

# AcSB Publicly Accountable Enterprises Strategy

## Accounting Standards Board's Implementation Plan for Incorporating International Financial Reporting Standards (IFRSs) into Canadian GAAP

**Progress Review — Preliminary Report, October 2007**

### Executive Summary

The progress review is a work in progress. This document summarizes activities and findings to date. The progress review will continue in the coming months. The AcSB's final decision regarding the date of adoption of IFRSs for Canadian publicly-accountable enterprises will be made on completion of the review, no later than March 31, 2008.

#### Introduction

This preliminary report on the Accounting Standards Board's (AcSB) progress review is for discussion with the Accounting Standards Oversight Council (AcSOC) in October 2007. The AcSB anticipates providing AcSOC with a final report in February 2008. On the basis of the completed progress review, the AcSB will confirm (or vary), no later than March 31, 2008, the expected IFRS changeover date of January 1, 2011.

The purpose of the progress review is to identify and assess any new information or new issues that would affect the AcSB's implementation of IFRSs for Canadian publicly accountable enterprises. This report evaluates three main considerations:

- Is sufficient progress being made in Canada in establishing the infrastructure for IFRS implementation?
- Were there any significant difficulties encountered in the initial adoption or ongoing application of IFRSs in the European Union, Australia, and other countries that the AcSB should consider in determining the timing of implementing the strategy for publicly accountable enterprises?
- Does the International Accounting Standards Board (IASB) continue to develop high-quality standards that are accepted as contributing to the improved functioning of global capital markets?

## Is sufficient progress being made in Canada in establishing the infrastructure for IFRS implementation?

The AcSB Chair and staff have met with Canadian securities and financial institutions regulators, financial analysts, major industry groups, financial statement preparers, academics and the AcSB's IFRS Advisory Committee. AcSB staff also plans to conduct roundtable discussions in November and December 2007 involving these groups, as well as smaller publicly accountable enterprises, major accounting firms and accountancy bodies, and other interested parties in Canada.

Our initial discussions have highlighted a number of challenges to be faced in preparing for the changeover, including the following:

- Challenges with training and education and finding sufficient skilled resources to support the changeover. Educators are, however, actively developing training materials and are beginning the process of updating textbooks and course curricula to reflect the change. Internal and external training courses are becoming more readily available.
- Oil and gas companies have expressed concerns over the extent to which the current Canadian standard for full cost accounting (the accounting method used by most oil and gas companies in Canada) might be inconsistent with IFRSs. Entities with rate-regulated operations have expressed concerns about the application of IFRSs to those operations. The AcSB Chair and staff are working with the affected industries and others to fully evaluate these concerns and what might be done to alleviate them.
- Constituents require clarity about the early adoption of IFRSs and the continued use of US GAAP in Canada, as well as the expected transitional disclosures to help financial statement users understand the effects of the adoption of IFRSs. Decisions about these items are largely in the hands of the Canadian Securities Administrators (CSA). The AcSB Chair and staff are regularly communicating with CSA staff on these matters.
- Adoption of IFRSs in an environment that also requires certification of disclosures in issuers' annual and interim filings will be a particular challenge for Canadian entities.
- The due process for adopting IFRSs into Canadian GAAP, including maintaining the bilingualism policy. The best means to maintain this process and policies is under consideration.

AcSB staff thinks that none of these challenges are unexpected. They do not appear insurmountable in the time available, nor do they suggest the need for delay of the changeover date.

Surveys of awareness and preparedness for adoption of IFRSs suggest that individuals who need to be aware of the plan to adopt IFRSs generally are aware, but few have commenced detailed planning at this time. This is not

surprising to the AcSB at this stage of transition. The general consensus is that awareness of the adoption of IFRSs has definitely risen in Canada since the spring of 2007, but there is still concern that enterprises have yet to take action. Once the AcSB has issued an “omnibus” exposure draft of IFRSs and the progress review confirms the changeover date, more targeted action by companies is expected.

**Were there any significant difficulties encountered in the initial adoption or ongoing application of IFRSs in the European Union, Australia, and other countries that the AcSB should consider in determining the timing of implementing the strategy for publicly accountable enterprises?**

AcSB staff has reviewed studies of the adoption of IFRSs in other countries, as well as general business media reports. The AcSB Chair and staff have also met with other national standard setters, securities regulators and representatives of major accounting firms to enquire as to their experiences with adoption and application of IFRSs.

