



# Managing the Transition to IFRS: Positioning for success

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KPMG IN CANADA

# Managing the Transition to IFRS: Positioning for success



**IMPORTANT  
INTERSECTION  
AHEAD**

## **Contents**

How quickly should you be moving?	<b>1</b>
Evaluating your progress to date	<b>2</b>
Critical action—undertaking systematic and detailed gap analyses	<b>4</b>
IFRS—a moving target	<b>8</b>
IFRS financial statements and disclosures	<b>13</b>
Managing your conversion	<b>16</b>
KPMG's IFRS resources	<b>20</b>

## How quickly should you be moving?

Deadlines are looming in Canada’s move to International Financial Reporting Standards (IFRS). Publicly accountable enterprises are discovering new obstacles and increasing challenges as they progress. Are you well positioned to make a successful conversion?

The timeline at the bottom of this page is really becoming compressed, isn’t it? The first real deadlines occur in late 2009—only a few months away!

And what is that red circle? Well, we refer to it as the “135-day crunch.” In 2011, many public companies will have 90 days to issue their 2010 annual Canadian GAAP financial statements, followed by 45 days\* to issue their first interim IFRS financial statements. You will find preparing these interim financial statements and the first-time adoption disclosures in Q1 2011 to be an onerous exercise that is very different from your usual quarterly financial reporting. This period will definitely not allow anyone time to play “IFRS catch-up.”

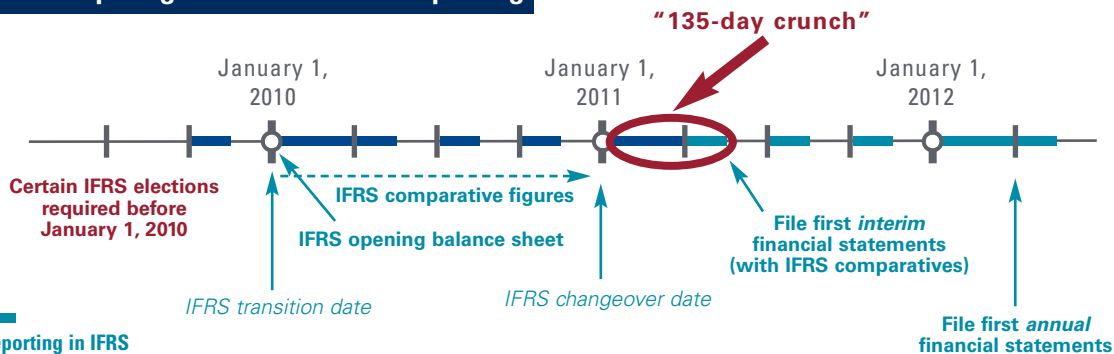
Unfortunately, according to several recent surveys, many Canadian enterprises appear to have been moving relatively slowly so far. What are directors, investors, and other stakeholders thinking as they monitor your interim and annual MD&A, and compare your progress with that of your peers and competitors? Look at the clusters on page 3 and critically assess where you think your enterprise fits.

Without question, economic conditions and uncertainty caused some organizations to focus on other priorities, perhaps contributing to their slow progress. The global credit crisis and fair value debate also created pressures in the accounting world. In response, the International Accounting Standards Board (IASB) has made significant changes to its agenda, adding and fast-tracking new urgent projects. As a result, Canadian enterprises moving to IFRS now face a wider array of changing standards, with much less predictable timing than was expected when IFRS conversion projects were first established and scoped. To be sure, IFRS conversion is becoming increasingly complicated.

### What can you do to ensure your enterprise is (or will be) well positioned for success?

In the pages that follow, we examine some of the challenges that enterprises need to address and actions to take to meet them.

#### Timeline\*\*: Preparing for IFRS financial reporting



Financial reporting in IFRS

Financial reporting in Canadian GAAP (including incremental MD&A disclosures regarding IFRS changeover)

\* As this publication was being printed, the Canadian Securities Administrators proposed providing “a 30-day extension to the deadline for filing the first interim financial report in the year of adopting IFRS in respect of an interim period beginning on or after January 1, 2011.” Compared with the magnitude of work needed to make a successful changeover to IFRS, this extension may offer only minor relief.

\*\* Timing shown for non-venture issuers with December 31 year ends

## Evaluating your progress to date

Companies in the EU and Australia strongly recommend *not underestimating* the work required in an IFRS conversion.

What's the critical path for your organization? Check your progress to see if you need to move more quickly.

Regardless of the size, scale, and complexity of your industry and your enterprise, all IFRS conversion projects include similar steps.



As we have described in earlier publications in this series, a conversion starts by initially diagnosing the key areas that will be affected by the move to IFRS and securing support throughout the organization. It then builds into a "deeper-dive" assessment of the accounting and financial reporting impacts, leading to a revised set of accounting policies. Next, it develops into a business requirements review, focused on how to produce the information needed both historically to restate numbers and prospectively to produce IFRS figures. Finally, the enterprise implements and tests those processes to produce IFRS accounting as "business as usual."

### How do Canadian enterprises appear to be progressing?

We asked KPMG teams working with Canadian enterprises what they are seeing, and also reviewed enterprises' assessments of their own progress in KPMG's *IFRS Readiness Questionnaires*. In early September 2009, respondents appear to be grouped into four clusters, according to their general project status, as highlighted on the facing page.

Unfortunately, recent surveys suggest that the first two clusters likely account for too many organizations.

