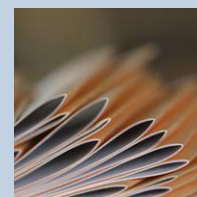


IFRS – Time to Get Ready

January 31, 2008



In March 2006, the Accounting Standards Board (AcSB) adopted a Strategic Plan calling for the adoption of International Financial Reporting Standards (IFRS) by publicly accountable enterprises in Canada. The plan called for a changeover date no earlier than 2011, which in March 2006 seemed to be a long way away. However it is now 2008 and 2011 is much closer than you think. Therefore, publicly accountable enterprises must start preparing now for this changeover.

What is IFRS?

International Financial Reporting Standards are globally accepted, high quality standards which are issued by the International Accounting Standards Board (www.iasb.org). IFRS applies to general purpose financial statements of profit oriented enterprises. They set the recognition, measurement, presentation and disclosure requirements for transactions and events that are important to general purpose financial statements.

Over 100 countries currently require, permit or have a policy of convergence with IFRS. The use of IFRS has grown substantially over the past number of years and continues to grow due to the increased globalization of trade and capital markets. Globalization has created pressure to harmonize accounting standards worldwide to reduce inconsistencies in financial reporting.

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Does IFRS Apply to You?

The first thing any entity must do is determine if it is a publicly accountable enterprise, as the adoption of IFRS only applies to these entities. The AcSB has tentatively concluded that a profit-oriented enterprise has public accountability unless it:

- has not filed, and is not in the process of filing, its financial statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market; and
- does not hold assets in a fiduciary capacity for a broad group of outsiders.

However, to date the AcSB has not provided any specific guidance on whether specific types of enterprises are required to adopt IFRS, and it is not expected that such guidance will be provided. In the Bulletin No. 5, "Adopting IFRSs: Next Steps – Ours and Yours, issued in September 2007 the AcSB stated the following:

"Canadian adoption of IFRSs is directed to publicly accountable enterprises: listed companies and other organizations that are responsible to large or diverse groups of stakeholders. These include financial institutions (listed and non-listed), securities dealers and many co-operative enterprises. As a rule of thumb, if you think your business is publicly accountable, consider that it is."

In addition the Public Sector Accounting Board has recently approved an exposure draft which states that government business enterprises and government business type organizations are publicly accountable enterprises and therefore will be required to adopt IFRS.

In many cases, such as with listed entities and financial institutions, it is very obvious that an entity meets the definition of publicly accountable and therefore is required to adopt IFRS. However, with other entities, such as some co-operative enterprises, it is not as clear cut therefore it is imperative that these entities review their accountability relationships and discuss their facts and circumstances with their professional advisors to make the appropriate decision.

When does IFRS Apply?

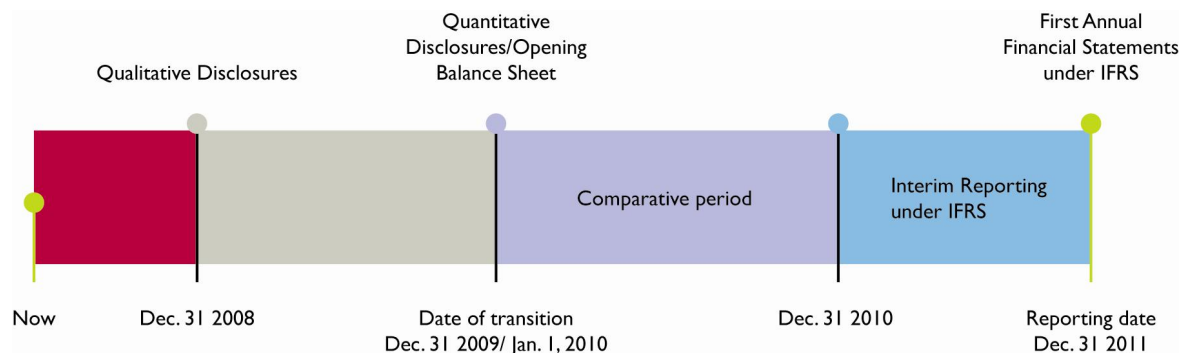
In March 2006, the AcSB Strategic Plan indicated that the changeover would happen no earlier than 2011. The AcSB is expected to confirm in early 2008 that the changeover date is January 1, 2011. Therefore the first annual financial statements impacted will be December 31, 2011 and the first quarterly statements impacted will be the three months ended March 31, 2011. With just under four years to the first annual reporting date, the adoption of IFRS still seems like a long ways away, however this 2011 date is very misleading.

