20 Questions

Directors and Audit Committees Should Ask about

IFRS Conversions

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Chartered Accountants of Canada

How to use this publication

Each "20 Questions" briefing is designed to be a concise, easy-to-read introduction to an issue of importance to directors. The question format reflects the oversight role of directors which includes asking management — and themselves — tough questions.

In some cases, boards and audit committees may not want to ask the questions directly and prefer to ask the Chief Audit Executive or management to include the topics or answers to the questions in the annual audit plan or other presentations to the Committee. The questions are not intended to be a precise checklist, but rather a way to provide insight and stimulate discussion on important topics.

The comments that accompany the questions provide directors with a basis for critically assessing the answers they get and digging deeper as necessary. The comments summarize current thinking on the issues and the practices of leading organizations. Although the questions apply to most medium to large organizations, the answers will vary according to the size, complexity and sophistication of each individual organization.

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Preface

The Risk Management and Governance Board of the Canadian Institute of Chartered Accountants commissioned this document to help boards of directors, and particularly audit committees, to fulfill their oversight responsibilities relating to the conversion to International Financial Reporting Standards (IFRS).

Although the Canadian transition to IFRS will likely occur in 2011, boards of directors need to begin now to address the implications of the conversion for their organization. This involves consideration not only of the conversion process itself, but of issues relating to risk, stakeholder relations, financial reporting, and internal controls which will be triggered by the transition.

In preparing for the conversion, Canadian companies have the benefit of the experience of companies in the European Union who converted to IFRS in 2005.

It will be crucial for all directors to have a general understanding of what the transition to IFRS will mean for their organization. Members of audit and other board committees will require a greater level of detail. While the level of detail in this document may be more directly relevant to members of audit committees, it will also provide a solid foundation for all board members.

This document provides suggested questions for boards to ask themselves, senior management and others. For each question, there is a brief explanatory background and some suggestions. Both the process and the implications of the conversion to IFRS will vary widely among Canadian companies, and no list of questions can be universally applicable. Directors must use their own judgment to determine if there is additional information that they need, but these questions are designed to focus thought and discussion on the issue.

The Risk Management and Governance Board acknowledges and thanks the members of the Directors Advisory Group for their invaluable advice, the authors Rafik Greiss and Simon Sharp of Ernst & Young LLP, and the CICA staff who provided support to the project.

Tom Peddie, FCA
Chair, Risk Management and Governance Board

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Introduction

In 2011, the accounting framework under which financial statements in Canada are prepared for all publicly accountable enterprises (PAEs) is scheduled to change to International Financial Reporting Standards (IFRS). Generally accepted accounting principles (GAAP) in Canada, as we currently know them, will cease to apply for this group of entities and will be replaced by IFRS. In practice, references to Canadian GAAP will remain in regulatory and legal contexts. IFRS will be incorporated into the Canadian GAAP handbook.

The Canadian Securities Administrators (CSA) *Corporate Governance Guidelines*[1] state that, as part of their stewardship role, boards of directors are responsible for "the identification of the principal risks of the issuers' business and ensuring the implementation of appropriate systems to manage these risks." In addition, the Guidelines state that boards are responsible for the "issuers' internal control and management information systems."

The responsibility for executing the conversion to IFRS will rest with management. It will be the board's responsibility to play an oversight role and ensure that management has discharged its responsibilities and executed an effective conversion.

Converting to IFRS will be one of the most fundamental changes that PAEs will have to deal with over the next few years. Such a momentous change will bring with it both significant risks and opportunities, and boards need to be prepared for the change if they are to adequately fulfill their function in this area and discharge their overall stewardship responsibilities.

The questions in this document are designed to help directors, and audit committee members in particular, understand the potential scope of the change management exercise that the conversion may present to their business. They will also provide guidance to the board of directors and the members of its particular committees on what questions they should be asking management as they prepare for the conversion.

[1] CSA Corporate Governance Guidelines NP 58-201 p. 3.4

[2] IASB Exposure Draft of proposed IFRS for Small and Medium-sized Entities

The questions are organized into four main groups:

1. Conversion project considerations
2. Financial reporting considerations
3. Non-financial reporting considerations
4. Other board considerations

The level of detail provided in the answers has been set deliberately to allow directors to better understand the issues management will face during a conversion and thereby better prepare boards to fulfil their oversight role throughout the conversion period.

What constitutes a publicly accountable enterprise?

The Accounting Standards Board ("AcSB") has yet to finalize its definition of what constitutes a PAE, but is expected to do so in 2008. At a minimum, it will include public companies.

Pending the finalization of the definition, it's most useful to refer to the International Accounting Standards Board's ("IASB") definition of public accountability[2]. This defines public accountability as "accountability to those present and potential resource providers and others external to the entity who make economic decisions but who are not in a position to demand reports tailored to meet their particular information needs. An entity has public accountability if:

(a) it has issued (or is in the process of issuing) debt or equity instruments in a public market; or

(b) it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance company, securities broker/dealer, pension fund, mutual fund or investment bank."

This definition does not preclude entities other than those listed in (a) and (b) from also being publicly accountable. It is a "principle-based" definition that requires entities to consider for themselves whether they fit within it.

The Public Sector Accounting Board is charged with the applicability of IFRS for public sector entities.

Glossary of terms

AcSB	Accounting Standards Board of Canada
CFO	Chief financial officer
CICA	Canadian Institute of Chartered Accountants
CSA	Canadian Securities Administrators
EU	European Union
FASB	Financial Accounting Standards Board
FPI	Foreign private issuers
GAAP	Generally accepted accounting principles
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IFRS	International Financial Reporting Standards
IT	Information technology
ITA	Income Tax Act of Canada
NPAE	Non-publicly accountable enterprise
NPO	Not-for-profit organization
Non-Public Group	Group containing only NPAEs
PAE	Publicly accountable enterprise
Public Group	Group containing at least one PAE
SEC	Securities Exchange Commission

Origins of IFRS

A single set of global accounting standards has been under development for over three decades since the International Accounting Standards Committee ("IASC") was first established in 1973. Today, this suite of standards comprises International Accounting Standards ("IASs") first issued by the IASC and, subsequent to April 2001, IFRS issued by the IASC's successor, the IASB.