- An FEI Canada survey provides one indication of progress. In early April 2009, the Canadian Financial Executives Research Foundation surveyed 256 organizations, including 147 publicly accountable enterprises, 51 private companies, 28 Crown corporations, and 30 other organizations. This research report<sup>1</sup> indicates that
  - About 80 percent of public companies remain short of the half-way mark in their overall conversion process. Of the 147 public companies, roughly 4 in 10 were 0–20 percent complete, and about the same proportion were 20–40 percent complete. A further 13 percent were 40–60 percent complete, 5 percent were 60–80 percent complete, and one company was 80–100 percent complete.
- Our Audit Committee Institute's spring roundtables provide another perspective.<sup>2</sup> In June 2009, when asked at what stage their enterprise was in its move to IFRS, roundtable participants replied: "not started" (3 percent); "management is assessing the impact of the change" (23 percent); "management is developing its plan for conversion" (36 percent); "beginning to implement management's conversion plan" (21 percent); "well advanced" (16 percent); and "already reporting in IFRS" (1 percent).

<sup>1</sup> Canadian Financial Executives Research Foundation, *IFRS Readiness in Canada: 2009 Survey Highlights*, June 2009.

<sup>2</sup> Results are based on responses from approximately 100 audit committee members and directors surveyed at Audit Committee roundtables in Toronto, Calgary, and Vancouver.

For Canadian publicly accountable enterprises, deadlines are looming! Only a few months remain until the January 1, 2010 transition date with its opening IFRS balance sheet. Clearly, enterprises are at very different stages of readiness to create this opening balance sheet.

**Where is your enterprise in its conversion project?**

Honestly assessing your progress is essential if you are to manage your conversion effectively. Consider the actions required throughout the entire project as well as your progress milestones. In addition, really focus on the continued availability of the resources you need, given the many competing demands for people’s time.

Different industries face different accounting issues. Not surprisingly, enterprises are also pacing their projects differently, and progress varies widely, even for those in the same industry sector.

**Is your enterprise in the “leaders” or “priority projects” categories?** Congratulations! Of course, if you are this far along, you are probably facing significant accounting issues with the potential to transform your business. Hence, you recognized early on your need for careful planning and excellence in execution.

But even a carefully planned journey can encounter unexpected challenges. Continue to monitor IASB activities, especially for IFRS standards that will affect you, but are in the process of being amended. As we discuss in more detail on pages 8–11, the IASB’s timing of completing projects and making standards effective is

much less predictable than in the past. You will need to reassess the likely impact of new or revised standards and interpretations, and adjust your project accordingly.

**Do you think your enterprise is a “steady ship”?**

Keep monitoring your progress against key benchmarks—you may discover that you really do need to accelerate your conversion project.

**Is your enterprise in the “laggers” category?** Some enterprises may have taken too much comfort from their initial high-level diagnostic, which suggested they would be affected by fewer differences or gaps between Canadian GAAP and IFRS. Thinking that their project would not require great effort, they have not really pushed forward. Others may have simply kept their heads in the sand.

**Be forewarned!** Enterprises that are in only the early diagnostic stage can seriously underestimate the effort required to manage their conversion and reporting processes, even if their accounting gaps turn out to be relatively limited.

No matter what category you think you are in, if you do not fully understand the accounting issues for your enterprise and the consequences of those issues, you really need to drive your project forward.

Your most important action will be taking a “deeper dive” to examine the differences between specific standards within IFRS and your enterprise’s current accounting policies, and understand how you will deal with those differences. We describe that process in the next section.

“Laggers”	“Steady ships”	“Priority projects”	“Leaders”
<ul style="list-style-type: none"> <li>• Have not given project much consideration</li> <li>• No formal project team or project plan in place</li> <li>• Potentially, some initial review of standards undertaken</li> <li>• Some consideration of key technical areas</li> </ul>	<ul style="list-style-type: none"> <li>• Project team mobilized</li> <li>• Detailed assessment of differences between IFRS and Canadian GAAP nearing completion, if not already finished</li> <li>• Key impacts understood at reasonable level of detail</li> <li>• Specific awareness training on key technical areas</li> <li>• Clear plan for subsequent phases</li> </ul>	<ul style="list-style-type: none"> <li>• Individual work stream project plans in place and progressing</li> <li>• Critical white papers completed and preliminary policy decisions made</li> <li>• Opening balance sheet for transition year planned</li> <li>• Training needs clear; some training undertaken</li> <li>• Good sense of business impacts and systems implications</li> </ul>	<ul style="list-style-type: none"> <li>• Tend to be utilities or other sectors in which issues are significant</li> <li>• Systems are being reviewed and converted</li> <li>• Clear strategy for external communication to markets</li> <li>• Quantifying certain adjustments and planning 2010 parallel-year dry run for data collection</li> <li>• Key business impacts well understood and being addressed</li> </ul>

## Critical action—undertaking systematic and detailed gap analyses

By thoroughly analyzing the gaps between IFRS and Canadian GAAP, you can begin to create the blueprint for the remainder of your project. Invest time in this activity—do not rush through it. Recognize that shortcuts can significantly increase the risk of surprises right up to your changeover.

Gap analyses are detailed examinations of the differences between IFRS and your enterprise's current accounting policies and practices, relating to balance sheet and income statement items and disclosures. Through this exercise, you identify the likely impact—on your financial reporting, IT systems, processes, controls, people, and the business itself—of adopting IFRS and the various accounting policy choices available to you.

### Invest both time and effort

These detailed gap analyses are critical elements of any IFRS conversion. Be sure to invest significant time and effort so you can create an effective blueprint for the rest of your project. Your investment in this process will contribute to a smoother changeover to IFRS.

If your enterprise has been slow to ramp up its conversion project, don't be tempted to shortcut this exercise. These gap analyses serve as the foundation of your project, and you need to get the blueprint right. Work to avoid problems such as

- needing expensive last-minute IT system changes or significant manual workarounds
- overburdening your financial reporting team and process
- triggering multiple approvals and reviews by external stakeholders. For example, before renegotiating debt covenants, ensure that all impacts have been considered—so you approach your lenders only once.

### Where to focus your attention?

Start with those standards and interpretations that are likely to have the most significant or pervasive effect on your organization, either in terms of the financial results or changes to systems and processes.

