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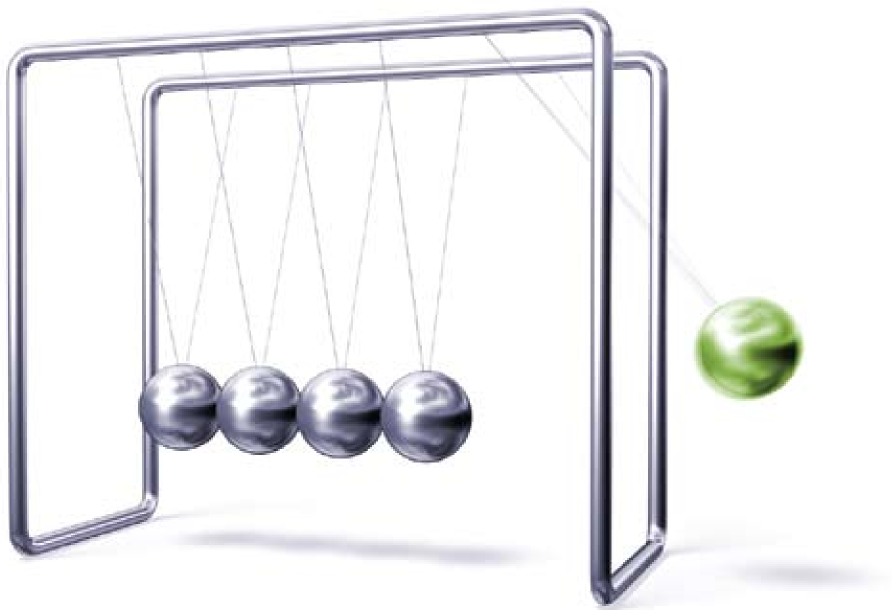

How to monitor a sea change

Discussing your IFRS changeover plan in the MD&A

The conversion of Canadian financial reporting standards to International Financial Reporting Standards ("IFRS") is likely to cause significant changes in the financial reporting practices of virtually all Publicly Accountable Entities, including all Reporting Issuers regulated by the Canadian Securities Administrators ("CSA"). In Staff Notice 52-320, *Disclosure of Expected Changes in Accounting Policies Relating to Changeover to International Financial Reporting Standards* (the "Staff Notice"), the Staff of the CSA provide guidance on their expectations of matters that they expect Reporting Issuers to discuss in an entity's management's discussion and analysis ("MD&A") in the time period leading up to conversion, which for most entities is expected to be on or about January 1, 2011.

Disclosure of changeover plans is expected for entities that at the time of issuing an interim MD&A have developed a changeover plan, but in no case should that discussion be provided later than in the annual MD&A published for the period three years before the changeover date. For most entities, this means the annual MD&A for 2008, with consideration to be given to quarterly disclosures during 2008.

The contents of a changeover plan

The Staff Notice recommends the discussion of key elements and the timing of an entity's changeover plan. The elements of a changeover plan can be conceptually considered as focusing on two parts:

- The production of IFRS-compliant financial statements delivered as of the entity's conversion date, which will likely be the first quarterly statements published in 2011; and

- Collateral matters, being those matters necessary to accomplish the conversion and to deal with its collateral effects.

IFRS Compliant financial statements

The entity's progress towards completing its first financial statements produced under IFRS is clearly a principal focus of the MD&A discussion. Matters considered in this discussion should include:

- Major identified differences between accounting policies under Canadian generally accepted accounting principles ("GAAP") and accounting policy choices under IFRS, both on an ongoing basis and with respect to certain choices to effect conversion, made in accordance with IFRS 1, First-time Adoption of International Financial Reporting Standards;
- A narrative description of such decisions; and
- Progress towards the quantification of key elements of the financial statements.

As the Staff Notice states, "As an issuer moves closer to its changeover date, the issuer should consider how it might make available meaningful quantified information to allow investors to understand the impact of IFRS on the issuer's financial statements." However, the decision to publish quantitative implications of conversion is somewhat complicated by the existence of options and alternatives, which are discussed on page 6.

Collateral matters

In addition to changing the structure and content of financial statements, the adoption of IFRS is also likely to have collateral effects on the financial reporting and business processes of an entity. The Staff Notice identifies matters that can be grouped in three categories:

- Infrastructure, including expertise and information systems;
- Business activities, including: contractual implications of IFRS on financing relationships and other arrangements; business policies, such as hedging and sales practices; compensation policies, to the extent they rely upon indicators derived from the financial statements; and capital adequacy issues; and
- Control activities, including the operation of internal controls over financial reporting ("ICFR") and disclosure controls and procedures ("DC&P") during the period of the changeover plan.