The IASB's mission[3] includes the development of "a single set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements…." The IASB seeks to "co-operate with national standard setters to achieve convergence in accounting standards around the world."

It wasn't until 2005, with the advent of the European Commission's requirement for public companies reporting within the European Union ("EU") to prepare consolidated financial statements compliant with IFRS that IFRS began to be widely applied around the world, and the IASB could be said to have moved significantly to achieving its goal. Australian and other standard setters soon followed the EU and today over 100 countries either require or permit the use of IFRS for public company reporting.

IFRS in Canada

Early in 2006, the AcSB released its new strategic plan[4] for carrying out its standard-setting mandate in Canada. The new plan recognizes that accounting standards for public companies may not be suitable for other organizations, and the AcSB foresees the need for separate strategies dealing with different categories of reporting entity. Under the plan, Canadian GAAP for PAEs will converge with IFRS over a transitional period. This transition period is expected to extend to 2011, with the first financial reports of PAEs required to comply with IFRS being for accounting periods commencing on or after January 1, 2011. The AcSB has yet to finalize its proposals for non-publicly accountable enterprises ("NPAEs") and not-for-profit organizations ("NPOs").

The AcSB has reserved the right to amend the IFRS conversion timetable but has committed to making a final announcement of the changeover date prior to March 31, 2008. Without pre-empting the AcSB's final decision, the consensus is that the current published strategy and timetable will likely stand.

In setting its conversion strategy, the AcSB preferred a clean, "one-time" changeover but concluded that taking such an approach without any exception was not feasible. Over the transitional period, the AcSB will:

1. address deficiencies in current Canadian GAAP by adopting certain elements of IFRS, and
2. adopt immediately new IFRS that emerge from the joint projects between the IASB and the Financial Accounting Standards Board ("FASB") to agree on new standards (harmonization of IFRS and U.S. GAAP).

As a result of this transitional convergence approach, based on the current timelines of the IASB and FASB standard setters, it is expected that certain standards will be converged prior to 2011 while the remainder will be adopted as at the changeover date. However, delays in the schedule of the accounting boards mean that progress toward convergence by 2011 is likely to be less than originally forecast, leaving a larger number of standards subject to a "big bang" conversion come the deadline.

3 http://www.iasb.org/About+Us/About+IASB/About+IASB.htm

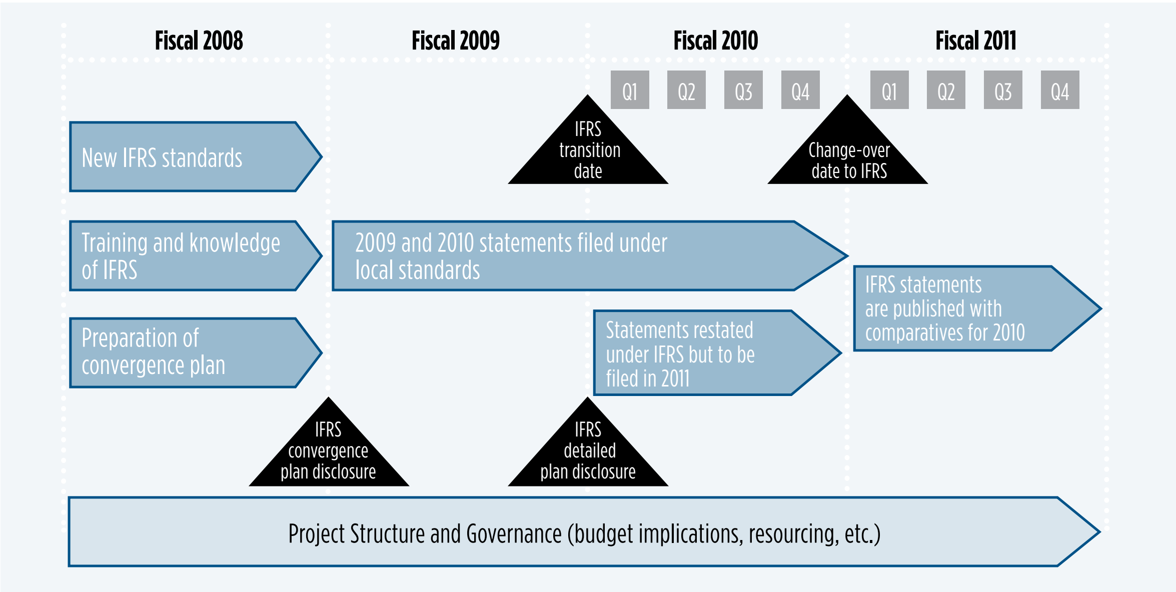
4 Accounting Standards in Canada: New Directions, published by the AcSB at http://www.acsbcanada.org

Rationale for conversion

The AcSB's rationale for conversion to IFRS centres on the anticipated benefits to Canadian companies of reporting using a single global set of accounting standards. Some believe that the increased comparability of financial statements arising from applying IFRS will improve accessibility to global capital markets, possibly reduce Canadian companies' cost of capital and thereby improve their global competitiveness. When considering the alternate option of U.S. GAAP, the AcSB cites the following influences on its decision:

1. A lower cost of compliance is expected with a principles-based accounting framework such as IFRS than with the rules-based U.S. GAAP system.
2. The joint partnership between the IASB and FASB means that, over time, the differences between IFRS and U.S. GAAP will diminish as joint standards are issued.