Recognize that the work effort required in analyzing a standard's impact can differ from the magnitude of a potential adjustment. For some items, you may have to do a lot of work before finally concluding that the impact for your enterprise is immaterial.

### Make well-considered decisions

As a part of your gap analysis, you will assess the impact of various accounting policy choices available under these IFRS standards. In some instances, you may be able to choose to keep your existing policies; in others, you may be required to change.

### **Consider your accounting policy choices carefully**

In some cases, you'll find it very difficult, if not impossible, to change your policies once your enterprise adopts IFRS.

When adopting IFRS for the first time, your enterprise is adopting a new framework of accounting standards, not just changing its accounting policies. Generally, no constraints apply to your choice of accounting policies under IFRS. Thus, on adopting IFRS, your enterprise can freely establish its accounting policies as either

- those IFRS policies that it may already follow under Canadian GAAP, or
- new choices available under IFRS.



#### Choosing accounting policies: Questions to ask/factors to consider

- What options do we have? How might different choices affect our financial reporting? our conversion effort?
- Will this accounting standard likely change again in the foreseeable future?
- What are other organizations like ours doing? our Canadian peers? companies in the EU and Australia? How will our choices likely compare? What might be the reaction of investors and analysts?
- What are the best policies for our enterprise? What outcome will likely result for us?
- What will be the effect on our internal control over financial reporting?
- Is it the right choice—or just the easiest?

Once you have adopted IFRS, however, any changes in those policies in periods subsequent to changeover are subject to the criteria in IFRS for accounting policy changes—the new accounting policy must result in financial information that is more relevant and reliable. For example, moving from a policy of measuring long-lived assets at fair value to measuring them at cost is rarely seen as a move to a more relevant and reliable policy.

IFRS 1 *First-time adoption of IFRS* does, however, permit an entity to change its initial IFRS accounting policies and elective exemptions between the issuance of the first interim financial reports it presents and the first annual IFRS financial statements. However, doing so will result in more effort, as IFRS 1 requires, in such situations, that an entity explain such changes and update the previously reported reconciliations required under IFRS 1.

Investing time to make the right choice is certainly worthwhile, as changing an accounting policy later may be difficult or even impossible. After their changeover, many European and Australian companies admitted they felt, on looking back, that they had moved too quickly to an easy answer and then regretted it afterward.

Sometimes, choosing the path of least resistance or the status quo may actually be your enterprise's best option—for example, if the requirements of specific standards are likely to change again post changeover.

In certain cases, enterprises are evaluating their policy choices by considering not only standards that apply today, but also those for which changes are planned. Revenue recognition serves as a good example of a standard requiring both a current and future focus

- Currently, IFRS provides less specific guidance on revenue recognition than either Canadian or US GAAP. IFRS does not contain specific guidance on identifying and accounting for
  - the various elements of a transaction
  - non-cash incentives and discounts given to customers
  - contracts involving specific customer acceptance provisions.

IFRS allows entities to consult and apply other authoritative literature, as long as it is not inconsistent with the IASB *Framework*.

- Looking forward, the IASB is now working on a project to replace its standards and interpretation on revenue with a single comprehensive set of principles for revenue recognition to be applied to all contracts under which revenue is earned. This project and its resulting standards would be substantially converged with US GAAP.
- Some enterprises will simply ensure that their existing revenue recognition practices will still be acceptable under IFRS at changeover, seeking the status quo where possible, since further changes to their policies and IT systems will likely be required post changeover when the amended IFRS standard becomes effective.

## Determining your IFRS 1 elections

The accounting policies you select are generally applied retrospectively in order to restate the enterprise's

- opening IFRS balance sheet on an IFRS basis at the date of transition, and
- financial results for each of the comparative periods presented.

As already noted, the initial IFRS accounting policy choices you make can affect the conversion effort required. Perhaps even more importantly, in certain respects, they can significantly affect your opening equity and post-changeover IFRS–reported results.

IFRS 1 *First-time adoption of IFRS* permits you to take certain optional elective exemptions and avoid the retrospective application of IFRS in specific areas. As in choosing IFRS accounting policies, electing certain optional exemptions can significantly reduce your conversion efforts, but will also affect your opening equity and IFRS–reported results.

### IFRS 1: Optional exemptions

#### May be easier to take

- Business combinations
- Actuarial gains and losses
- Pension disclosures
- Compound instruments
- Cumulative translation differences
- Share-based payments
- Decommissioning liability
- Service concessions
- Borrowing costs
- Insurance contracts
- Customer contributions
- “Day one” gain or loss
- Oil and gas assets
- Proposed exemptions for rate-regulated operations

#### Should think strategically

- Deemed cost
- Arrangements containing a lease
- Designation of previously recognized financial instruments
- Assets and liabilities of subsidiaries, associates, and joint ventures

For some elections, you will easily be able to evaluate the tradeoffs between conversion effort and financial reporting impact, and decide on your elections. Retrospective application of certain standards will be onerous and not cost effective, for example, in areas such as actuarial gains and losses on defined benefit pension plans, and cumulative foreign exchange adjustments.

In other areas, you will need to analyze the exemptions carefully and strategically. For example, where there may not be significant impacts arising from retrospective application of IFRS to certain property, plant and equipment, it may be more cost effective to apply the standard retrospectively than to obtain, at the date of transition, a costly valuation to apply the deemed cost exemption. Entities will make different decisions, depending on their specific facts and circumstances.

**Pay careful attention!** In IFRS 1, some optional exemptions need to be applied to classes of items or transactions, whereas other exemptions may be elected on an item-by-item basis. The optional exemptions are specific and cannot be applied to other items by analogy.

### **Your gap analysis—really an ongoing exercise**

Remember, IFRS is not static. Changes are occurring now, and will continue during and after Canada's changeover to IFRS. Monitor all changes in standards and interpretations. Be sure your conversion plan and resources are flexible to address any changes occurring before changeover.

