Accounting alert

Canadian Securities Administrators approve IFRS-Related Amendments to Securities Rules and Policies

October 12, 2010

On October 1, 2010 the Canadian Securities Administrators (CSA) approved the following materials that will be effective for January 1, 2011:

- National Instrument 52-107, *Acceptable Accounting Principles and Auditing Standards* (NI 52-107);
- Companion Policy 52-107CP, *Acceptable Accounting Principles and Auditing Standards* (Companion Policy 52-107CP); and
- Amendments to National Instrument 14-101, *Definitions* (NI 14-101).

These materials are collectively referred to as the "Final Materials". The Final Materials reflect the changeover to International Financial Reporting Standards (IFRS) as well as changes from adopting International Standards on Auditing.

The CSA also published amendments to other National Instruments, Forms and Companion Policies to reflect the changeover to IFRS in the continuous disclosure rules, prospectus rules and certification disclosures. These amendments include:

- National Instrument 51-102 *Continuous Disclosure Obligations*
- National Instrument 41-101 *General Prospectus Requirements*
- National Instrument 44-101 *Short Form Prospectus Distributions*
- National Instrument 44-102 *Shelf Distributions*
- National Instrument 71-102 *Continuous Disclosure and Other Exemptions Relating to Foreign Issuers*
- National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*
- National Instrument 31-103 *Registration Requirements and Exemptions*
- National Instrument 33-109 *Registration Information Requirements*
- National Instrument 45-106 *Prospectus and Registration Exemptions*
- National Instrument 13-101 *System for Electronic Document Analysis and Retrieval (SEDAR)*
- National Instrument 21-101 *Marketplace Operations*
- National Instrument 52-110 *Audit Committees*
- National Instrument 54-101 *Communication with Beneficial Owners of Securities of a Reporting Issuer*
- Multilateral Instrument 11-102 *Passport System and its Companion Policy*
- Multilateral Instrument 62-104 *Take-over Bids and Issuer Bids*
- National Policy 12-202 *Revocation of a Compliance-related Cease Trade Order*
- National Policy 12-203 *Cease Trade Orders for Continuous Disclosure Defaults*

The Accounting Standards Board (AcSB) has incorporated IFRS into the Canadian Institute of Chartered Accountants (CICA) Handbook as Canadian GAAP for publicly accountable enterprises. The CICA Handbook currently has two sets of standards applicable to public entities. These are:

- Part I – Canadian Generally Accepted Accounting Principles (Canadian GAAP) for publicly accountable enterprises that will apply for financial years beginning on or after January 1, 2011 (the mandatory effective date), and
- Part V – Canadian GAAP for public enterprises which are the standards constituting Canadian GAAP before the mandatory effective date (i.e. current Canadian GAAP).

The Canadian Auditing and Assurance Standards Board published its strategic plan to adopt International Standards on Auditing (ISAs) as Canadian Auditing Standards (CASs) in February 2007. The effective date for CASs is for audits of financial statements for periods ending on or after December 14, 2010. Auditing standards will continue to be known as Canadian Generally Accepted Auditing Standards (Canadian GAAS) within the various securities rules.

Financial Statement Requirements

Domestic Issuers

The Final Materials outline the financial statement requirements for **domestic issuers** for financial years beginning on or after January 1, 2011:

- annual financial statements and interim financial reports must be prepared in accordance with Canadian GAAP applicable to publicly accountable enterprises;
- **annual financial statements** must include an unreserved statement of compliance with IFRS;
- **interim financial reports** must include an unreserved statement of compliance with IAS 34, *Interim Financial Reporting*; and,
- an auditor's report accompanying an issuer's annual financial statements must **refer to IFRS** as their applicable fair presentation framework and be in the form specified by Canadian GAAS for financial statements prepared in accordance with a fair presentation framework.[1]

A **domestic issuer** who is also an SEC issuer (SEC issuer) will continue to have the option to use U.S. GAAP. However, the proposed changes eliminate the requirement for an SEC issuer that previously used Canadian GAAP and changed to U.S. GAAP, to reconcile its financial statements to Canadian GAAP for two years. This is effective for financial years beginning on or after January 1, 2011. If an SEC issuer changes from Canadian GAAP to U.S. GAAP in 2010, the SEC issuer will only prepare a one-year reconciliation for 2010.