Figure 1. IFRS Conversion Timeline



[5] Based on Implementation Plan for Incorporating IFRSs into Canadian GAAP (as of March 31, 2007), published by the AcSB

Conversion timeline

When one considers the practicalities of the AcSB's proposed conversion timeline, it becomes clear that there is not as much time as one might first expect to complete the transition to IFRS. Figure 1 outlines the expected timeline for PAE "Example Ltd." converting to IFRS. Example Ltd. has a fiscal year end of December 31. The first set of annual IFRS financial statements for Example Ltd. will be for the year ending December 31, 2011. These financials will need to include comparative information also compiled under IFRS for the year ending December 31, 2010. In order to determine the profit and loss result and cash flows for 2010, management will also need to restate Example Ltd.'s opening balance sheet from Canadian GAAP to IFRS. This date, January 1, 2010, is known as Example Ltd.'s "transition date" as this is the earliest date the company is required to prepare IFRS information. Further, as a public company, Example Ltd. must submit quarterly accounts under IFRS commencing with the quarter ending March 31, 2011. These too will need IFRS comparatives. Hence, the first IFRS filing will be Quarter 1, 2011. One must also remember that Example Ltd. will still be required to report under existing Canadian GAAP for 2010.

This means that companies only have 2008 and 2009 to understand the impacts of converting to IFRS, conduct appropriate planning activities, decide on a conversion approach, select revised IFRS-compliant accounting policies, train personnel, and test and roll out implementation strategies. This is in addition to running their day-to-day operations and addressing the compliance issues arising from the AcSB's convergence activities during the transition period.

In order to keep investors and other stakeholders informed about the coming change in financial reporting, companies will be expected to include disclosure of their progress toward IFRS conversion in their 2008 and 2009 accounts[5]. At the time of writing, the extent of this disclosure had not been elaborated.

Conversion Project Considerations

1. What will converting to IFRS mean for our business?

The AcSB's proposals will result in major change for business. The change driven by IFRS will not be restricted to the finance function. Converting to IFRS will not merely be a technical accounting exercise but more a widespread change management exercise that will impact many areas of the business. Any business function required to prepare financial information, or impacted by financial information, has the potential for change. Given the expected change in earnings and financial position, one should expect changes to:

- executive and employee evaluation and compensation plans (Human Resources),
- foreign exchange and hedging activities (Treasury),
- corporate income taxes (Taxation),
- ratios and bank covenants (Finance and Treasury),
- internal controls and processes (Finance),
- investor relations and communication to capital markets (Finance and Investor Relations),
- management reporting (Finance), and
- IT and data systems (IT).

As one can see from the potential changes, various committees of the board of directors, in addition to the audit committee, will have a vested interest in the conversion to IFRS, including Human Resources, Executive Compensation and Risk Management. Specifically, the CSA *Corporate Governance Guidelines*[6] state that the board of directors should, as part of their overall stewardship responsibility, assume responsibility for:

- the identification of the principal risks of the issuers' business and ensuring the implementation of appropriate systems to manage these risks,
- adopting a communication policy for the issuer, and
- the issuer's internal control and management information systems.

All this being said, it is important to note that each company's concerns and the extent to which IFRS will impact them will be different. For some, the impacts will be pervasive; for others, they may be minimal.

2. How do we plan to approach the conversion to IFRS?

Converting to IFRS will entail a business-wide change management exercise and should be approached using a structured methodology encompassing the best practices of project management.

Boards should pay close attention to the details of management's proposed approach to the IFRS conversion and satisfy themselves that it covers all appropriate areas and is based on sound project management principles. Whereas management will be responsible for the conversion execution, boards need to be confident in management's plan, thoroughness and diligence.

Management should inform the board and the audit committee on a regular basis as to its plan and progress. As such, audit committees will generally include a standing IFRS agenda update item at its periodic meetings.

Any GAAP conversion project should commence with some form of impact assessment, diagnostic activity or scoping exercise. This will allow management and boards of directors to visualize the extent and complexity of the conversion and allow them to make better decisions about how to plan, structure and resource the project and determine the next steps. Typically, the chief financial officer ("CFO") would be the sponsor.

6 CSA Corporate Governance Guidelines NP 58-201 p. 3.4

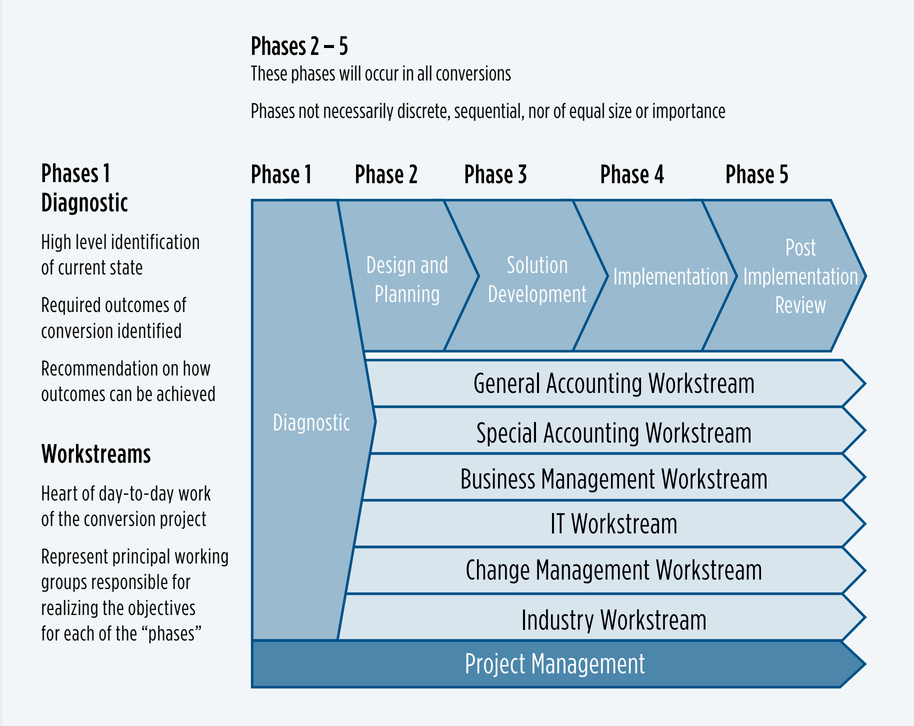
The major outcomes management should expect from this phase are as follows:

- The determination, at a high level, of the financial reporting differences (including the major GAAP differences) under IFRS, compared to the company's current accounting policies.
- The identification of the main business impacts expected from the adoption of IFRS.
- An assessment, at a high level, of the likely impacts on IT systems and identification of the modifications necessary to facilitate collection of the information required to satisfy all IFRS disclosure requirements.
- The identification of all major change management issues arising from the conversion.
- The identification of any hurdles to conversion presented by the existing finance organizational structure.
- The identification of any significant industry specific issues.
- The provision of base information to facilitate the structuring of the IFRS conversion project.