As the IASB issues new standards or interpretations, you will likely have to return to "gap analysis" mode. Examine how these amendments will affect your enterprise. Then consider what new accounting policy choices you require, or whether you will elect any consequential new optional exemptions in IFRS 1.

In the next section, we examine some areas in which IFRS standards are continuing to evolve, and the implications and potential challenges for Canadian enterprises.



## IFRS—a moving target

Canadian enterprises knew that IFRS would continue to evolve. But current economic conditions have added new complications and made the timing of changes less predictable. *Fasten your seat belt.*

Canadian enterprises will not enjoy a stable platform of standards or quiet period leading up to IFRS changeover, unlike European and Australian companies that adopted IFRS in 2005. Rather, Canada's move to IFRS spans a period of tremendous change in standards. New standards are expected to become effective in 2010, 2011, 2012, and beyond.

Addressing the global credit crisis and fair value debate became a lightning rod in 2008, and the IASB's agenda has changed significantly in response. The IASB has added new projects, accelerated certain existing projects, and moved others to the sidelines. For Canadian enterprises trying to monitor the IASB's work plan and assess the implications for their conversion plans, the timing of certain projects has, unfortunately, become much less predictable.

### New and unexpected IASB projects

In late April 2009, the IASB decided to replace IAS 39 *Financial Instruments: Recognition and Measurement*, one of the most complex standards, with a new accounting model on financial instruments. The proposed changes have been separated into three phases:

- **Classification and measurement** – In July 2009, the IASB issued an exposure draft on classification and measurement. The Board expects to finalize these amendments in time to allow early application for 2009 year-end financial statements. The approach being developed would require almost all financial assets and financial liabilities to be measured at either amortised cost or fair value. Existing categories of loans and receivables, held-to-maturity investments, and available-for-sale financial assets would therefore disappear.
- **Impairment** – Many of the concerns raised during the financial crisis arose from the impairment requirements for financial assets and liabilities, particularly loan losses and those securities for which there are inactive markets. By replacing the base classification and measurement requirements in IAS 39, the IASB believes it will quickly address impairment of financial instruments. The Board intends to issue an exposure draft on impairment in the fourth quarter of 2009.
- **Hedging** – The IASB is also going to work with the FASB on a joint project to improve hedge accounting by reducing its complexity. The Board intends to issue an exposure draft on hedge accounting in the fourth quarter of 2009.

The IASB's addition of this project adds significantly to the differences that Canadian enterprises need to address on conversion, because the financial instruments standard was one of the few Canadian GAAP standards already substantially converged with IFRS. Thankfully, the IASB has indicated that these amendments would not be mandatorily effective prior to 2012. However, this new project has caused the timing of other planned changes to IFRS standards to become more unpredictable.



### Additional accelerated IASB projects

In its revised project timetable, the IASB has given “express” status to certain standards:

- **Consolidations** – The IASB decided to forgo issuing a discussion paper in order to expedite issuing a new standard on consolidations. The IASB is proposing that a single control model be applied to all entities, including special-purpose (structured) entities. On the surface, this change appears to bring IFRS closer to Canadian GAAP; however, the IASB has indicated that the proposed new standard is *not designed to converge with US GAAP*.
- **Derecognition** – As set out in its exposure draft, the IASB’s proposal on derecognition veers away from the Board’s initial proposal to converge with US GAAP.

Consistent with the current approach under IFRS, the proposal will require derecognition to be evaluated at the level of the reporting entity. An entity therefore first consolidates all subsidiaries and special-purpose entities that it controls, and then applies derecognition to the resulting group.

The IASB proposes to require enterprises to derecognize a financial asset or financial liability when it ceases to qualify as an asset or liability as defined in the IASB *Framework*.

The proposed derecognition approach focuses on

- whether the transferee of the financial asset has obtained control of the economic benefits of the asset, or
- when the present obligation of a financial liability is eliminated and the entity is no longer required to transfer economic resources in respect of that obligation.

A final standard is expected to be issued in the first half of 2010, and, based on the current timelines, it may be effective for Canadian enterprises making their changeover in 2011.

- **Fair value measurement** – The IASB’s exposure draft proposes to replace the fair value measurement guidance contained in individual standards with a single definition of fair value, and provide further authoritative guidance on the application of fair value measurement in inactive markets. This proposal will neither require more use of fair value measurements nor change when fair value measurements must be applied. The proposed guidance simply explains how to measure fair value when it is already required by existing standards.

The final standard is expected to be issued in the first half of 2010, and may be effective for enterprises moving to IFRS in 2011.

## Projects delayed

To accommodate the new or accelerated projects, other projects have been delayed. For example, proposed amendments to the standard on earnings per share have been shelved until 2011.

## Project still unclear—*Income tax accounting*

The IASB project on income taxes is particularly important for Canadian companies. Amendments to the international income tax accounting standard (IAS 12 *Income taxes*) have been anticipated for some time, leading some companies to delay performing their detailed assessment of the impact of adopting IFRS.

In its exposure draft on March 31, 2009, the IASB finally introduced the much-anticipated proposed changes to the standard on accounting for income taxes. These proposed changes will present additional challenges to Canadian companies making their initial assessment and planning their conversion efforts in the area of income taxes.

The IASB has proposed a rewritten and restructured standard to replace the existing IAS 12. The Board is attempting to clarify and reduce the complexity in accounting for income taxes, without changing the basic accounting model for income taxes.

Whether the IASB has succeeded in clarifying and improving IAS 12 is, however, debatable. Several of the IASB's proposals are open for interpretation, and certain aspects of the proposed standard appear to be inconsistent with one another. Critics argue that the exposure draft incorporates some of the most complex and difficult aspects of US GAAP into the proposed standard. Many comment letters have criticized the proposals, suggesting that the project should be delayed or dropped. It is currently unclear what action the IASB will take as it begins to deliberate the responses to the exposure draft.

