

# The Transition to IFRS: Implications for the Audit Committee

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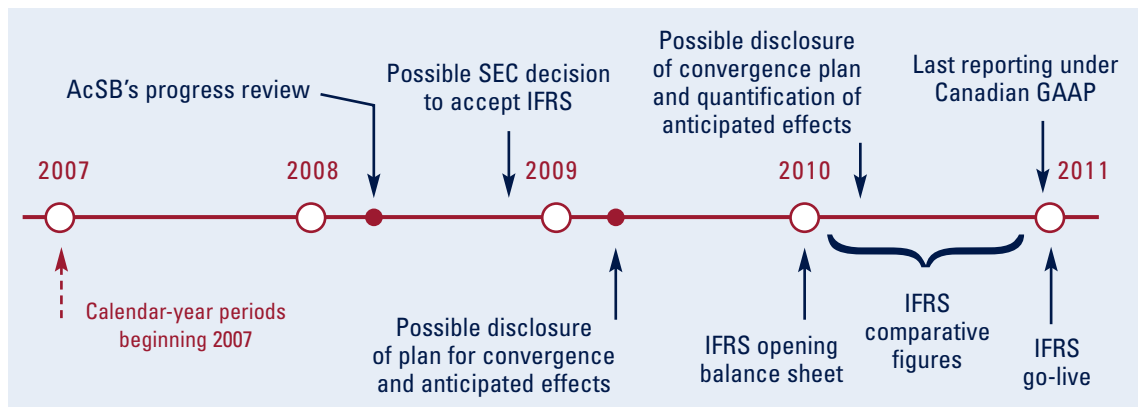
In this article, we discuss the audit committee’s role in the oversight of an enterprise’s transition to IFRS. Readers are encouraged to consult the rules and their advisers for further guidance.

The Canadian Accounting Standards Board has announced that generally accepted accounting principles, as we currently know them, will cease to exist for all publicly accountable enterprises as at a target date in 2011. From that date onward, these enterprises will be required to report under International Financial Reporting Standards. With this move, Canada will join over 100 countries, including five of the G8 countries, in applying IFRS, a single set of globally accepted, high-quality accounting standards.

The publicly accountable enterprises affected by this change include publicly traded companies and certain other organizations holding assets in a fiduciary capacity for large or diverse groups of users. Canadian SEC registrants may have additional options, depending on future SEC decisions affecting foreign filers.

But 2011 seems far off in the future—so why be concerned now? The answer is simple—this announcement marks a fundamental shift in financial reporting that will affect all areas of an enterprise. Also, as the chart illustrates, enterprises may experience the first impact of this change sooner than they expect—as early as 2008.

## Timeline for adoption of IFRS



Further, certain Canadian standards will likely converge with IFRS prior to 2011. The AcSB wants to minimize at least some of the differences between Canadian GAAP and IFRS at the changeover date, and has identified standards for early convergence including inventories, business combinations, income taxes and earnings per share.

Canadian enterprises will therefore have to make a phased transition to IFRS over the next few years.

### **How should the audit committee be preparing for this change?**

Management may have already started or should begin very soon to develop its transition plans for the enterprise. The experiences of companies who have already converted to IFRS suggest that planning and executing an effective transition is no small task.

The audit committee should therefore begin its thinking about this transition to IFRS—the potential impact on the enterprise as well as its financial reporting—and what issues the committee needs to consider in providing its oversight. For example, the audit committee’s focus will likely include the following.

#### **Management’s plan for transition**

Management’s transition plan should demonstrate that it clearly understands the extent of change—identifying all key conversion activities, the timetable, the resources required, and education for people throughout the enterprise (not just in finance) who will be affected by the changeover.

The audit committee will want to be comfortable with management’s plan, its timing, project management, and the adequacy of resources. This plan can serve as a basis for the audit committee’s developing its own oversight plan for the IFRS transition. Both the audit committee and the board will need to be well informed about the progress of management’s implementation of the transition plan.

#### **Impact on management reporting, operating and control systems**

Management’s transition plan should consider the impact on systems and processes, whether change is required, and how to maintain controls and the integrity of information through the transition period. The upcoming requirements for CEO and CFO certifications on the effectiveness of internal control over financial reporting add another dimension to any systems changes.