A sample methodology for conversion is shown in Figure 2 below. This is an example of one phased approach management may consider. Embedded within each phase are functionally based work streams. Each work stream contains specific areas to be considered as follows:

- General accounting work stream – comprises all routine accounting activities, such as the development of IFRS accounting policies, drafting skeleton IFRS financial statements, updating IFRS reporting packages, management reporting, other local reporting requirements, and updating the group reporting manual.
- Special accounting work stream – deals with the restatement from Canadian GAAP to IFRS of specific, complex accounting areas.
- Business management work stream – comprises all activities related to addressing and resolving the issues identified during the diagnostic phase that impact business functional areas outside of financial reporting.
- Change management work stream – addresses the need for change in all areas of the business arising from the conversion. It will generally comprise the following main components: communication, training and education, organization and human resources, and implementation support.
- IT work stream – deals with issues such as the way IFRS may affect IT systems and the resolution of any required changes to IT systems as a result of the conversion to IFRS.
- Industry work stream – deals with restatement from Canadian GAAP to IFRS in industry-specific areas.

Figure 2. IFRS Conversion Roadmap



3. What are the key areas that need to be addressed during the conversion?

No two IFRS conversion projects will ever be the same – while the specific issues companies will face during their conversion will vary widely because of the all the variables at play, the key areas management and boards will need to address during the conversion should be broadly similar.

1. **Project launch and planning activities –** Initial decisions made during the project set-up phase tend to be crucial to eventual project success. These include:
   a. creating a project management function to co-ordinate project activity and monitor/report progress,
   b. structuring the project team based on the results of the impact assessment phase – this helps to make sure that all potential issues get addressed,
   c. assigning sufficient resources to the project and ensuring that the team comprises individuals with appropriate skills and background to fulfill their responsibilities.

2. **Revision of accounting policies –** Reassessing accounting policies under IFRS will be one of the most important elements of the project because the decisions made in this area will drive many of the changes required throughout the business and have direct implications for future business results. For instance, accounting policy decisions will impact data collection requirements, which, in turn, will impact IT system requirements, business processes to collect and record the data, internal control systems covering data validity, and functional resourcing requirements. Audit committees will need to review and be comfortable with the policies selected by management.

3. **Application of IFRS 1 –** Another key area management will need to address in relation to accounting policies is how they are going to apply IFRS 1, "First-time Adoption of International Financial Reporting Standards." This standard provides guidance for businesses on how they should apply IFRS for the first time and provides companies with a number of exemptions from the requirements of other standards. Decisions made in applying IFRS 1 could have a significant impact on the financial statements for many years to come.

4. **Development of skeleton financial statements compliant with IFRS –** Companies will have to redraft sections of their financial statements to meet IFRS disclosure requirements. Management may take the approach of preparing a skeleton set of financial statements during the preliminary phases of the project. This has multiple benefits as it focuses attention on the actual disclosure requirements of the business and therefore is crucial in the process of identifying "data gaps" that need to be plugged. It is also useful to put the overall change management challenge in perspective and gives project teams a concrete goal.

5. **Preparation/restatement of financial information from Canadian GAAP to IFRS for all comparative accounting periods –** The need to compile comparative financial information for inclusion in the first set of IFRS accounts is likely to prove to be one of the most challenging areas of the project. The board, through its audit committee, needs to satisfy itself that careful consideration is given to the approach adopted by management to compile this information.

6. **Transition approach –** Whereas some companies globally converted "top-side" only at a consolidated level, this spreadsheet approach is not ideal. Accounting treatments and controls should be pushed down to the transaction level. This is particularly important in Canada given management's internal control certification requirements (SOX 404 or MI-52-109). The audit committee will need to carefully consider which transition approach is appropriate for their business.

7. **Identifying and resolving data capture issues –** The increased level and complexity of the financial disclosures expected under IFRS are likely to require significant project resources to identify and set up processes to collate this data. Some of the data underlying the new disclosures may be time-consuming to extract or may need significant analysis before it is ready for disclosure purposes. Boards need to be satisfied that management's plans include adequate mechanisms to identify and resolve data gaps.

8. **Retraining of personnel –** Boards need to be satisfied that adequate investment is being made in the retraining of employees throughout the organization in order to meet their changed technical knowledge needs as well as to facilitate the roll-out of accounting policy changes and the associated revised business processes and procedures.

9. **Communication with stakeholders –** Managing investors' and other stakeholders' expectations with respect to the impacts of IFRS and the company's progress toward conversion will be an important area for boards to monitor. Clear, continuous and consistent communication with stakeholders will reduce the risk of misunderstandings and aid a smooth transition.

10. **Audit committee financial literacy and retraining –** The training requirements will also apply to members of the audit committee. Whether trained through management briefings or by outside parties, audit committee members should have sufficient knowledge about IFRS to be able to evaluate management's assessments and selection of accounting policies. This is elaborated upon in Question 20.

4. What is the timeline for our IFRS conversion project, what resources will be required and how much will it cost?

The main consideration regarding the timeline will be "will the organization be ready on time?"