When the final standard will become effective also remains unclear. While the IASB seems receptive to the idea that first-time adopters would be permitted to early adopt the new standards, should they become mandatorily effective in 2011, it is not definitive that this option will be available.

In the meantime, Canadian companies cannot ignore existing IAS 12. Do not leave income tax computations to the last minute!



### Canadian taxing authority's view

The Canada Revenue Agency (CRA) has also taken steps to get itself ready for the transition to IFRS. The CRA has formed an IFRS Advisory Committee on Taxation between the CRA and the business community, which includes representatives from various industries, accounting organizations, and public accounting firms. The mandate of this committee is to advise the CRA on tax administration issues as corporations plan their transition to financial reporting under IFRS. The CRA will undertake to publicize key decisions and interpretations made by this committee, once finalized, and will work with the Department of Finance to make legislative changes to the tax law, if appropriate.

The CRA has also issued for comment a "draft" issue of *Income Tax Technical News*. It indicates the following:

- It is the CRA's view that financial statements based on IFRS would be an acceptable starting point to determine income for tax purposes. If a taxpayer prepares only IFRS financial statements for other users, and wishes to use those statements for tax purposes, the CRA will permit this. However, if a taxpayer is not obliged to use IFRS statements for accounting purposes, and does not prepare them for other users, the taxpayer should not prepare IFRS statements solely for tax purposes.
- Given the extent of tax rules that override accounting treatment, the CRA expects that taxable income will not be significantly affected by the adoption of IFRS. However, the CRA does recognize that the computation of taxable income could be much more complex, because the accounting treatment and tax treatment will vary in more ways than they do now.
- The CRA expects taxpayers to apply IFRS on a consistent basis to all income tax filing and all years after initial adoption. For example, a taxpayer could not use current GAAP to compute its thin capitalization limit and use IFRS to compute its revenue recognition in the same year.

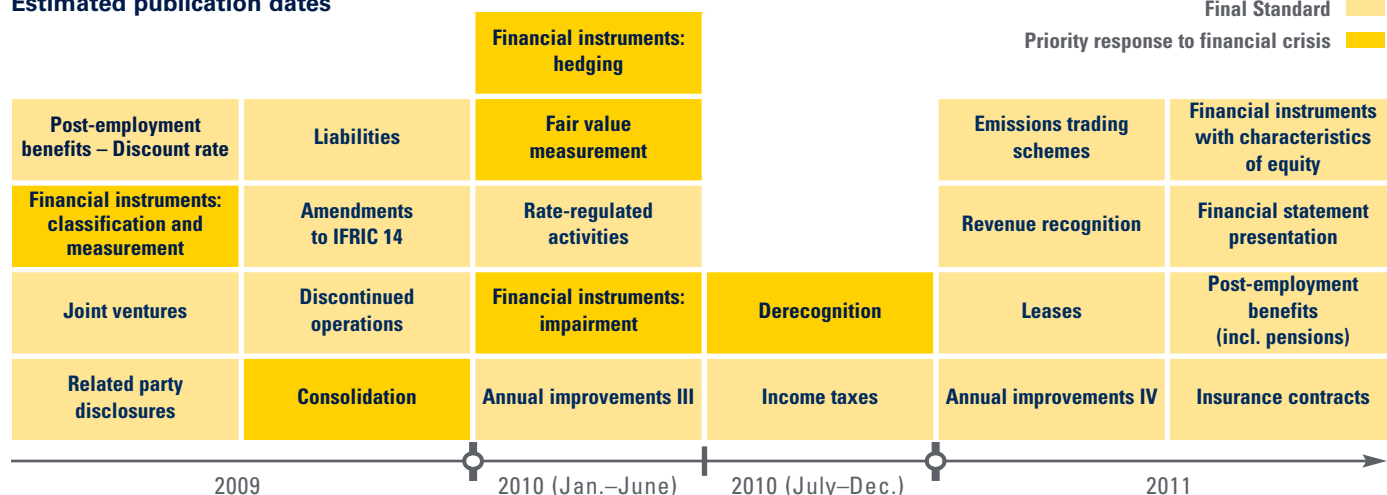
### When will standards become effective?

The IASB's expediting certain standards makes it increasingly difficult to predict when standards will be effective. Although the effective date of a standard is generally not known until later in the standard-setting process, it is *usually* 6 to 18 months after the publication date. Consequently, for calendar year-end enterprises, standards issued in 2011 would normally not have effective dates before 2012. For those standards expected to be issued in 2010, however, the effective dates are difficult to predict.

With these new and expedited projects, the IASB may not be able to maintain its current estimated publication date for other standards. The following table is intended to help you to visualize how the timing of standards currently in the IASB work plan may affect your enterprise's changeover to IFRS.

## IASB work plan until 2011 (as of August 1, 2009)

## Estimated publication dates



Projects with unconfirmed timing: Credit risk in liability measurement, Extractive activities, Common control transactions, Earnings per share, Government grants

## Assessing the impact on your enterprise

Actively monitor the IASB's activities—including its work plan and likely effective dates for amendments, exposure drafts, and final standards.

Carefully assess the implications of changes to IFRS for your enterprise. Keep your conversion plans somewhat flexible, and adjust them as required—depending on the accounting standard and your business, changes can have widespread impact.

Be sure that you understand the implications of different effective dates:

- **On or before December 31, 2011** – When moving to IFRS, calendar year-end Canadian enterprises *must apply* new or amended IFRS standards that are effective for the fiscal year ending December 31, 2011—generally those in the 2009 column, but potentially some in the first half of 2010 column as well. These standards would need to be applied retrospectively, unless IFRS 1 is simultaneously amended to permit otherwise.

Your conversion plans will need to consider what effect these standards will have on your accounting policy choices, IFRS 1 elective exemptions, opening IFRS balance sheet, and the dry run of your restatement process through 2010.