To truly understand when an entity has to be ready for the adoption of IFRS, we need to look at IFRS 1 - First Time Adoption of International Financial Reporting Standards. IFRS 1 defines the following dates:

The transition date – *"the beginning of the earliest period for which an entity presents full comparative information under IFRS in its first IFRS financial statements."* For an enterprise with a fiscal year end, the transition date is January 1, 2010. The entity is required to prepare an opening IFRS balance sheet as of the transition date.

The reporting date – *"the end of the latest period covered by financial statements or by an interim financial report."* For an enterprise with a fiscal year end, the reporting date is December 31, 2011.

We believe an entity with a fiscal year end should be prepared for the adoption of IFRS by the transition date of January 1, 2010, which is two years earlier than the first annual reporting date. The requirement to prepare comparatives creates the need to be ready by the transition date. There are many recognition, measurement and disclosure differences between IFRS and Canadian GAAP, so the most efficient way to build the 2010 comparative statements is to maintain a set of Canadian GAAP and a set of IFRS statements in 2010.



In addition to 2010 comparative requirements, it is expected that the Canadian Securities Administrators (CSA) will require qualitative disclosure of the impact of the adoption of IFRS for 2008 year ends. For publicly accountable enterprises that are not regulated by the CSA, the possibility exists that the AcSB will require similar disclosures. The AcSB's IFRS Implementation Plan also discusses the possibility of quantitative disclosures being required by 2009.

More than an Accounting Exercise!

It is very important to stress that the adoption of IFRS is much more than just an accounting exercise. In fact all areas of an organization will be impacted by IFRS not just the financial statements. Although the main focus will be on the financial statements, an entity that just focuses on the statements may not adequately focus on all of the required areas. Areas that will have to be considered include the following:

Human resources

The most important change will be to an entity's accounting resources. Teams will need to be built to champion the IFRS conversion process, therefore one of the first decisions that has to be made relates to human resources - does the organization have adequate resources on staff? A plan for developing IFRS capabilities will be required. Organizations will also have to consider if the existing accounting group has the resources to maintain the existing reporting requirements as well as start to develop the IFRS information. This will be a significant challenge to smaller organizations, which already are stretching their accounting resources to their limits. In fact many organizations, both large and small, will have to look to outside consultants.

Contractual arrangements

Many of an organization's contractual arrangements are linked to the financial statements. For example, the changes in recognition and measurement requirements could result in non-compliance with existing debt covenants or other financial requirements. To ensure these are adequately dealt with an organization needs to review its contractual arrangements and identify where these situations will arise.

The organization must then discuss these situations with the relevant users of the financial statements and stakeholders well in advance. This will allow the users to understand the impact of IFRS before it happens and enable them to modify contractual arrangements appropriately.

Compensation plans

The measurement and recognition requirements of IFRS will have an impact on earnings and in many cases will result in increased volatility in net income. To the extent that compensation plans such as bonuses, incentive plans and/or stock options are tied to Canadian GAAP, companies will need to consider what impact the IFRS reporting requirement may have on existing plans. Like other contractual arrangements mentioned above, it is important the impact on compensation plans be dealt with well in advance.

Taxes

Taxable income is not determined by GAAP income; however GAAP is usually the starting point from which adjustments are made to reach taxable income. The move to IFRS will require different adjustments than are currently required. It is also important to consider any taxes which are based on GAAP income, such as capital tax. These taxes will be directly impacted by the adoption of IFRS.

Information Systems and Controls

The conversion to IFRS will create a demand for new information to comply with the disclosure and presentation requirements of IFRS, as well as for decision making. Therefore organizations will have to implement new internal controls to ensure that the information is reliable and in some cases implement new systems to gather and report data under IFRS.