By performing an impact assessment exercise and conducting careful planning at the beginning of the project, it should be possible to determine the major areas relevant to the business and from there construct reasonable estimates of the resources required, the time to complete the project and thus the costs and resources involved.

Few meaningful benchmarks exist regarding effort and cost, as the impact of changes in accounting principles on functional areas and related processes varies significantly amongst companies and within industries, depending on pre-existing business or accounting processes.

The size and complexity of accounting conversion projects mean that there are so many variables impacting the timeline and cost considerations that concrete assessments are not possible without an appropriate diagnostic and project plan. Also, as with any sizable project, there will be shortcuts that can be taken, workarounds available and elements that can be side-stepped or ignored. However, these may lead to hidden costs, which should be taken into account when estimating budgets.

It follows then that until management completes the impact assessment and planning activities, it is difficult to determine if the business has sufficient time to adequately complete the conversion. For this reason, the best advice regarding the timing of the conversion project is to start as early as possible!

5. What can we learn from the European Union conversion experience?

Canadian business has the benefit of the experience of countries that have already converted to IFRS. Below are some of the issues encountered and the key lessons one can learn from their experiences.

Issues identified	Key lessons learned
Scale and complexity of the project and the time frame needed were underestimated.	Start early! Conducting a thorough impact assessment followed by a detailed planning exercise up front is crucial to a successful transition. Conversions could entail functional changes as well as technical accounting changes.
Project lacked adequate buy-in from senior management early on in the project.	The “tone from the top” is an important driver of change. Board sponsorship of the project is crucial.
Projects suffered from poor project management.	The importance of having a proper Project Management Office function capable of co-ordinating project activities and a well-structured conversion methodology.
Project teams were unprepared to deal with the technical issues encountered.	Developing IFRS technical knowledge early on will prevent last minute “fire drills” and minimize the risk of missed reporting deadlines.
Slight accounting differences can have a significant impact on financial results.	A methodical approach to reviewing accounting differences is essential to assessing financial impacts.
Unfamiliarity of “numbers” and principles arising from changes.	Technical training will be a critical component of the IFRS conversion, especially for business unit heads who may not be familiar with the implications of the changes that IFRS will bring. Investor relations will also need a strong educational grounding to communicate the impact to investors.
Poor communication existed between project team and business units regarding impacts of changes.	Invest the time necessary to roll-out business process changes such as accounting practices, updated control mechanisms, changes in reporting requirements to the wider organization.
IFRS changes were often not fully embedded in back offices and general ledger systems. As a result, “stand alone manual workarounds” were created, including “spreadsheet accounting.”	EU companies that used manual workarounds to meet short IFRS deadlines are now redesigning processes and augmenting their systems to eliminate the inefficiencies these workarounds created. Canadian firms will benefit from longer lead times to proactively address these changes.
Top side solutions didn’t work.	Top side solutions don’t cause the organization to adjust, and the Finance group feels “all the pain.” It is important to “push down” the IFRS conversion to the transaction level throughout the organization as early as possible.
Insufficient communication with stakeholders.	Capital markets are reactive and companies should more proactively manage investor communications and perceptions.

Financial reporting considerations

6. How will converting to IFRS impact external financial reporting in our organization?

Converting to IFRS will have far-reaching effects on the way financial reporting is conducted. Some of the key impacts include:

1. **Transitional impact on bottom line –** While the conceptual frameworks upon which current Canadian GAAP and IFRS are formulated are both principles based and are generally considered to be broadly similar, there will remain at the conversion date a number of significant differences and numerous minor differences between the two sets of standards that have the potential to create material impacts on reported results. Companies should expect a change in earnings and financial position. The expectation should also be that the "devil is in the detail." Audit committees should review and be comfortable with the changes to the key accounting policies selected by management, including the sensitivity analysis that led to management's decisions.

2. **Potential for increased volatility of reported results** – Adopting IFRS could result in increased volatility of reported financial results, depending on circumstances. IFRS provide for some optional uses of fair value measurements that are likely to have that effect, as both write-ups and write-downs are reported.

3. **Increased volume and complexity of financial disclosures –** Reviews of the 2005 financial statements of EU companies suggested financial disclosures under IFRS increased by upwards of 30% over prior national GAAP levels. Changes in level of disclosure in Canada are expected.

4. **Increased transparency and comparability –** Many users of financial statements in the EU reported finding IFRS accounts very clear and easy to understand and many found them more useful than U.S. GAAP. As use of IFRS becomes more embedded and experience in applying IFRS grows, increased transparency and comparability are benefits that should become more pronounced as the 2011 deadline approaches. Improved levels of disclosure have been noted in the EU over the past two years. Canadian preparers will benefit from these advancements when comparing within their industries.

5. **Impacts from pension plans –** IFRS will require different accounting and actuarial calculations in relation to pension plan accounting. These may significantly change disclosures in the notes to the financial statements, as well as earnings and the balance sheet. In addition, the changes may lead to different information presented to employees or union groups.

> The AcSB has assessed that about half of current Canadian accounting standards have "slight" differences compared to IFRS while the remainder have more than "slight" differences[7]. Conceivably, a "slight difference" could lead to a significant or material impact on financial results.

[7] Summary of Comparison of Canadian GAAP and IFRSs, March 31, 2006, published by the AcSB

7. What will be the impact on management reporting?

IFRS will influence the way management runs the business and assesses performance. One of the significant trends reported in Europe was the increased use by management of "non-IFRS" measures[8] (i.e., performance indicators not defined under IFRS) when communicating business performance to the market. Indeed the issue of the relevance of IFRS to the needs of external users is commonly raised as one of the main weaknesses of IFRS.

The changes to accounting policies expected from applying IFRS and the need to record and classify information in specific ways to comply with the new standards may impact the financial information generated by the business. Management reporting formats and processes will need to be reviewed and updated accordingly. In addition, management will need to give some consideration to impacts on the key performance indicators used for measuring success and reviewing trends. There may also be impacts on the way budgeting and planning functions operate.