- **After December 31, 2011** – *Unless the individual standards permit early adoption*, Canadian enterprises *cannot apply* on their transition to IFRS those amended IFRS standards with publication dates on or before December 31, 2011, *but not yet effective*—generally those in the 2010 and 2011 columns. Any new or amended standards issued in 2010 and 2011 may therefore have substantial impact on your conversion plans, depending on whether or not early adoption is permitted.
  - *If early adoption might be permitted*, evaluate the merits of voluntarily early adopting the new or amended standard. Consider the impact on both your reported results and your overall conversion efforts. Your conversion plans will have to be flexible. When it becomes clear whether early adoption will be permitted, you may need to adjust your plans to address the implications of different effective dates.
  - *To the extent that early adoption is not permitted*, enterprises will need to plan to maintain resources and stamina beyond 2011. You will need resources and energy to implement the major standards being revised later in 2010 and in 2011.

In your IFRS conversion plans, you will have to grapple with the interpretation and application of new and amended standards. Remember—Canadian enterprises will be dealing with the interpretation and application of these standards far earlier than current IFRS users.

## IFRS financial statements and disclosures— *be prepared*

Your financial statement disclosures will change significantly under IFRS. Plan for substantial data collection and considerable work.

Even if you are lucky enough to have limited accounting GAAP changes, you will still encounter differences in the way your financial statements, notes, and disclosures are presented under IFRS.

Financial statement preparers could *easily underestimate* the extent of the differences or the effort required to present financial statements in accordance with IFRS. In addition, financial statement disclosures required under IFRS are extensive. Early on, consider the information requirements, the impact on your financial reporting close processes, the timing, and any potential resource constraints.

- Do you understand what these IFRS financial statements and notes look like?
- Do you know what first-time adoption disclosures are required?
- Do you know what extra information might be needed from your IT system to fulfill these disclosure requirements?
- When is the right time to review whether you can bring that information into the system rather than resorting to a work around solution?
- How do you plan to review the presentation choices available with the CFO and audit committee for their approval?
- When do you need to draft a set of mock IFRS financial statements, and do you need to apply a disclosure checklist to those drafts?

### **Not your usual quarterly financial reporting**

Your first IFRS interim financial statements for Q1 2011 will be *unlike any other interim statements you have ever prepared*.

First, think about the timeline on page 1—enterprises with December 31 year ends will have no time to spare between January 1 and May 15, 2011. For many public companies, financial statement preparers and approvers face a “135-day crunch” to meet their filing deadlines. You will have 90 days to issue your audited 2010 Canadian GAAP annual financial statements; this is always a busy time. However, in 2011, expect the following 45 days in which you issue your first IFRS interim financial statements to be much more action packed than usual.\*

Then, recognize that *IFRS first-time adoption disclosures will be onerous*. Remember, these first IFRS financial statements have to explain the material adjustments made to amounts reported under Canadian GAAP to corresponding amounts under IFRS. In Q1 2011, you must provide all the information listed on page 15.

Even for the simplest of Canadian entities, starting and finishing all this work in a 45-day timeline is unrealistic, especially right after issuing your annual financial statements. Trying to do so will create unbelievable pressure on your financial reporting team, increase the risk of error or crisis situations, and could even lead to key staff departures at a critical time in the project.

Avoid such risks. Begin this process now by assessing the IFRS disclosure differences.

\* As this publication was being printed, the Canadian Securities Administrators proposed providing “a 30-day extension to the deadline for filing the first interim financial report in the year of adopting IFRS in respect of an interim period beginning on or after January 1, 2011.” Compared with the magnitude of work needed to make a successful changeover to IFRS, this extension may offer only minor relief.

### Key differences from Canadian GAAP financial statements

Highlighted below are just a few of the many differences you should expect to encounter in preparing your first IFRS financial statements.

#### Third balance sheet

Under IFRS, you must present *three balance sheets* in your annual financial statements when you need to restate comparative information for retrospective application of an accounting policy (as well as for retrospective restatements or when items are reclassified). The Canadian Securities Administrators have issued a staff notice indicating that this third balance sheet, as at the IFRS transition date, is also required to be included in the first IFRS interim financial statements.

#### Classification differences

Numerous classification differences exist on the balance sheet and the statement of profit and loss. For example,

- Under the existing IFRS standard for income taxes, *deferred taxes* are always presented as long term in nature, regardless of when they are expected to be realized or the classification of the balance sheet item to which they relate.
- Entities with *asset retirement obligations* will be required to reclassify the annual accretion associated with such liabilities from operating costs to interest expense under IFRS.
- Entities with minority interests may have higher profits and equity under IFRS as a result of *minority interest* being classified as a component of equity and reflected as an allocation of profit or loss (rather than as a deduction in arriving at net income).



### First-time adoption requirements in Q1 2011

#### Balance sheets for

- March 31, 2011
- Restated December 31, 2010
- Restated January 1, 2010

#### Income statements for three months ended

- March 31, 2011
- Restated March 31, 2010

#### Statement of cash flows for three months ended

- March 31, 2011
- Restated March 31, 2010

#### Statement of changes in equity for three months ended

- March 31, 2011
- Restated March 31, 2010

#### Reconciliations (previous Canadian GAAP to IFRS)

- Equity at transition date (January 1, 2010)
- Equity at end of comparative annual period (December 31, 2010)
- Equity as at comparative interim date (March 31, 2010)
- Comprehensive income for the annual period (December 31, 2010)
- Comprehensive income for comparative interim period (March 31, 2010)

#### Many other considerations, including

- Full set of IFRS accounting policies
- Material adjustments to the cash flow statement
- Information regarding impairment losses or reversals recognized at transition

### Classification of expenses in the income statement

As an explicit accounting policy choice, IFRS requires an entity to choose to classify expenses based on the nature or the function of the expenses. Examples of this classification include

- **Nature** – purchases, transport, depreciation and amortization, and salaries
- **Function** – cost of sales, distribution, and administration.

