to adopt early if they wish.

Extract from PwC comment letter: Exposure draft – Proposed amendments to IAS 19

Question 15

Should entities apply the proposed amendments retrospectively? (Paragraphs 162 and BC97–BC101) Why or why not?

We agree that the amendments should be applied retrospectively. We also suggest that the Board consider transitional relief from some of the new disclosure requirements, in particular the proposed sensitivity analyses.

Extract from PwC comment letter: Exposure draft – Presentation of items of other comprehensive income (OCI)

Question 5:

In the Board's assessment:

(a) the main benefits of the proposals are:

- (i) presenting all non-owner changes in equity in the same statement.**
- (ii) improving comparability by eliminating options currently in IAS 1.**



- (iii) **maintaining a clear distinction between profit or loss and items of other comprehensive income.**
- (iv) **improving clarity of items presented in OCI by requiring them to be classified into items that might be reclassified subsequently to profit or loss and items that will not be reclassified subsequently to profit or loss.**
- (b) **the costs of the proposals should be minimal because in applying the existing version of IAS 1, entities must have all the information required to apply the proposed amendments.**

Do you agree with the Board's assessment? Why or why not?

We agree with the Board's assessment of the benefits and that the costs of the proposal are likely to be minimal.