8. How will management address the need for 2010 financial information prepared under both Canadian GAAP and IFRS?

For companies with a December 31 year end, the transition date for applying IFRS will be January 1, 2010, as this is the opening balance date for the first set of IFRS financial statements. Companies will need to restate their opening balance sheet and be in a position to report under both IFRS and Canadian GAAP for the calendar year 2010. How companies address this challenge will be one of the more significant issues they will face during the transition. The main options available to converters involve either dual GAAP accounting throughout the transition period or some form of restatement from Canadian GAAP to IFRS at each reporting date. Boards should pay special attention to the process management follows to arrive at a recommendation and be comfortable with the approach adopted.

The decision will be based on a wide range of factors, including:

- the estimated benefits in terms of time/cost,
- the perceived risk of errors arising during the restatement process,
- the ability of the present accounting system to handle dual GAAP accounting (parallel runs) or the costs of upgrading to a system that does, and
- the implications for internal control certification.

9. What are our competitors and industry peers doing?

Companies often compare themselves to industry norms and peers, from both a strategic and a business focus as well as from a measurement and results basis. Most companies will want to know what their peers are doing as it relates to IFRS and, specifically, the financial reporting decisions that are being made. Investors and market analysts will also want to be aware of the differences in decisions made by peer companies so they can take into account these differences when making decisions.

In order to remain true and consistent with the IFRS objectives of comparability and transparency, management will need to assess the accounting principles selected by its industry peers. Although not all companies within the same industry will select identical policies, management's analysis would not be complete without this peer assessment.

[8] Observations on the Implementation of IFRS, published by Ernst & Young LLP, 2006

10. Will publicly accountable enterprises be required to apply IFRS throughout their group structures?

Converting to IFRS will mean that the classification of companies as PAEs or NPAEs will have implications for the form of financial reporting that they will be required to follow. PAEs will have to apply IFRS whereas NPAEs will likely have a choice between IFRS and some alternative accounting framework yet to be prescribed by the AcSB. However, transactions within a PAE group will need to be accounted for under IFRS for consolidated reporting purposes.

This choice will likely be available to all NPAEs whether they are sole companies, part of a group comprising only NPAEs ("Non-Public Group") or a part of a group containing a mixture of PAEs and NPAEs ("Public Group").

For public groups, management will likely have to decide whether a NPAE subsidiary will report under IFRS for stand-alone reporting purposes such as contractual, statutory or regulatory obligations. In addition, management will need to decide how the group will apply IFRS at the transactional level. Management may either:

- apply IFRS throughout all companies in the group, or
- apply IFRS only in PAEs within the group and apply the AcSB's other option in the NPAEs.

This second alternative may be particularly attractive to public groups in which the parent company is the only PAE in the group.

In general, one would expect that management will wish to minimize their financial reporting compliance costs and will tend to follow the course of accounting which best achieves efficiency and effectiveness.

This decision may not be as simple or as clear cut as it first appears, as there are advantages and disadvantages to each alternative. The complexity of the group structure and the number of PAEs and NPAEs in the group will likely be a key factor in the decision. The advantages of applying IFRS consistently throughout the group may include:

- reduction of compliance costs
  – everyone in the group will be using the same accounting language,
  – employees will only need to be trained in one accounting framework,
  – only one set of accounting procedures will be required,
  – fewer finance resources may be required,
  – internal control certification processes may be simplified,
  – reduced audit complexity and cost;
- reduction of risk
  – less complexity,
  – no need to restate results between GAAPs, which are often performed outside of accounting systems using spreadsheets,
  – no need to develop controls over accuracy and completeness of the restatement process,
  – data and accounting personnel can move seamlessly within the group;
- facilitation of financial comparisons across subsidiary groups
  – performance measurement,
  – asset allocation.

Management will need to take into account the relative advantages and disadvantages of the alternative accounting framework available for NPAEs, once the AcSB has determined what form this will take. Depending on the ACSB decision, disadvantages of applying IFRS group-wide may include:

- increased complexity in certain circumstances, depending on group structures,
- increase in compliance costs due to the level of disclosure required by IFRS for statutory reporting purposes,
- complicating the process of calculating taxable profit by increasing the number and prominence of adjustments in the tax calculation.

11. How will IFRS impact tax reporting and tax filings?

Tax reporting in financial statements under IFRS will likely change. Converting to IFRS may impact the deferred taxation accounting of the business, particularly in relation to the value of timing differences and the time frame over which these are expected to reverse. Given this different time frame, the corresponding tax rates applicable to these timing differences may significantly impact the effective tax rate borne by the business and, consequently, the net reported earnings available to shareholders.

When preparing tax filings, there is no requirement in the Income Tax Act of Canada ("ITA") directing the use of one particular accounting framework or a particular methodology for calculating profit for income tax purposes.

Taxpayers therefore may be able to choose the method of calculating taxable profit that they believe arrives at the "truer picture" of taxable profit. This can include, but is not restricted to, GAAP. The conversion to IFRS from Canadian GAAP therefore does not in itself alter the obligations of taxpayers; it merely provides them with an alternate basis of accounting for the purposes of calculating taxable profit.

Consequently, as businesses convert to IFRS for financial reporting purposes, management will need to assess whether this new accounting framework is a reasonable foundation to use as the basis for the income tax calculation or whether some alternate approach will lead to a truer picture of taxable profit.

Just as is the case currently under Canadian GAAP, if IFRS is adopted as the starting point for calculating taxable profit, management will need to assess what, if any, adjustments to accounting profit are required to arrive at taxable profit based on the provisions of the ITA and well established business principles.

Boards and audit committees will need to carefully review management's recommendation regarding the approach to be used for calculating taxable profit and satisfy themselves that management has put in place adequate procedures and systems of control over the calculation of taxable profit for tax reporting purposes.