Classification of expenses by function is the only method that will result in cost of sales and gross margin being presented on the face of the income statement. When disclosing by function, all costs should be allocated to the applicable category, including impairment or restructuring charges, rather than the typical “one-line” classification under Canadian GAAP.

### Preparing mock financial statements and disclosures

Many enterprises are planning to prepare mock financial statements under IFRS in 2010, applying their understanding of IFRS disclosure differences. By doing so, you will also be taking advantage of a good opportunity to test the effectiveness of your current systems and processes.

To prepare draft IFRS financial statements, assess what information will be needed, where it will come from, and how it will be generated. Identify any information gaps and how to resolve them.

Take time to consider the long-term benefit of creating system-generated information, rather than having it prepared manually.

Recognize that IFRS specifies significantly more and different disclosures than Canadian GAAP. Be sure to allow ample time to prepare all IFRS–required disclosures. Delaying this activity to the last minute may be unrealistic, even for a small entity with few IFRS adjustments.

## Managing your conversion

Of course, your end goal is “IFRS—business as usual.” To achieve it, you will need to embed IFRS changes throughout your organization. Success is knowing that your people are operating confidently in an IFRS world.

So far, we have focused on accounting and reporting requirements, where much of the challenge lies for enterprises moving to IFRS. However, any IFRS conversion project must also think about business areas outside finance. While the Canadian GAAP to IFRS debits and credits must be systematically addressed, dealing with consequences of those accounting changes for your business and people will pose other challenges.

### More than an accounting change

The figure opposite highlights areas beyond accounting and reporting that must be understood as part of the conversion. Of course, the effect in some enterprises will be more widespread than in others. Those in industries with major accounting impacts (e.g., rate-regulated entities or those with derecognition issues surrounding securitizations) will experience major “ripple” effects across many parts of their businesses.

Think of the financial statement disclosure requirements related to most long-term assets and provisions as providing a good illustration of how the impacts reach beyond the accounting function. All entities will likely need to deal with these requirements. Consider how the consequences of this accounting gap analysis flow through the organization:

- IFRS requires disclosure of “continuity” schedules, mapping movement in account balances from one period to the next. **(Accounting & Reporting)**
- The logic of this reporting issue means you need to track the item-by-item movements in your IT system. **(Systems & Processes)**

- Furthermore, anyone inputting the data in a new form will need to be trained to do so without error. **(People)**
- Finally, those who review the statements will have to consider whether any part of this continuity schedule might be used for commercial advantage. **(Business)**

While this is a simple example, it illustrates that you need to ensure that your conversion project team understands the broader consequences and when they need to be addressed.

### Key factors to consider: *How to manage risk?* *Where could it all go wrong?*

The fundamental starting point for an IFRS conversion is a systematic assessment of the accounting gaps. You may determine that your accounting gaps are limited. Nevertheless, do not be lulled into a false sense of security.

In our experience, the following critical issues must be considered—even with the most basic and simple IFRS conversion.

### Project structure: *Who is accountable?* *Who is doing the heavy lifting?*

From the experience in Europe and Australia, the single biggest differentiator between IFRS projects that ran smoothly and those that “muddled through” was the appointment of a dedicated IFRS project manager.

Clearly, this role is very difficult when enterprises are small and resources stretched. However, having IFRS as a part-time job that is picked up between quarter-ends may lead to critical tasks not being completed on a timely basis, or, worse still, not being tackled at all until it is too

### Accounting and Reporting

- Identify GAAP differences
- Identify additional IFRS disclosure requirements
- Update accounting policies and procedures
- Assess impact on tax and regulatory reporting
- Modify financial statements presentation
- Revise and/or design and implement templates for data gathering

### Systems and Processes

- Identify information gaps for conversion
- Assess impact on internal controls and certification processes
- Identify current system functionality/suitability, related new IT system needs, and period-end-close contingency plans
- Tailor chart of accounts considering regulatory and IFRS accounting needs



### Business

- Develop communication plans for all stakeholders, including
  - audit committee/board
  - corporate units and lines of business
  - regulators
  - shareholders/debt holders/analysts
  - external auditors
- Assess internal reporting and key performance indicators
- Assess impact on general business issues, such as contractual terms, treasury practices, risk management practices

### People

- Develop and execute training plans for all corporate units and lines of business, including
  - IFRS technical topics
  - new accounting policies and reporting procedures
  - changes in processes and controls
- Revise performance evaluation targets and measures, and communicate to affected personnel
- Consider impact on incentive compensation programs

late. Unless assistance is close at hand, with all the different tasks and steps ahead, the lack of dedicated resources will greatly increase the risks associated with the conversion project.

Project managers can bring a variety of skills and experiences to a conversion project. We have found that an important success factor is having someone who not only is knowledgeable about the enterprise's current accounting policies and past practices, but also has a good network across the organization.

The sponsorship of a senior figure in the organization is also essential to a successful project. Visible executive support for and approval of the IFRS conversion is critical in helping to manage resources, influence priorities, and steer the path through the audit committee. *Do not underestimate the importance of this visible senior leadership support.* Throughout all phases of an IFRS conversion, resources from outside the accounting function are required. A detailed gap analysis cannot be

effectively completed without understanding the impact on actual business processes. Processes cannot be changed without the agreement of those affected. Time and time again, we find that obtaining input from the necessary business resources is one the biggest challenges to a successful conversion.

#### **IT systems evaluation: *Twice as long and double the cost?***

The sooner you understand what IFRS information you need, the better off you will be in determining how to collect it. If sourcing this information needs to be embedded into your IT requirements, then you need to engage the IT department sooner rather than later. IT scoping, functionality, and technical specifications take time and planning. *Be forewarned*—if your IT department has not yet been engaged in your project, you may well have, albeit inadvertently, severely restricted your ability to perform any IT system changes. Your only option to deal with the dual reporting requirements may be to design manual workarounds.