Corporate Governance

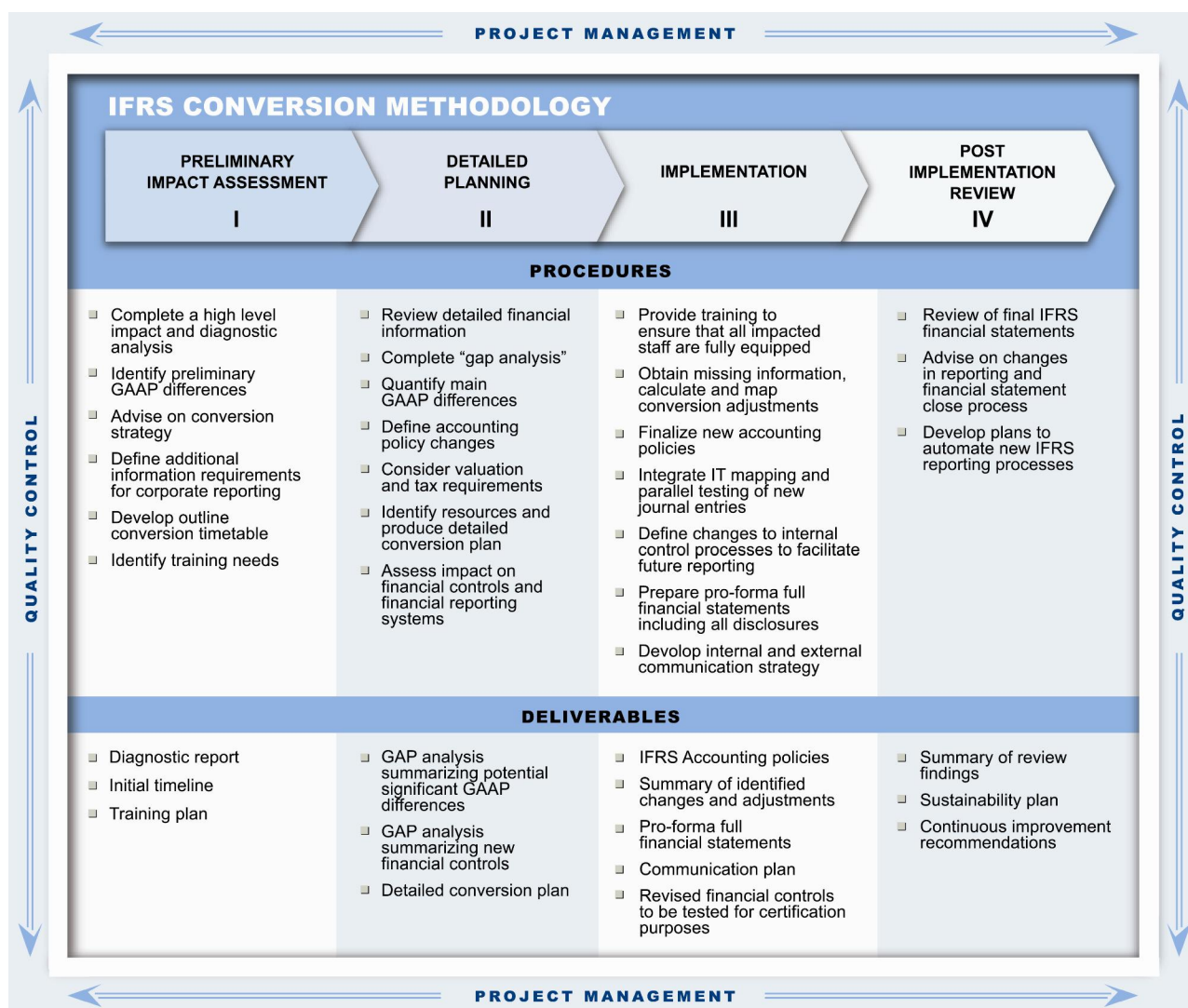
The Audit Committee and/or Board of Directors must be made aware of the changes in accounting policies that will occur and the process of selecting policies and options within IFRS. In addition, it will be necessary for Audit Committee members to ensure that they have an adequate knowledge of IFRS in order to make sure that they are considered to be financial literate.

If the conversion to IFRS is treated as more than an accounting exercise, benefits beyond financial reporting can be achieved. The conversion should be looked as an opportunity to review and improve information systems, improve communication with financial statement users and other stakeholders and to benchmark against international companies in the same industry.

The Need for Project Planning

As mentioned above the conversion to IFRS is much more than an accounting exercise and as a result the conversion will require involvement from individuals from all areas of the organization, each with different skill sets. For this reason we believe it is crucial that entities treat the move to IFRS as a project and manage it as such.

We believe that any project plan should encompass the four stages of Preliminary Impact Assessment, Detailed Planning, Implementation and Post Implementation Review.



This document will only look in more detail at the preliminary impact assessment and detailed planning phases of the project, as we believe it is crucial that all entities required to adopt IFRS complete these two stages as soon as possible.