Foreign Issuers

For **foreign issuers**, the Final Materials outline the acceptable accounting principles which are IFRS, U.S. GAAP (if the issuer is also an SEC issuer), accounting principles for foreign private issuers in the U.S., and accounting principles of designated foreign jurisdictions (if the issuer is a designated foreign issuer as defined in NI 52-107). The Final Materials remove the option of preparing financial statements in accordance with the same core subject matter as current Canadian GAAP.

Domestic Registrants

The Final Materials require that, for financial years beginning on or after January 1, 2011, **domestic registrants**[2] prepare**:**

- annual financial statements and interim financial information in accordance with Canadian GAAP applicable to publicly accountable enterprises, except that any investments in subsidiaries, jointly controlled entities and associates must be accounted for as specified for separate financial statements in accordance with IAS 27 *Consolidated and Separate Financial Statements.* Separate financial statements are sometimes referred to as non-consolidated financial statements.
- financial statements and interim financial information for periods relating to a financial year beginning in 2011 may exclude comparative information relating to the preceding financial year;

[1] The auditor's report must indicate that the financial statements are in accordance with IFRS. However, this does not limit a company from also referring to the financial statements being prepared in accordance with IFRS and Canadian GAAP for publicly accountable enterprises in the auditor's report. The additional reference to Canadian GAAP for publicly accountable enterprises may be required when an entity is party to a contract which requires compliance with Canadian GAAP and the financial statements are required to be furnished to the counterparty to demonstrate such compliance. In summary, the auditor's report must be consistent with the basis of presentation disclosed in the notes to the financial statements.

[2] Domestic registrants, as described in CSA Staff Notice 33-314 International Financial Reporting Standards and Registrants, are entities regulated directly by the Canadian securities regulatory authorities that are not members of a self regulatory organization, such as the Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA). Domestic registrants include investment counsel and portfolio managers, limited market dealers, exchange contracts dealers, scholarship plan dealers, restricted dealers and, in Québec, mutual fund dealers.

- annual financial statements must include a statement that the financial statements are prepared in accordance with the financial reporting framework specified in NI 52-107 for financial statements delivered by registrants, and must also describe the framework; and
- the auditor's report accompanying financial statements must be in the form specified by Canadian GAAS for an audit of financial statements prepared in accordance with a fair presentation framework.

Extension periods

The amendments to NI 51-102 provide for a 30 day extension for reporting issuers to file the first interim financial report in the year of adopting. Thus, a non-venture issuer will have 75 days to file the first interim financial report and a venture issuer will have 90 days to file the first interim financial report. There is no extension for filing subsequent interim financial reports or the first IFRS annual financial statements.

This extension only applies to reporting issuers. Accordingly, if a non-reporting issuer is preparing an IPO prospectus, it must include the first interim financial report prepared in accordance with IFRS within the standard timeline.

General Requirements

The financial statements for domestic issuers, domestic registrants, and foreign issuers must be prepared using the same accounting principles for all periods presented. However, the Final Materials do not require all financial statements included in a document to be prepared using the same accounting principles if more than one set of financial statements are included in a document. For example, in a business acquisition report which requires the presentation of both annual and interim financial statements, these financial statements may be prepared using both current Canadian GAAP and IFRS. Additionally certain offering documents may include both Canadian GAAP and IFRS. For example, an IPO prospectus filed in 2011 may include annual financial statements prepared in accordance with current Canadian GAAP and an interim financial report that complies with IFRS.

In instances where financial statements to be included in a document predate the IFRS transition date, the Final Materials clarify that two different financial statement formats are allowed to meet the requirement that financial statements must be prepared using the same accounting principles for all periods presented. NI 52-107CP states the following example – if the earliest of the three financial years relates to a financial year beginning before January 1, 2010, the issuer should provide one set of financial statements that presents information for the most recent two years using the accounting principles in Part 3 of the Instrument (Part 3 of NI 52-107 relates to rules applying to financial years beginning on or after January 1, 2011), and one set of financial statements that either:

a) presents information for a third and fourth year using the accounting principles in Part 4 (Part 4 of NI 52-107 relates to rules applying to financial years beginning before January 1, 2011), or

b) presents information for a second and third year using the accounting principles in Part 4.

