



Approaching the transition date

Canadian Audit Committee Network (CACN) members agreed to devote a portion of each network meeting in 2010 to discussion of the status of the transition to International Financial Reporting Standards (IFRS) from Canadian Generally Accepted Accounting Principles (GAAP). Members discussed progress on open questions raised in prior sessions and emerging issues as they approach year end and look ahead to 2011.¹

As they approach the fourth quarter of 2010, audit committees and external auditors are beginning to review the audited opening 2010 IFRS balance sheet. Members remain comfortable that their companies are well prepared for transition and expect a relatively limited impact from the conversion. Still, some policy decisions remain, and though members report significant coordination within industry groups, they continue to express frustration over the lack of clarity from standards that are still in flux. Discussion focused on the following regarding their companies' transition status:

- **Confidence in preparedness has increased over time.** Members of the CACN were comfortable with their companies' planning, organization, and processes when the group first began discussing the transition to IFRS in January. When asked to rate management's readiness and progress in September 2009, several members rated management as a 7, 8, or 9 out of 10, but acknowledged that audit committees still had work to do to catch up. Since then, confidence has grown as audit committees have begun reviewing the 2010 opening balance sheets and are preparing to review their financial statement notes under IFRS: members rated their readiness at 8 or 9 out of 10.
- **Audit committees see limited impact on financial statements.** CACN members reported a limited impact on income statements, with more changes to balance sheets under IFRS accounting. Several agreed with one member who said that the IFRS transition process involves *"an amazing amount of work, but with limited impact."* Members did note substantial differences in the accounting for specific items like convertible debentures and said that because balance sheets are typically more impacted than income statements, companies in financial services, *"book-value based companies,"* are seeing a greater impact.
- **Analysts are not focused on the impact of IFRS.** In discussions prior to the meeting, several audit committee chairs questioned whether more education was necessary to bring analysts up to speed on the potential impact of IFRS, including on an industry-wide basis. During the meeting, some members suggested analysts were surprised by specific impacts, which demonstrated that, as one said, *"analysts are nowhere near where they need to be [in understanding IFRS]."* But members generally agreed that analysts tend to focus on cash flow, which should not change significantly under IFRS. One member said, *"EBITDA hasn't changed or the balance sheet impact is typically from charges that are easy to explain."* Because of the impact on balance sheets, financial institutions may need to spend more time educating analysts. The supplemental information will be substantial, but

¹ See Canadian Audit Committee Network, ["IFRS update: confidence in progress as the conversion date approaches."](#) *IFRS Update*, July 14, 2010.



most audit committees expect analysts will pay little attention, though in some industries analysts have begun producing related research.

- **Some short-term compensation metrics could be impacted.** Several audit committees have begun reviewing compensation plans with the compensation committee to consider any potential impact from IFRS. Most see little or no impact on long-term incentives, but some companies are seeing an impact on short-term metrics like earnings per share.
- **Reviewing financial statement notes is the next step.** One member noted that initial financial statement notes under more principles-based IFRS *“could be extensive – it is quite daunting.”* Another quipped that companies will need *“an MD&A just to explain the notes”* in the first year. In order to work through them, audit committees are considering scheduling separate meetings before year end for the sole purpose of reviewing the notes and disclosures with management, *“rather than try to squeeze it into a regular [audit committee] agenda.”*

Looking ahead, members discussed next steps for management and the audit committee, and the questions and challenges they will face:

- **Audit committee must ensure systems are ready.** When the CACN met in June, a member said, *“It is basically a manual, spreadsheet-based process through 2010. You won’t know if everything works until you get there in the first quarter of 2011.”* As they approach that date, members emphasized the need to be sure systems are updated and IFRS accounting processes are formalized across the globe. One member said, *“Much of this has been focused around the corporate office, a central team, working on spreadsheets, etc. We need to get that process embedded throughout the organization around the globe.”* This is critical to ensure controls are in place and effective, and especially so for SOX 404 compliance for SEC registrants.
- **Achieving global consistency will be challenging.** Members expressed concerns about ongoing questions regarding US adoption of IFRS, the potential for adoption of variations of IFRS in different markets, and the impact of ongoing changes related to IFRS-US GAAP convergence projects. One member observed, *“Accounting for insurance contracts will be up in the air for 2–3 years. How Europeans do it compared to the US, compared to Canada – they are trying to reconcile. They expect some compromise in 2012, but there is some suggestion that there will still be a lot of leeway.”* Members also noted that the leaders of the International Accounting Standards Board and the US Financial Accounting Standards Board both recently announced they would be leaving, which may slow progress on convergence and adoption of IFRS in the United States. Over time, members are concerned about the potential for differences in interpretation across markets. Avoiding different interpretations across locations will require auditors to consult with their teams globally for companies with international operations.
- **Companies are considering how best to handle ongoing changes to IFRS.** Companies put together teams to manage the transition to IFRS, but changes are expected well beyond the transition date. Members do not expect to keep project teams intact; instead, most will embed responsibility for managing ongoing changes within the businesses.



Appendix: Questions for audit committees

- ? Are you comfortable with management's preparation for reporting under IFRS? With the audit committee's level of understanding? The full board's?
- ? What has been the greatest impact on financials from the transition to IFRS? Have there been any surprises?
- ? How is your audit committee planning to review financial statement notes?
- ? Has the audit committee reviewed the potential impact on compensation plans with the compensation committee?
- ? After the official transition date, what are the biggest ongoing challenges for the audit committee?
- ? How does the company plan to handle ongoing accounting changes?

About this document

The Canadian Audit Committee Network is a group of audit committee chairs drawn from leading companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is convened by Ernst & Young and orchestrated by Tapestry Networks to access emerging best practices and share insights into issues that dominate the new audit committee environment.

IFRS Update is produced by Tapestry Networks to stimulate timely, substantive board discussions about the choices confronting audit committee members, management, and their advisers as companies transition from current Canadian Generally Accepted Accounting Principles to International Financial Reporting Standards. The ultimate value of *IFRS Update* lies in its power to help all constituencies develop their own informed points of view on these important issues. Anyone who receives *IFRS Update* may share it with those in their own network. The more board members, members of management, and advisers who become systematically engaged in this dialogue, the more value will be created for all.

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