Preliminary Impact Assessment

The key step in preliminary impact assessment is to put a steering committee together and an implementation team who will be ultimately responsible for the IFRS conversion project. In smaller organizations this may only be one or two people and may not be a formalized project management structure; however the key point is someone needs to be put in charge of the conversion project.

Once these individuals are identified, they need to receive IFRS training. When providing these individuals with training, not everyone will need the same level of training. For example, in a larger organization the CFO will likely be project sponsor and therefore a member of the steering committee. The CFO's understanding of IFRS needs to be at a high level, so he or she understands the impact on the organization, however members of the implementation team will need a much more detailed level of

knowledge. Once this training is complete the steering committee and implementation team will be able to understand the complexity of the assignment.

It is also important to note that when providing training individuals are being trained on the standards which will exist in 2011. The IASB has many projects in process, which will result in significant changes to standards between now and 2011. Therefore, it is not appropriate to train individuals on all the standards that exist today, some training will have to be delayed until the revised standards have been finalized.

Detailed Planning

The key step in the detailed planning stage is the gap analysis. The gap analysis will identify the differences between an entity's current accounting policies and practices and those required by IFRS. At this stage of the project many organizations tend to focus on recognition and measurement requirements, however we feel it is important that organizations also consider presentation and disclosure at the gap analysis stage. We feel addressing presentation and disclosure at this stage is critical due to the extent of disclosure required by IFRS, which in many cases will create new information needs.

This gap analysis is also needed to properly assess the main business impacts such as the impact on information systems, which contractual arrangement may need to be modified, which processes are required to change, etc. All of these considerations must be known so they can be built into a detailed project plan. The detailed project plan can then be used to determine timelines and resource requirements.

Until the detailed planning stage is completed an organization does not know how much time the IFRS conversion will take, or the resources needed. For some organizations, particularly in certain industries, the work effort will be very significant and the detailed planning stage will identify that they need to start the implementation phase of their project immediately. For other organizations, the differences may not be that significant and they may not need to begin the implementation phase of their project immediately. This is why it is critical that organizations complete the assessment stage of their project as soon as possible.

In both the preliminary impact assessment and the detailed planning stages, we feel that *IFRS 1 - First Time Adoption of International Financial Reporting Standards* should be given significant prominence. IFRS 1 provides transitional guidance and relief for entities adopting IFRSs for the first time. As such, it has an important role to play in any IFRS conversion project. In general IFRS 1 requires retrospective application of the standards which are applicable on the IFRS reporting date; however it also provides relief from this retrospective application in certain situations. This relief comes in the form of mandatory exemptions (situations where retrospective application is prohibited and prospective application must be applied) and optional exemptions. Understanding the optional exemptions is very important in preparing the project plan as the options chosen will impact the information needs and alter the steps needed to complete the IFRS conversion project.

As mentioned above it is critical to complete these two phases of the project as soon as possible. On completion of these two stages an entity should have:

- identified and trained its IFRS conversion team;
- completed a gap analysis;
- selected the appropriate IFRS 1 options; and
- completed a detailed project plan

At the completion of these phases you can then move onto implementation, which encompass making the accounting policy choices, calculating the required adjustments and drafting financial statements. Proper planning and assessment are essential to the success of the implementation phase. It is also important to note that the conversion to IFRS will eventually have to move beyond a project, and become a sustainable part of an entity's process, this should be considered throughout the project; however is one of the explicit goals of the post implementation review.

The Devil is in the Details!

Both IFRS and Canadian GAAP are principle based frameworks and from a conceptual standpoint many of the general principles are the same. However, how those general principles are applied in IFRS can be significantly different than how they are applied in Canadian GAAP. Therefore, to truly understand the magnitude of the differences between IFRS and Canadian GAAP, it is essential to look beyond the general principles and look at the detailed guidance provided in the standards.

This document will not cover in detail any of the IFRS – Canadian GAAP differences. However, it will briefly cover four areas where IFRS are significantly different to Canadian GAAP. These areas are derecognition of financial assets, impairments, fair value options and provisions.

Derecognition of Financial Assets

The differences related to derecognition deal with transactions such as securitizations, factoring of receivables, etc. In Canadian GAAP these transactions are dealt with by *AcG-12, Transfers of Receivables*. Under AcG-12 to determine if a transfer of receivables should be treated as a sale or financing is based on control of the financial assets being transferred. Under IFRS, the derecognition model is based on the transfer of risks and rewards and in some circumstances control. As a result some transactions which are treated as a sale under Canadian GAAP will be treated as financing under IFRS. In many cases the agreements related to such transfers are written specifically to comply with AcG-12 to ensure a sale treatment is achieved. Many of these agreements will not meet the criteria to be recorded as a sale under IFRS.

