AUDIT COMMITTEE INSTITUTE

IFRS Transition—What Audit Committees Should Be Asking

KPMG IN CANADA

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With only six or seven audit committee meetings remaining until many companies begin to prepare their opening IFRS balance sheets, is your committee effectively focusing its oversight?

Canada's move to IFRS is now confirmed—"publicly accountable enterprises" will have to report under IFRS for fiscal periods beginning on or after January 1, 2011. Some Canadian enterprises are making major strides in planning their transition, while others admit they have barely started.

The timeframe in which to make this change is actually tighter than it first appears. To publish IFRS–compliant financial statements in 2011, an enterprise will require IFRS 2010 comparatives. Any enterprises contemplating early adoption will face even closer deadlines!

Build on the lessons learned by others

Make "IFRS—business as usual" the end goal.

European countries and Australia are among those that have made this transition ahead of Canada. Their experience emphasizes the importance of investing time and effort early, building momentum, and focusing on the end goal of "IFRS—business as usual." This change can bring not only different results and added complexity to financial accounts and disclosures, but also enterprise-wide implications for people, processes, and systems.

As might be expected, some enterprises planned carefully with the goal of achieving other benefits—using their conversion as a catalyst for making other changes, such as streamlining internal reporting systems and processes, or improving their internal control. In contrast, others now admit that they waited too long to get started, leaving themselves open to potentially serious consequences.

Strive for the right outcome for the business, not just the easiest one.

Some lessons became evident only after the changeover, as companies stepped back and considered the decisions they made. Admitting that some of their decisions may have been made in a "knee-jerk" fashion, rather than strategically, some companies found themselves wondering after their changeover whether they had achieved the right outcome for the business, or just the easiest one.

MD&A disclosures of IFRS—as early as Q2 2008!

Audit committees and boards of directors should carefully review the guidance from CSA staff on the disclosures expected (refer to CSA Staff Notice 52-320, released in May 2008). Companies planning to adopt IFRS on January 1, 2011 are expected to discuss the status of the key elements and timing of their changeover plans no later than their annual MD&A for 2008. This disclosure will be even earlier if a company has developed its changeover plan at the time of its 2008 interim MD&A filings.

Consider how your company's progress will compare with that of key competitors.

Although companies should be moving forward on their own initiative, these disclosure requirements could create a form of peer pressure as investors compare how different companies are progressing. A public company's progress, or lack of it, will become more evident as companies discuss, in their annual and interim MD&A, their IFRS changeover plans and progress, and, ultimately, the impact on their financial statements.

Oversight by audit committees and boards

While the "heavy lifting" is clearly management's responsibility, the transition to IFRS also requires thoughtful and ongoing oversight by audit committees and boards. Directors should be asking senior management many questions to assess how effectively they are focusing on this change process and managing the related risks, and whether they are taking a long-range view of all options.

Initially, audit committees and boards will need to focus on the major elements of this journey. What are the implications of making the change to IFRS? Is the changeover plan realistic and likely to achieve the desired results? Are critical milestones being met in the process of conversion to IFRS? What resources and expertise will be needed to ensure success? How can the audit committee gain comfort that everything is or will be in place?

Questions that audit committees should be asking

No list of potential questions can be complete or definitive for every company. In providing oversight and seeking to gain comfort, audit committees will need to ask many questions.

The questions listed in the following pages should serve as a stimulus for audit committees beginning their oversight process. They are intended to help an audit committee to think about the areas that it may need to explore—obviously, probing will be required for the audit committee to become comfortable that its enterprise is effectively meeting this challenge. We have clustered these questions into four broad areas:

- changeover project itself
- financial reporting impact
- broad impact on the enterprise and its stakeholders
- implications for the board and board committees.

Changeover project itself

1. What is the strategy for changeover to IFRS? (e.g., embed IFRS throughout the accounting process vs. use IFRS only at a consolidated level; use the changeover as catalyst for other change, such as streamlining processes or enhancing controls)
2. What tone has management set for the IFRS changeover project? Does this initiative have senior management support?
3. Have the leaders of business units, treasury, HR, IT, tax, and investor relations been engaged and educated on the possible implications for them of the IFRS changeover? How and when will they be involved in the changeover project?

Changeover plan, timeline, resourcing

4. What is the detailed plan for changeover to IFRS? What level of change is likely to be required for IT systems—modify existing systems or implement new ones?
5. How do the IASB's work program and AcSB's phased transition plan affect the changeover plans?
6. What is the timetable for the IFRS changeover plan? Is the timetable achievable?
7. Who is on the changeover project steering committee?
8. Has a responsible individual been appointed to lead the changeover project? Does that person have strong support from senior management?
9 How is project management being handled? Who is acting as project manager? How will progress be monitored and reported?
10. Are there sufficient resources within the organization to undertake a successful IFRS changeover? What skills, knowledge, and expertise are required? How will they be secured? What IFRS training is required?
11. What will be the role of internal audit?
12. How are our auditors being kept in the loop? What assistance/advice are they providing throughout the project?
13. How is progress on the changeover schedule being monitored? How are issues being addressed?

Risk management

14. Are the major risks and opportunities associated with the IFRS changeover being identified, evaluated, and documented?
15. How will these risks be managed and the opportunities exploited?

