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TRANSITION TO IFRS: IS YOUR DISCLOSURE OF THE TRANSITION PROCESS ADEQUATE?

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With less than a year to go until the changeover to International Financial Reporting Standards (“IFRS”) as the basis for the preparation of financial statements by Canadian public issuers, it is important for issuers to review their current progress towards IFRS conversion and their disclosure about the IFRS transition process, particularly as they are finalizing their 2009 annual MD&A.

The transition from Canadian GAAP to IFRS (mandated by the Canadian Accounting Standards Board to be adopted for financial years beginning on or after January 1, 2011) is a substantial undertaking that has the potential to affect an issuer’s reported financial position, operating results and business functions. Disclosure about an issuer’s transition process is required by MD&A Form 51-102F1. Important guidance is also provided in CSA Staff Notice 52-320, *Disclosure of Expected Changes in Accounting Policies Relating to Changeover to International Financial Reporting Standards* and the recently published OSC Staff Notice 52-718, *IFRS Transition Disclosure Review*.

Disclosure Requirements and Guidelines

An issuer is required in its interim and annual MD&A to discuss and analyze any changes in accounting policies that it expects to adopt. Specifically, section 1.13(a) of the MD&A Form 51-102F1 requires issuers to include the following:

- a description of the new accounting standard;
- disclosure of methods of adoption permitted and the method the issuer expects to use;
- discussion of expected effects on the issuer’s financial statements; and

- potential effects on the issuer’s business.

For the financial year ended December 31, 2009 (in the case of an issuer that will change to IFRS for its financial year beginning January 1, 2011), an issuer should provide an update on the key elements of its changeover plan and timing of its changeover plan, including a discussion of the impact of IFRS on:

- accounting policies, including choices among policies permitted under IFRS and implementation decisions;
- information technology and data systems;
- internal control over financial reporting;
- disclosure controls and procedures (including investor relations and external communications plans);
- financial reporting expertise (including training requirements); and
- business activities and other matters that may be influenced, such as debt covenants, capital requirements and compensation arrangements.

According to CSA Staff Notice 52-320, the 2009 annual MD&A should also discuss major identified differences between current accounting policies and those that the issuer expects to apply under IFRS. While this disclosure can be provided in a narrative fashion at this stage and need not be quantitative, it should enable investors and other market participants to understand what parts of the issuer’s financial statements and/or business will be impacted by the changeover.

For the interim and annual periods of the financial year ending December 31, 2010 (in the case of an issuer that will change to IFRS for its financial year beginning January 1, 2011), the MD&A should provide an updated discussion of the issuer’s preparation for changeover to IFRS and provide significant details of its changeover plan and information about key decisions on policy

choices under IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

Results of OSC's Disclosure Review

OSC staff conducted a review of issuers' IFRS transition disclosure provided by 2008 annual and 2009 interim MD&A to assess the extent and quality of the IFRS disclosure in light of the disclosure guidance provided by CSA Staff Notice 52-320. The results of the review were published in OSC Staff Notice 52-718.

The OSC analyzed the disclosure of 106 reporting issuers. The findings of the review indicate that overall, reporting issuers are not adequately discussing the key elements of their IFRS changeover plan or their progress towards achieving IFRS conversion. In particular, the OSC noted that:

- 40% of the issuers reviewed did not provide any IFRS transition disclosure and received a letter from staff questioning whether a changeover plan was in place;
- of the remaining 60% of the issuers that discussed an IFRS changeover plan in their 2008 annual MD&A, approximately half simply provided a generic description of the plan without disclosure that was specific to the issuer;
- 80% of the issuers that discussed an IFRS changeover plan failed to describe significant milestones and anticipated timelines associated with each key element; and
- 48% of the issuers that discussed their IFRS transition in their 2008 annual MD&A failed to provide quarterly updates in their 2009 interim MD&A on the progress made in their changeover plan.

The OSC warned that it will conduct future targeted reviews of issuers' IFRS transition disclosure and may request re-filings of MD&A in the future. It may also consider other regulatory action when circumstances warrant. What may be helpful to issuers are the examples of entity-specific disclosure included in OSC Staff Notice 52-718.

Below is a sampling of entity-specific disclosure included in OSC Staff Notice 52-718 and some other guidance provided in the Notice:

- Accounting policies - entity-specific accounting policy disclosure for a real estate company

included a statement that while under both IFRS and Canadian GAAP, investment property is initially measured at cost, IFRS will allow investment property to subsequently be measured using the fair value model. The company stated that it will use the fair value model when preparing its IFRS financial statements and expects the fair value of its investment properties to be greater than the carrying value of the properties under Canadian GAAP. The disclosure went on to describe how the company would determine the fair value of each investment property.

- Information technology and data systems - changes made to accounting policies for the recognition, measurement and disclosure requirements of IFRS may necessitate IT system changes to accurately support these new requirements, which changes will generally need to be made prior to the changeover date to ensure the issuer's systems can generate the comparative 2010 IFRS data required for its first interim IFRS filing in 2011. Some issuers with investment properties disclosed that system changes would be needed to track additional fair value information for their properties.
- Internal control over financial reporting - an issuer noted that changes in accounting policies could result in additional controls or procedures being required to address first-time adoption as well as ongoing IFRS financial reporting. In particular, the issuer noted that additional controls will need to be designed and implemented to ensure that the recorded balance of its manufacturing plants is fairly stated in each reporting period and that it was anticipated that such controls will include the use of independent valuers and senior management oversight on the development of key assumptions. Some issuers provided a discussion of their plan to test controls throughout 2010 to facilitate certification in 2011.
- Disclosure controls and procedures - as issuers progress through their IFRS changeover plan, it is important that accurate information about the conversion process is communicated in their MD&A in a timely manner.
- Financial reporting expertise – one of the critical elements of an IFRS conversion plan is technical training for an issuer's board, management and employees. An issuer's

management and employees need the technical knowledge to lead the IFRS conversion and implement the accounting policy changes throughout the organization. Board and audit committee members will need to be sufficiently knowledgeable about IFRS in order to evaluate management's selection of accounting policy choices permitted under IFRS and to consider the impact of IFRS conversion. One issuer stated that following an IFRS information session with members of the board (including audit committee members), the audit committee will review the audit committee charter to make any necessary changes.

- Business activities - one issuer identified certain material contracts that would be affected and explained in detail the process required to amend such contracts before the changeover date.

With less than one year to go until the changeover date, issuers that have not dedicated sufficient resources to preparing for the transition to IFRS are well advised to map out a specific plan and timeline. Disclosure of the IFRS transition process is necessary to meet the requirements of securities law and to provide to shareholders meaningful and timely information so they can assess whether an issuer will be able to satisfy filing obligations that will apply for the first quarter in 2011 with comparatives for 2010.

CONTACT US

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