Impairments

In both IFRS and Canadian GAAP, the requirements on when to test long lived assets for impairments are very similar. The major difference between IFRS and Canadian GAAP relates to how the test is performed. The first difference relates to the level at which the test is performed. Under Canadian GAAP testing for impairment is a two step process:

1. Compare the carrying value of the asset group to the expected undiscounted cash flows.
2. If the carrying value is less then the undiscounted cash flows, compare the carrying value to fair value and record an impairment loss if the carrying amount is less.

IFRS uses a one step test. The carrying value is compared to the recoverable amount, which is defined as the higher of the fair value less cost to sell or the value in use. The fact that IFRS does not consider the undiscounted cash flows, results in more impairment losses being recorded under IFRS then would be required under Canadian GAAP. This difference is one of the reasons why it is said that the use of IFRS results in greater volatility in earnings.

Fair Value Options

Fair Value concepts exist in current Canadian GAAP in various standards, including:

- Initial recognition of financial instruments and subsequent measurement of held-for-trading and available for sale financial instruments
- Measurement of stock based compensation
- Purchase price allocation on business combinations
- Impairment testing for long lived assets, intangibles and goodwill

Under IFRS fair value will continue to be used in the situations described above; however IFRS also allows for Property Plant & Equipment, Intangibles and Investment Property to be re-valued at each balance sheet date to fair value.

Investment Property consists of property held to earn rental income or for capital appreciation or both. IFRS provides two accounting models for investment property: at cost depreciated over its useful life or at fair value with changes in fair value included in profit and loss. Even if the cost model is chosen the fair value of investment property must be disclosed. In the case of real estate companies it is very common for the fair value option to be used.

In the case of property, plant & equipment and intangibles, the mechanics of the option to record at fair value is very different than it is for investment property. The change in fair value is recorded in a revaluation reserve, which is a separate component of equity, as long as the revalued amount is greater than the original depreciated cost. If the revalued amount is less than the original depreciated cost the change in fair value is recorded in profit and loss. Property, plant & equipment and intangibles with finite lives continue to be depreciated, however depreciation is based on the revalued amount and the entire amount of depreciation goes through profit and loss. This rather complicated bookkeeping has resulted in very few entities using the fair value option for property, plant & equipment and intangibles. In addition, in the case of intangibles, the fair value option can only be used if an active market exists for the intangible.

Provisions

Provisions is not a term that is described in current Canadian GAAP. Under IFRS a provision is defined as a liability of uncertain timing or amount. In some cases items which would have been considered contingent liabilities under Canadian GAAP, would be considered provisions under IFRS. This creates a very significant difference as contingent liabilities are recognized under Canadian GAAP if they are likely, while provisions under IFRS are recognized if an outflow of resources is probable, which IFRS defines as greater than 50%. Therefore under IFRS more of these types of liabilities will be recognized on the balance sheet, than would be recorded under Canadian GAAP.

The differences described above only scratch the surface. As mentioned above, to truly understand the differences you must look at the detailed guidance provided in the individual standards, as the Devil is in the Details!

The Road to IFRS

One of the significant challenges that we face with the adoption of IFRS is we are not dealing with a stable platform. The IASB has many projects in place and standards will change between now and 2011. In the AcSB's November 2007 publication, *Publicly Accountable Enterprises – The Road to IFRSs*, it stated that that 26 of the existing 37 IFRSs are expected to remain essentially unchanged from their current form, of the 11 IFRSs expected to change, five are expected to be amended only in respect of narrow aspects of the requirements. We do not feel this should be used as an excuse to delay IFRS conversion projects, rather this should be incorporated into training and project plans and work can begin on areas which will remain unchanged. Details of timing of expected changes are available on the IASB website (www.iasb.org). This timing should be built into detailed project plans and a member of the implementation team should be charged with monitoring IASB projects.

Conclusion

The conversion to IFRS will be a significant project for all entities impacted, therefore we recommend you begin planning your projects and assessing the impact as soon as possible. If you require further IFRS information or reference sources, please contact your local BDO Dunwoody LLP office or visit www.bdo.ca/ifrs