Change management

16. What changes are required, and how are they being managed? Is a significant "change management" focus necessary to achieve the desired results? If so, how is it being incorporated?

Financial reporting impact

For more information on how these standards compare with Canadian GAAP, refer to KPMG's publication, IFRS compared to Canadian GAAP: An overview.

1. What accounting policies will be most affected by IFRS changeover?
2. Has the impact been assessed? What is expected?
3. How will IFRS likely affect earnings, equity, key ratios, and realized profits? Are we likely to see more volatility?
4. What are the implications of our converting to IFRS on, for example, financial covenants, capital requirements, or our dividend policies?
5. What are the implications of our converting to IFRS on our performance indicators and reporting, as well as incentive compensation arrangements?

Making choices—accounting policies and elective exemptions

6. How and when is management assessing all accounting policy choices as well as specific elective exemptions under IFRS 1?
7. How is management learning about and assessing what other companies in our industry and our competitors are doing in their move to IFRS? Would industry consultation and/or consensus be desirable in any areas?
8. What is management's rationale in selecting specific accounting policies? What judgment process will be applied?
9. What elective exemptions are available for first-time adoption under IFRS 1? Which ones is management considering, and why? What are the cost/benefit trade-offs?
10. How is management monitoring the IASB and AcSB's programs? Which IASB projects may have to be assessed for their impact on changeover? Which IASB projects may result in further accounting changes post-changeover?

IFRS financial statements

11. When will management prepare mock financial statements under IFRS?
12. What are management's plans for preparing the restated opening IFRS balance sheet, and 2010 comparative information under both Canadian GAAP and IFRS?

ICFR and DC&P

13. How is management addressing the internal control certification requirements while also making the changeover to IFRS?
14. Are our current DC&P for financial information adequate for public disclosures about our changeover to IFRS?

Disclosures

15. What should be reported in interim and annual MD&A between 2008 and 2011 about our changeover to IFRS?
16. How do our disclosures compare with other similar enterprises?
17. What other information should be disclosed about the broader implications of our changeover to IFRS? How should it be disclosed?
18. What new information will we disclose under IFRS that we did not disclose before? When and how will it be disclosed?
19. How might our disclosures affect external perceptions of our enterprise?

Broad impact on the enterprise and its stakeholders

1. What are the training requirements? Who needs training or retraining because of the IFRS changeover—beyond the finance department and accounting staff? How will people be trained in time? Does the enterprise need external help in this area?
2. How well will our financial and reporting systems and processes support our move to IFRS? Will they provide the information required under IFRS?
3. What data will need to be gathered to make new estimates required under IFRS at the beginning of the comparative period? (all the information required for the opening balance sheet)
4. How will our business processes and IT systems be affected by our changeover to IFRS? How much change will be required—will existing systems need to be modified, re-mapped, reconfigured, or upgraded, or will new systems be needed?
5. How are opportunities for improvement being captured?
6. What issues are anticipated, and how will they be dealt with?
7. Will there be a parallel run to test any systems put in place?
8. How will our changeover to IFRS affect management reporting within the enterprise? How will key performance indicators change? How will these changes affect the planning, budgeting, and forecasting processes? How will they affect performance-related compensation?
9. How will IFRS affect our tax reporting and tax filings?
10. What are the communication plans and timing for informing investors or analysts about the impact of IFRS on our industry or our enterprise? What other internal and external stakeholders may require education—employees, lenders, creditors, regulators, suppliers?

For more information about the transition to IFRS in Canada, visit our Web site at www.kpmg.ca/ifrs.

Implications for the board of directors and board committees

1. What risks or changes associated with the changeover to IFRS will be relevant to the board and its committees? (e.g., level of commitment, potential IT system issues, short-term versus long-term thinking, performance indicators, cost or timing overruns, internal controls and certifications, accuracy and timeliness of financial reporting, investor and stakeholder expectations and perceptions)
2. How and when will the board of directors, including the audit committee, learn about IFRS and its impact on our financial reporting and management information?
3. Which directors should become financially literate in IFRS? (i.e., required for audit committee members, but may be desirable for other directors to support board effectiveness and potential succession of audit committee members) How and when will they be educated in IFRS?
4. How are the board and its committees (e.g., audit committee, compensation committee, risk committee, others) understanding and monitoring how this change will affect their oversight activities? What do they know and need to learn about the impact of the changeover to IFRS?
5. How will the full board receive regular periodic reporting on the progress in the changeover to IFRS?

Audit committees

6. As the audit committee, are we comfortable with management's actions and the plan to date? How do we plan to oversee progress on the changeover plan? How and when will we receive regular periodic reporting on progress?
7. Are audit committee members comfortable with our current knowledge of IFRS and our ability to consider the choice of accounting policies and management's judgment processes? If necessary, what actions will we take to reach our desired financial literacy?
8. When and how will we review the proposed selection of new IFRS accounting policies and IFRS 1 elective exemptions? How will we gain comfort that these choices are most appropriate for our enterprise?
9. How are our internal and external auditors involved? How can they help us gain comfort that the implications of IFRS changeover are being considered and addressed?
10. How will we satisfy ourselves regarding the integrity of the IFRS financial statements and financial reporting system?
11. Are we comfortable that our current review processes (for financial statements, MD&A disclosures, etc.) are appropriate for this changeover period?
12. Will our normal schedule of meetings likely be sufficient?