The IT assessments and solution options are clearly not helped by the continuing fluidity of the IFRS standards, compared to the fixed (and rapidly approaching) deadlines. However, you are better to plan for the worst than hope for the best as you respond to the IT challenge.

Workaround spreadsheets are possible and were widely used in the UK and Europe, but potential control issues surround such a response. Such solutions may therefore be unacceptable in a regulatory environment that requires internal control certifications.

Beyond actually collecting new information, key issues include the following:

- Do you understand how you will deal with the parallel reporting in 2010 (the comparative year)?
- Do you know what you will do at the cut-over date to IFRS going live on January 1, 2011?

#### For more information

IFRS-related issues regarding systems and internal control are examined in more detail in two KPMG publications posted on our Web site, [www.kpmg.ca/ifrs](http://www.kpmg.ca/ifrs):

- *The Effects of IFRS on Information Systems*
- *IFRS Conversions: Implications for CEO and CFO Certifications.*

#### **Audit involvement: Seeking a “no surprises” approach?**

Experience suggests that the more successful projects employed a consultative approach with their auditors. This dialogue helped avoid last-minute disagreements on critical accounting policy choices and approaches to determining the opening balance sheet.

At certain key points in the conversion process, we would expect to see auditors assessing the enterprise’s selection of accounting policies and application of those policies to specific transactions and fact patterns. While your auditor may be hesitant to provide assurance on preliminary choices and opinions, you should be aware of any significant auditor concerns regarding either your interpretation of the IFRS requirements or your planned application of those requirements.

You need to be confident in your approach prior to investing significant resources in system and process change or restatement exercises. Do not put yourself in a position where late issues derail the conversion process.

#### **Stakeholder management: The right message at the right time**

Internally, you should ensure that the board and audit committee are always fully briefed on the progress of the project. Do not let your CEO answer the question “So, how is your IFRS project going?” with “I don’t know.”

Some not-so-obvious stakeholder groups also need to be involved in the process at certain key times. Outside your organization, you will need to develop a full communications plan to ensure all stakeholders are fully engaged in the process. People who have a vested interest in your enterprise’s performance—your shareholders, analysts, regulators, unions, and lenders—need to be informed and understand what your transition means for them.

If you haven’t reviewed who will need to be told about IFRS, then start compiling that list now.



### Other important areas to consider

Once you have a handle on the key issues above, then you need to consider other broader implications of the conversion process. In no particular order and in brief, these include

- **Site versus central activity** – How will you ensure engagement by business units to your group project? How will you ensure that IFRS is business as usual outside the corporate office?
- **Documentation of accounting white papers** – How will you ensure that you have the appropriate analysis of issues and proposed policy choices? What are the expectations of your audit committee and auditors regarding accounting policy choices and quantification of adjustments?
- **Are you on top of what enterprises in your peer group are doing?** – Tap into any industry groups that you can join, and ask questions to check your own progress.
- **Training strategy for your accountants** – Will you adopt a “big bang” training course or take a workshop approach to specific topics?
- **Budgets and management reporting** – How will you deal with 2011 budget preparation when, in 2010, you will still be reporting under Canadian GAAP?
- **Control certification** – IFRS is complex and brings change; both elements increase the risks and required controls that will need to be documented.
- **Have you identified the benefits that may arise from your transition project?** – Do you have a group accounting manual? Do you wish for consistent and faster consolidation processes? Are your current IT processes streamlined? An IFRS conversion project has the potential to be much more than just a compliance exercise.

## KPMG's IFRS resources

Look to KPMG for assistance and information to support your conversion to IFRS.

IFRS conversion projects are challenging. Canadian enterprises' projects will differ from those of the first wave of adopters in Europe and Australia, reflecting the current Canadian accounting requirements as well as the regulatory environment, quarterly reporting, and internal control certifications.

You can, however, learn much from the experiences of the first wave. KPMG has a team of professionals in Canada, who have literally "done it before." They are available to assist you in managing your conversion, whether or not you need to accelerate your project right away.

### For further information

KPMG provides many materials to help Canadian enterprises in not only understanding the standards and their ongoing evolution but also developing and refining their own plans for adopting IFRS. Here are a few examples:

- *IFRS Briefing*, our regular e-newsletter, can help you to track IFRS developments internationally and in Canada.
- *IFRS compared to Canadian GAAP: An overview (Second Edition 2008/9)* can help you to understand the significant differences between IFRS and Canadian GAAP. An updated third edition (2009/2010) will be released at the end of 2009.
- Our series of brief, industry-specific publications highlight the top IFRS accounting issues for a wide variety of sectors.
- *IFRS Conversion: Implications for CEO and CFO Certification* focuses on some of the issues affecting disclosure controls and procedures, and internal control over financial reporting that certifying officers of non-venture issuers should be considering as their company prepares to move to IFRS.

- Other publications in our Managing the Transition series include ideas that continue to be relevant for your conversion project; for example: *Managing the Transition to IFRS: Moving forward* (January 2009); *Managing the Transition to IFRS: Clearing the path to 2011* (April 2008).
- *The Effects of IFRS on Information Systems* can help you to benefit from the IFRS implementation experience in Europe and Australia. Many companies found that, while their conversion initially appeared to be an accounting challenge, it quickly evolved into a multifaceted business initiative involving systems and processes, people and change management, and other business considerations.
- For more detailed guidance on the application of IFRS in practice, such sources as *Insights into IFRS: practical guide to International Financial Reporting Standards* can be extremely helpful. These publications are available in electronic, searchable format through **Accounting Research Online** at [www.aro.kpmg.com](http://www.aro.kpmg.com). Take advantage of a free trial subscription.

Visit our Web site, [www.kpmg.ca/ifrs](http://www.kpmg.ca/ifrs), for easy access to these and other KPMG publications.

## Contact us

If you have questions or issues you would like to discuss, please get in touch with a member of your KPMG engagement team or one of our IFRS professionals, some of whom are listed below.

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