Infrastructure

The production of IFRS-compliant financial statements is predicated on the existence of appropriate human and technology resources. The development of IFRS expertise in the entity's financial reporting functions should be the organization's the first order of business. The development of this expertise should extend from the line and staff functions through to the Board of Directors – and in particular the members of the Audit Committee. The systematic production of IFRS-compliant financial statements by an entity's information technology platform may involve the detailed reprogramming of general ledger routines and the collection of data not previously required under Canadian GAAP. The lead times and control environments governing IT systems may make this one of the more challenging areas of conversion.

Business activities

It is a well-known adage in sports that changing the rules changes the way the game is played. The adoption of IFRS changes the rules of financial reporting: the optimal conduct of business may be different under IFRS. In some circumstances, the changes may be compelled by existing contracts or statutes: compliance with debt covenants and regulatory capital requirements, for example, are usually driven in part by GAAP measures which may differ with a change to IFRS. Such covenants may need to be renegotiated by the parties. Risk management policies may be changed, for example, by the determination of a different functional currency for the entity. Compensation contracts may need to be modified to reflect new accounting policies permitting the recognition in income of recoveries of impairment, and of fair values of investment properties. Finally, sales contracting and purchasing procedures may be modified to reflect the effects of new revenue recognition policies adopted on conversion to IFRS.

Control activities

The conversion to IFRS does not absolve reporting issuers of the need to comply with CSA Multilateral Instrument ("MI") MI 52-109, *Certification of Disclosure in Issuers' Annual and Interim Filings*, including the certification of internal controls. This means that processes need to be in place to permit the required certifications to be provided on and after the date of conversion to IFRS. Processes should be in place to ensure that no material error has taken place in the implementation of IFRS. This requires a comprehensive set of change management protocols so that the evidence required for those assertions can be assembled by management. Similar challenges face the entity's disclosure processes: for example, controls and procedures should establish the accuracy of statements made in the MD&A concerning the changeover plan. Announcing the consequences of accounting policy determinations as suggested by the Staff Notice presents another challenge to disclosure controls: when will an entity "know" that an accounting policy and its effects have been determined with sufficient certainty to provide before-the-fact communication when the financial statements are not yet finalized and/or published?

Describing a changeover plan – and its status

An IFRS changeover plan needs to address the key dimensions that challenge the conversion process. As outlined above, these are:

1 the **discrete tasks**, such as financial statement completion, infrastructure development, and business policy reviews, stated in both aggregate and disaggregated form, that need to be completed in order to produce IFRS-compliant financial statements and the related collateral activities;

2 the **timeline** for such tasks, identifying the time remaining for each activity (which may not be the same, as conditions precedent may have to be fulfilled before finalization can proceed);

3 A **measure of the hours** or other resources needed to complete the task so that the magnitude of the effort needed to complete the task can be assessed;

4 A **prioritization schedule** for such tasks, identifying which activities need to be completed before subsequent ones; and

5 An indication of the extent to which there are **interactions or interdependencies** between various tasks, such as accounting policy determination and financial statement ratio requirements of debt covenants.

A example of one possible format for a qualitative narrative version of the discussion in the MD&A of a changeover plan, and an assessment of progress towards it, is provided on the right. The dates and activities, while considered typical, are not all-inclusive and are only examples, and accordingly entities should determine the specific activities and timelines appropriate for their own circumstances. Once quantitative disclosures have been prepared and reviewed, and are available for disclosure, the format for such disclosure should be carefully considered in order to provide relevant and factual information.

XYZ Corp. sample IFRS changeover plan: Assessment as of [December 31, 2008]