Lastly, the impact of IFRS on the balance sheet may also impact a company's tax on capital, where applicable.

To the date of writing, the Canada Revenue Agency has not issued any formal statement or guidance on the effects of the transition to IFRS.

Non-financial reporting considerations

12. Other than financial reporting, which other business areas will be impacted by the conversion?

Boards should expect that IFRS will impact a wide range of business functions beyond financial reporting. These may include changes to management's internal reporting, data gathering and IT systems, the use of key performance indicators, the content of employee and executive compensation plans, the activities of investor relations, changes to policies and procedures and the resultant impacts on internal control documentation and certification requirements.

The following outline some of the potential impacts:

1. **Performance reporting –** The accounting recognition and measurement changes brought about by IFRS will affect the measures used by companies and investors to assess performance and may lead to a realignment of management's performance targets, financial covenants and performance related remuneration.

2. **Financial covenants –** Key performance indicators and ratios used by businesses to measure performance are also closely tied to the financial covenants a company may have in its contracts. A complete review of, and modification to, significant contracts may be required.

3. **Executive compensation –** Compensation committees should be able to articulate their process for establishing compensation for executives based on objective criteria tied to the company's performance targets. Companies should expect earnings, earnings per share and financial position to change. Insofar as these changes also affect the metrics used to evaluate or compensate executives, evaluation and compensation guidelines may also need to change.

4. **Investor relations –** During the transition, it will be important to manage investor expectations and respond quickly to issues to avoid misunderstandings. Going forward, companies will need to be aware that analysts will have access to comparable global data on their industry sectors against which they can benchmark their results, and be prepared to react accordingly. An effective communication strategy to respond to investor queries and concerns arising during and immediately after the transition will be vital.

5. **Dividend distribution policies –** Boards may need to review and, if necessary, amend dividend distribution policies in light of the company's changed financial situation that could emerge from applying IFRS.

13. Can our current IT systems handle the business' revised data collection requirements under IFRS?

Since IFRS will likely increase the amount of data collection and change both the level of disclosure in financial reporting and the manner in which financial information is reported, IT systems used to collect and report financial data may need modification in order to meet the new reporting requirements.

It will be important to identify as early as possible the specific impacts on IT systems and to understand how easily financial reporting changes can be made to a company's existing systems. The age, flexibility and upgrade path of the current IT systems will be key factors in determining whether the existing systems can be enhanced or must be replaced.

While the impact of IFRS on each company's IT systems will be different, the experience in Europe and Australia was that the systems most likely to be impacted were the financial, treasury and human resources systems. The impact on IT systems and business processes was often not considered until late in the project, resulting in manual workarounds and heavy reliance on spreadsheets. One would also expect that the need for IT system changes will be greater for companies operating in industries where the differences between Canadian GAAP and IFRS are more significant (e.g., Financial Services, Utilities, Mining, and Oil and Gas).

Where the volume of IT system changes required in order to be IFRS ready is significant, management should consider the IT resource requirements and also whether the IFRS project plan reflects the IT upgrade timelines. Also, many companies may already be planning to replace or upgrade their existing financial systems. As such, the new IFRS requirements should be included in the system selection process and form part of the design phase.

Boards and audit committees need to satisfy themselves that management has taken adequate steps to determine that the IT impacts of the IFRS conversion project are being assessed. They also need to consider whether management's transition plans adequately address potential IT issues and that, if system changes are required, they are included in the overall conversion project timeline.

14. What IFRS training programs are management planning to provide to finance personnel?

Based on the experience of other jurisdictions that have converted to IFRS, a shortage of trained resources is a significant challenge companies will face. Addressing the organization's skill requirements should therefore be an immediate priority for management.

The primary oversight responsibility for monitoring such training programs usually lies with the Human Resources Committee of the board. This committee should satisfy itself that training strategies and plans for the board, its committees, and the finance personnel of the company are set up, and over the remainder of the transition period, continue to monitor their execution and effectiveness. At the same time, due to high demand for IFRS-trained resources, the Human Resources Committee may also decide to develop succession plans for key IFRS-trained technical resources, and revisit the company's compensation strategy to better mitigate the risks of losing their key finance people. As a leading practice, many companies have developed accounting standard groups within the finance department who are responsible for IFRS training, communication and the maintenance of centralized accounting repositories and intranets. This will vary depending on the size and needs of the organization.

Other board considerations

15. What are the most significant risks associated with converting to IFRS?

The conversion to IFRS is one of the most fundamental changes in financial reporting in Canadian history. The potentially pervasive nature of the changes at the accounting, functional, transactional and internal control levels increases the risks of both misstatement and fraud.

A robust system of internal controls is a company's best method of ensuring reporting integrity and minimizing the risk of misstatement and fraud. A period of change, such as one encountered during an accounting conversion, could lead to modifications in the design and effectiveness of internal controls, hence increasing risk.

Risk management functions will need to be engaged in the conversion process. For many companies, it will represent one of the highest risk areas as it directly impacts the integrity of the company's financial reporting.

The audit committee's role in risk management is to review and oversee the process to ensure it incorporates an effective risk management program and a sound internal control framework that will effectively manage risks and controls within the company. Often, the key to an effective mitigation plan is to understand what the common risks are that others have experienced in similar conversions. Directors and audit committee members in particular will need to ask how management has anticipated these risks in formulating their mitigation plan.

16. What are the other key risks associated with converting to IFRS?

Today's financial reporting environment has little tolerance for mistakes and it will be important for all companies to get the conversion right the first time. Errors and misstatements as well as missed reporting deadlines present a significant risk to companies which are converting.

Other significant risk areas include:

- failure to communicate the impacts and results to stakeholders including boards, audit committees, investors and analysts,
- accounting and reporting multiple GAAP in the 2010 period,
- internal controls and the certification process,
- retention of key employees,
- excessive costs brought on by ineffective planning, project management and/or rework,
- unreasonable or excessive work levels, brought on by inappropriate planning or unreasonable expectations,
- inability by management to conclude and certify on the design or effectiveness of the company's internal controls over financial reporting.