The audit committee will need to consider the transition to IFRS within the context of its ongoing responsibilities for oversight of internal control and related disclosures.

### How do IFRS and Canadian GAAP actually compare?

In IFRS, the standards themselves are comprehensive and principles-based. These standards have few “bright lines,” and their application requires even greater use of professional judgement than Canadian GAAP. More accounting policy choices are available in IFRS, so taking time now to evaluate these choices may enable enterprises to generate valuable outcomes in the long run.

While IFRS include some standards that appear to be very similar to existing Canadian standards, remember that the “devil is in the details.” Do not underestimate the effort required to understand and apply such standards. Also remember that IFRS include some broadly applicable standards, such as impairments and provisions, that differ substantially from those under Canadian GAAP. Make understanding these standards a high priority when developing conversion plans.

### Implications for audit committee members’ financial literacy and/or expertise

To fulfill the audit committee’s oversight of financial reporting, audit committee members are expected to be financially literate. With the transition to IFRS, committee members must not only understand the key differences between IFRS and Canadian GAAP, but also be able to discern the likely effect of accounting policy choices and the transition on the company’s financial picture. As noted earlier, IFRS requires even greater use of judgement than Canadian GAAP. Members should have a good understanding, not just an awareness, of IFRS accounting principles.

The audit committee must obtain sufficient knowledge of IFRS and the transition process. Members need to be able to understand and question management’s accounting policy choices and assumptions and effectively oversee the convergence of specific standards as well as the overall transition. Committee members may choose to attend external education programs, be briefed by management, the external auditors or others, and/or engage in self-study.

To support board effectiveness and potential succession of audit committee members, other directors on the board may require similar education.

### Implications throughout the enterprise of IFRS-based reporting

The change to IFRS from Canadian GAAP will have implications not only for financial reporting and areas such as taxation and financing, but also for management reporting, budgeting and forecasting throughout the organization. In particular, it may affect the enterprise’s key performance indicators, and therefore performance-related compensation.

The audit committee itself will want to understand and be comfortable with management’s approach for identifying and resolving potential issues. The committee will also want to ensure that the board and other board committees, such as the compensation committee, understand and are comfortable with changes that the IFRS transition may trigger.

### Educating the enterprise’s stakeholder community

A broad group of stakeholders will likely need help in understanding the changes that the transition will trigger in management and financial reporting as well as operations. In the short term, this focus should include the board and board committees, and over time it will extend to broad groups of external stakeholders (suppliers, investors, analysts, lenders, creditors). The transition to IFRS will significantly change each enterprise’s financial statements, and these groups may need to understand the nature of the accounting policy changes and the potential impact of these changes on the accounting information they use.

The audit committee will want to be confident throughout the transition process that management is anticipating the information needs and perceptions of stakeholders, including shareholders and analysts, and addressing them appropriately.

### **Anticipating “bumps in the road” – what can we learn from the experience of others?**

Canadian enterprises, and their audit committees, are fortunate in the timing of our move to IFRS in that we can learn from those enterprises in Europe, Australia, and other countries that have already completed this transition. Among their lessons learned, many enterprises mentioned that they:

- underestimated the scale of the undertaking including the time to complete and/or resources required
- waited too long to get started and spent insufficient time in upfront planning
- lacked support from senior management in the early stages of the project
- suffered from poor project management and failed to create a formal process for identifying and resolving issues
- needed to invest heavily in training finance staff, upgrading IT systems, and renegotiating contracts (debt agreements and financial covenants, compensation, and other agreements)
- should have involved the auditors—both internal and external—throughout the transition process
- saw the accounting rules as “quite similar,” but found that small differences can matter a lot
- should have spent more time communicating to stakeholders about what would be affected by the change to IFRS.

While management of Canadian organizations will likely incorporate these lessons into their transition plans, individual audit committees can use these lessons to strengthen their oversight plan while watching for potential bumps along the way.

### **Begin now**

Clearly, the audit committee should talk soon with management about its plans for making the transition to IFRS—and begin to think about its own oversight plan. While an enterprise’s conversion to IFRS will take several years, the audit committee certainly will be involved in the journey.

For more information about IFRS and the transition in Canada, visit our Web site at [www.kpmg.ca/ifrs](http://www.kpmg.ca/ifrs).

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