Key activity	Milestones/deadlines	Effort accomplished/ remaining effort to complete
Financial statement preparation: Identification of differences in Canadian GAAP/IFRS accounting policies and choices • selection of entity's continuing IFRS policies • selection of IFRS 1 accounting policy choices • Financial statement format • quantification of effects of change in IFRS 1 disclosures and 2010 financial statements including note disclosure	Ready for commencement of planning for 2011 fiscal year (Approximately 3rd quarter, 2010)	Significant accounting policy choices identified; remaining activities underway
Infrastructure: IFRS expertise identification and development at level of • Operating division accounting staff • Head office and consolidation group • Senior Executive and Board level, including Audit Committee	Ready for commencement of 2010 conversion exercise (approximately 2nd quarter, 2010)	Leadership team/expert resources identified: level 1 training underway
Infrastructure: Information technology • Systematic processing changes • Program upgrades/changes • One-off calculations (IFRS 1) • Disclosure data gathering • Scope of consolidation package • Budget/plan/ forecast monitoring process	Ready for parallel processing of 2010 general ledgers and planning/monitoring processes	Scoping study completed: resource assessment underway
Business Policy Assessment Financial covenants and practices (including securitization program)	Renegotiated covenants by June 30, 2010; replacement securitization program: by September 30, 2010	Identification of all relevant GAAP-dependent covenants and contracts complete; assessment of alternative securitization vehicles underway
Business policy assessment Compensation arrangements	Renegotiated arrangements by 3rd Quarter 2010	Identification of metrics affected by GAAP/IFRS
Business policy assessment Capital Adequacy	Capital plan completed by June 30, 2010	Completion of capital change model
Business policy assessment Customer and supplier contract evaluation	Review of customer/supplier contracts and revenue/cost recognition model by 1st quarter 2010	All revenue contracts and supply contracts assembled; evaluation of IFRS consequences underway
Control environment: ICFR • Accounting policy determination, documentation and implementation • Independent review of applications • Error processing facilities	Review and sign off by management, and review by the Audit Committee, of all accounting policy changes by Sept 30, 2010; implementation audit by Internal Audit, 4th quarter, 2010; CEO/CFO certification process updated by 4th quarter 2010	Identification of all material sites underway; accounting policies manual rewrite team assembled
Control environment: DC&P • Investor day 2011 requirements re: guidance, expected earnings • MD&A communications package verification • Responses to queries	Publication of material changes in policy, expectations, January 10, 2011 (Investor Day); Publication of revised 2010 results and MD&A by March 30, 2011	Standard comment on IFRS inquiries drafted; Investor Day 2011 organized;

Interaction effects can be expected to occur

No changeover plan to convert to IFRS should be published without recognition of the potential for significant interactions to exist between accounting policy choices under IFRS in general and under IFRS 1 (applicable only on the date of conversion) and other aspects of the entity's financial policies and condition.

For example, there are a variety of options that an entity may elect upon its first-time adoption of IFRS. These include:

- Setting all accumulated actuarial gains and losses in defined benefit pension plans to nil;
- Setting all cumulative translation gains or losses for self-sustaining foreign operations to nil; and
- Electing to deem the fair value of individual items of property, plant and equipment determined on the date of conversion as the opening cost of those items.

Depending upon the circumstances, the decision to employ one or all of these options may have a significant impact on the opening balance of the entity's retained earnings, and on the subsequent income recognized from operations involving the realization of such amounts.

Furthermore, the balance of the amounts of such accounts at the date of conversion (that is, January 1, 2010 for a calendar year entity) will likely not be known with certainty (although there may be very good estimates) until early in 2010. The balances as of the date of adoption of IFRS – the first full year in which comparative statements are published – will likely not be known with certainty until the close of the 2010 fiscal year – sometime in early 2011, when the entity's 2010 financial statements and its IFRS policies will need to be formally approved by management and the entity's governance body: until that point, there is always the possibility of change.

Accordingly, some entities may not be in a position to formally declare their accounting policy choices until close to the last possible moment – January 1, 2011, being the first day such policies need be applied. In addition, entities may be unable to determine with certainty the quantitative implications of policy choices until the dust has settled on all decisions. Prudence would suggest that an announcement of the effect that any particular accounting policy decision may have on the financial statements should be made only if all remaining decisions would not offset or negate the effects of the decisions already made.

Disclaimer

Given these potential circumstances, it may be prudent to ensure that MD&A discussions of IFRS accounting policy choices are accompanied by a disclaimer such as the following, to the effect that "there may be significant changes in financial condition that may occur, and in the nature and materiality of accounting policy choices that may be made by management, between the present date and the date of formal transition to IFRS, which is expected to be January 1, 2011. No inferences should be made about the individual or aggregate effects of the conversion of the financial statements to IFRS until the entity publishes its opening IFRS balance sheet as at January 1, 2010 and related IFRS 1 disclosures, which may not occur until the first quarter of 2011." In our view, such decisions and disclaimers should be made in consultation with the entity's Audit Committee and, where appropriate, its legal counsel.