As with all relevant risks, directors will need to ask how management is planning on controlling these issues.

17. How can our organization take advantage of the opportunities presented by the conversion to IFRS?

The conversion to IFRS presents potential opportunities that boards and companies may wish to examine further.

The IFRS accounting framework contains numerous instances where multiple accounting options are permitted. This creates opportunities for companies to identify and select options that may result in a more appropriate representation of their financial results and position. Boards will need to be aware of the choices made by management and may wish to scrutinize management's rationale to establish that they are the most appropriate. Management and boards may also need to satisfy themselves that proper account is taken of any "global consensus" regarding specific accounting options for their industry lest they be seen as diverging from the "norm."

Some companies will find there will be significant opportunity to use the conversion project as a means to drive through other areas of change. These include streamlining accounting and reporting processes, and accelerating the financial statement close process. Some companies successfully seized these opportunities when they addressed their internal control certification requirements, whereas others may choose to do so now.

18. How will converting to IFRS impact our stakeholders, and what should be done to manage the expectations of capital markets?

The European experience in adopting IFRS was that the conversion from the various local GAAPs to IFRS did not impact market ratings. However, the experience did show that companies needed to do a lot of explaining to the market about the change and the potential implications, and the market needed to do a lot of internal IFRS education to help understand where the differences should impact the financial results.

In Canada, it will be equally important that the market is informed early and often. Boards should satisfy themselves that the company has a communication plan for managing stakeholder expectations and that it is responsive to investor and analyst needs.

As part of this communication plan, boards should consider how best to communicate the company's results under IFRS leading up to the January 1, 2011, changeover date.

19. What should the role of our auditor be in the conversion process and do we need a third-party advisor independent from our auditor?

Many companies will engage a third-party advisor to assist with the conversion process. Management cannot, however, delegate away its reporting responsibilities or its responsibilities over the selection of appropriate accounting policies. Some companies will seek assistance directly from their auditors, whereas others will turn to another service provider.

In many cases, the auditor will be able to assist management in various ways. The auditor knows the business, management and current policies. Generally, the auditor should be able to provide diagnostic and training services, advise on alternative accounting options, assist with the interpretation of IFRS, and observe and review project progress.

The extent to which companies request assistance from their auditors will depend on several factors. Obviously, auditors cannot perform services that would be considered proscribed services. Whatever non-proscribed services are offered will depend on maintaining auditor independence, including the perception thereof. Auditors should not be perceived as assuming a management role or auditing their own work.

Lastly, the degree of auditor assistance boards will find appropriate will be a function of their scope of service limitation philosophy as it pertains to auditors providing non-attest services.

Notwithstanding the above, the company's objectives should be to avoid surprises in the audit process. As such, auditors should at a very minimum be involved in reviewing and commenting on (or accepting) management's analyses of accounting alternatives and the selection of appropriate accounting policies. In addition, management or audit committees may ask the auditor for observations regarding management's assessment of the conversion issues, timeline and risks.

20. Other than financial reporting integrity, what are the other implications for boards of directors?

IFRS will present many challenges for boards of directors and their various committees. Set out below are some additional areas not already covered that boards or their committees should consider:

1. **Educational requirements for boards and their committees –** Audit committees need to be sufficiently educated and knowledgeable about IFRS to enable them to fulfil their duties and discharge their responsibilities. This includes being able to pass judgment on management's analysis of accounting alternatives and the selection of accounting policies. All members of the audit committee should be financially literate. While the board shall determine the definition of and criteria for financial literacy, this shall, at a minimum, include the ability to read and understand a set of financial statements under IFRS applicable to their company. Boards will therefore want to perform frank assessments of their knowledge levels in relation to IFRS and take the necessary actions to address any gaps that process identifies.

2. **Directors' and Officers' Liability –** The high risk and volatile financial reporting environment over the next few years may lead boards to question the levels of their directors' and officers' liability insurance, and what steps should be taken to mitigate these elevated risk levels.

3. **Reputational risk –** The potentially pervasive nature of the accounting and functional changes arising during an IFRS conversion, combined with a limited timeline, could result in the company's inability to adequately prepare for an audit. This in turn could lead to the auditors being unable to opine on a company's financial statements.

Where to get more information

Conversion to IFRS is by its nature a transitional process. As a result it is important for directors to remain updated about continuous new developments from accounting and regulatory bodies. Updates are available on the Transition to International Standards section of CICA's website www.cica.ca/IFRS.

Notes

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Rafik Greiss is a partner in Ernst & Young's Assurance and Advisory Business Services practice. He began his career in 1985 with a national accounting firm before joining Ernst & Young in 1987 in the audit practice. Over the course of his career, he has assumed different leadership responsibilities involving various change management initiatives. He was an audit partner until 2003, at which time he joined the Risk Advisory Services group, where he continues to practice.

Rafik has been responsible for delivering audit and advisory services to global and national clients, both private and public, in a wide range of industries. In particular, he has extensive experience providing advisory assistance to clients in complex environments. This assistance includes technical, organizational and project management services related to accounting policy changes, accounting department transformations, internal control certification initiatives, and financial and operational process changes. In addition, he has been and continues to be the co-ordinating partner on certain of the firm's largest accounts.

As Ernst & Young's Canadian leader for International Financial Reporting Standards, Rafik is responsible for overseeing IFRS conversion services provided to clients. Rafik is a frequent keynote speaker at high-profile IFRS-related industry conferences and seminars and is a go-to media spokesperson.

Rafik is also actively involved in various community organizations. He has been on the board of directors, acting as chair of the Audit and Finance Committee, of St. Mary's Hospital Center since 1999, and of the Loyola High School Foundation since 2004. He is also a member of the board of directors of Lac Marois Country Club.

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20 Questions

Directors and Audit Committees Should Ask about

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