Note that under option (a), a fourth year not otherwise required would be included to satisfy the requirement in the issuer's GAAP for comparative financial statements. Under option (b), information for a second year would be presented in both sets of financial statements. This second year would be included in the most recent set of financial statements using accounting principles in Part 3 of the Instrument and also in the earliest set of financial statements using accounting principles in Part 4 of the Instrument.

Acquisition statements and pro forma financial statements:

The Final Materials allow acquisition statements to be prepared in accordance with the following accounting principles – Canadian GAAP applicable to publicly accountable enterprises, IFRS, U.S. GAAP, SEC accounting principles for foreign private issuers, Canadian GAAP applicable to private enterprises (if certain conditions are met), and designated foreign issuer accounting principles.

For acquisition statements prepared in IFRS or U.S. GAAP, no reconciliation to the issuer's GAAP will be required, whereas acquisition statements prepared under the disclosure requirements of a Designated Foreign Jurisdiction require reconciliation to the issuer's GAAP. For acquisition statements prepared under Canadian GAAP applicable to private enterprises, the requirement to provide a reconciliation is triggered by the nature of the issuer. In all cases where the acquisition statements do not need to be reconciled to the issuer's GAAP, pro forma adjustments to conform amounts to the issuer's accounting policies will still be necessary.

Canadian GAAP applicable to private enterprises

The Final Materials **allow acquisition statements to be prepared in accordance with Accounting Standards for Private Enterprises,** if certain conditions are met. The Final Materials refer to these standards as Canadian GAAP applicable to private enterprises. Canadian GAAP applicable to private enterprises is allowed for acquisition statements if the following 3 conditions are met:

1. The acquisition statements consolidate any subsidiaries and account for significantly influenced investees and joint ventures using the equity method;
2. Financial statements for the acquired business were not previously prepared under other allowable accounting principles; and
3. The acquisition statements are accompanied by a notice stating:

    These financial statements are prepared in accordance with Canadian GAAP applicable to private enterprises, which are Canadian accounting standards for private enterprises in Part II of the Handbook.

    The recognition, measurement and disclosure requirements of Canadian GAAP applicable to private enterprises differ from those of Canadian GAAP applicable to publicly accountable enterprises, which are International Financial Reporting Standards incorporated into the Handbook.

    The pro forma financial statements included in the document include adjustments relating to the [insert "acquired business" or "business to be acquired" as applicable] and present pro forma information prepared using principles that are consistent with the accounting principles used by the issuer.

The CSA also developed different reconciliation requirements for non-venture and venture issuers after considering the costs to prepare reconciliations and informational needs of investors and their advisors.

For **non-venture issuers**, acquisition statements prepared using Canadian GAAP applicable to private enterprises must be reconciled to the issuer's GAAP for all annual periods and the most recently completed interim period and the reconciliation to the issuer's GAAP for the most recently completed financial year is subject to audit. The reconciliation must:

a) describe the material differences between the issuer's GAAP and the accounting principles used to prepare the acquisition statements that relate to recognition, measurement and presentation,

b) quantify the effect of each difference referred to in clause (A), and include a tabular reconciliation between profit or loss reported in the acquisition statements and profit or loss computed in accordance with the issuer's GAAP, and

c) for each difference referred to in clause (A) that relates to measurement, disclose and discuss the material inputs or assumptions underlying the measurement of the relevant amount computed in accordance with the issuer's GAAP, consistent with the disclosure requirements of the issuer's GAAP. The required disclosure only relates to disclosure and discussion of material inputs and assumptions relating to items quantified in the reconciliation. It does not require all of the required disclosure elements identified under the issuer's GAAP.

For **venture issuers**, a reconciliation to the issuer's GAAP is not required for acquisition statements prepared using Canadian GAAP applicable to private enterprises. However, as pro forma financial statements must be prepared using principles that are consistent with the issuer's GAAP, non-venture pro forma financial statements will require pro forma adjustments to reconcile to the issuer's GAAP. Note, if acquisition statements are included in an initial public offering (IPO) for a venture issuer, a reconciliation in all annual financial statements and most recently completed interim financial statements will be required, and the reconciliation for the most recent annual period is subject to audit.

Designated Foreign Jurisdiction

Acquisition statements prepared in accordance with accounting principles that meet the disclosure requirements of a designated foreign jurisdiction continue to have the requirement of a reconciliation to the issuer's GAAP. Thus, consistent with current rules, the acquisition statements would be required to be reconciled for the annual financial statements and the most recent interim period (if applicable), and the most recent annual financial statement reconciliation would be subject to audit. These requirements are consistent for both venture and non-venture issuers.

Pro forma Financial Statements

The CSA has clarified in the Final Materials that pro forma financial statements should be prepared in accordance with the issuer's GAAP. However if accounting principles used to prepare an issuer's most recent annual financial statements differ from the accounting principles used to prepare the issuer's interim financial report for a subsequent period, the issuer may use the accounting principles used to prepare the interim financial report for the annual pro forma period.

Essentially this allows an entity that files pro forma statements in a document during the 2011 year to prepare its pro forma financial statements under either; 1) Part V Canadian GAAP for the annual pro forma period and Canadian GAAP applicable to publicly accountable entities for the interim pro forma period, or 2) Canadian GAAP applicable to publicly accountable entities for both the annual and interim pro forma periods despite the fact that the annuals were most recently issued under Part V Canadian GAAP.

Significance Tests

Under the continuous disclosure rules the CSA has clarified what accounting principles to use for the calculation for the significance tests. For all issuers other than venture issuers, significance tests must be calculated based on the issuers GAAP. For venture issuer's acquisition statements which are prepared under Canadian GAAP applicable to private enterprises, significance test calculations do not need to be in accordance with the issuer's GAAP, and the calculations are allowed to be performed under Canadian GAAP applicable to private enterprises, with certain conditions specified in amended NI 51-102.

IFRS 1 Reconciliation

IFRS 1 *First-time Adoption of International Financial Reporting Standards* (IFRS 1) reconciliations and the transition opening statement of financial position are required to be presented in the first interim financial report and the first annual financial statements. This disclosure is not required in the second and third interim financial reports under the continuous disclosure rules unless there has been a change in accounting policy. However, if an issuer files an Initial Public Offering (IPO) prospectus, and was not a reporting issuer in at least one jurisdiction immediately before filing the prospectus, there is a requirement to include IFRS 1 disclosures at the time when the second or third quarter interim financial report is required to be included in the prospectus, and the first quarter interim financial report is no longer required to be included in the prospectus. To satisfy this requirement, the issuer may include the first interim financial report as well as the required second or third interim financial report, as the first interim report has all the required reconciliations, or include the required IFRS 1 transition disclosure within the current interim report.

Other

IFRS requires only a statement of cash flows for the year to date period and the corresponding comparative period, whereas current Canadian GAAP requires issuers to present a cash flow statement in their interim financial statements for the current three month interim period and year to date cumulative period, with comparatives. The amendments to NI 51-102 contemplate this change and only require a cash flow statement for the year to date periods

The continuous disclosure rules NI 51-102 now include a transitional provision which provides that the amendments may be applied to financial years beginning before January 1, 2011 if the immediately preceding year ends no earlier than December 21, 1010. This essentially allows reporting issuers with 52 or 53 week financial years to adopt IFRS when their new financial year begins.

The Final Materials include an exemption that allows a rate regulated qualifying entity to continue to be allowed to use Canadian GAAP under Part V of the CICA Handbook, and to defer the implementation of IFRS for up to one year.

The CSA support the AcSB's deferral of the mandatory adoption of IFRS for investment companies to financial years beginning on or after January 1, 2012. This deferral will permit entities whose financial statements are currently subject to Accounting Guideline 18 and will be impacted by the IASB's consolidation project to attain certainty about IFRS requirements for accounting for investment holdings.

The CSA expects to publish final IFRS-related materials for National Instrument 81-106 *Investment Fund Continuous Disclosure* once the IASB revised standard on consolidation for investment companies is final in 2011.

Final Materials

The Final Materials can be accessed at:

- http://www.osc.gov.on.ca/en/NewsEvents_nr_20101001_csa-approve-ifrs.htm?homelink=NREN&id=29348

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