In general, IFRS adoption in other countries seems to have gone smoothly. In particular, few, if any, issues seem to have arisen in the second year of reporting. This suggests that first-year adoption was rigorous.

Matters the AcSB and constituents might take into account in learning from the experiences of others include the following:

- IFRSs as promulgated by the IASB are preferred to any modified versions. Modifications can cause difficulties for cross-border consistency and analysis, as well as for the use of IFRS 1, *First-time Adoption of IFRSs*, which allows for significant transitional relief in the first year of full adoption of IFRSs. Australia’s experience with initially eliminating choices in IFRSs and modifying disclosures, but subsequently reversing those decisions, is instructive in that regard. Challenges with respect to European Union non-endorsement of certain parts of IFRSs also highlight difficulties if “full IFRSs” are not adopted.
- Some CFOs in Europe and elsewhere have expressed concern that adoption of IFRSs was costly and made it more difficult for them to explain their financial results. The costs to convert accounting systems can be extensive and the benefits (including reduced costs of capital) are often hard to identify and do not arise until later. Communication by enterprises of the impact on financial reporting of the transition to IFRSs has been beneficial in aiding understanding by users of financial statements. This suggests that companies need to pay attention to management discussion and analysis and other supplementary disclosures as the vehicle for conveying their perspectives. It should also be noted that many European countries were faced with more extensive change than will be expected in Canada, as a result of a greater difference between IFRSs and pre-existing standards. For example, many European companies adopted standards for

the recognition and measurement of financial instruments for the first time on changeover to IFRSs — the vast majority of those standards have already been adopted in Canada.

- A comprehensive education programme is an important part of preparation.
- Industry groups can work together effectively to resolve common issues.
- The transitional challenge is greater for smaller listed companies because of their relative lack of resources.
- The extent of additional disclosure was a surprise to many. Disclosure considerations were often left to the end, with the result that information gathering was a challenge and many financial statement disclosures were of the “boilerplate” variety.
- The time to convert IFRSs into local law or to translate into local languages needs to be taken into account. Copyright issues also need to be resolved early. (The AcSB is presently negotiating copyright agreements and translation arrangements with the IASB).
- Active engagement with the IASB’s International Financial Reporting Interpretations Committee to resolve interpretation matters is important, rather than creating local interpretations.
- A clear and uniform statement by preparers and auditors that financial statements have been prepared in accordance with IFRSs is desired by securities regulators. (It would be acceptable to refer also to conformity with local requirements, such as Canadian generally accepted accounting principles (GAAP).)

The AcSB will continue to learn from the experiences of others with a view to enhancing the Canadian implementation experience.

### **Does the IASB continue to develop high-quality standards that are accepted as contributing to the improved functioning of global capital markets?**

AcSB staff has reviewed commentaries about the quality of IFRSs in the world-wide media, professional journals and academic papers. The staff has also considered whether IFRSs are affected adversely by undue political or special interests, and evaluated IASB-FASB convergence activities and the oversight role of the IASC Foundation Trustees. Since the AcSB approved its strategy in 2006, more countries have adopted or agreed to adopt IFRSs, including Japan, India, China, Korea and Brazil. According to Deloitte, there are now over 100 countries that use, or are in the process of adopting, IFRSs as their basis for financial reporting.

Many people in Europe are concerned that IFRSs are unduly influenced by US GAAP and will become “rules-oriented” rather than “principles-based.” Certainly, the US as a significant global capital market has an influence in the development of IFRSs. However, US standards have been changed in several

cases to adopt the “better” financial reporting in accordance with IFRSs. Current global convergence projects seem likely to result in as much change to US GAAP as to IFRSs, if not more in some cases. The IASB and FASB continue to make progress on the projects in their Memorandum of Understanding. Although there is inevitable slippage in some areas, there seems no cause for alarm that convergence will not continue. The convergence programme is a high priority for both the IASB and FASB.

In contrast to the concerns about the influence of US GAAP, some are concerned that the European Union (EU) might have undue influence on IFRSs as a result of its process for endorsing standards. Overall, it seems that these concerns reflect a healthy tension between major organizations with an interest in IFRSs. They do not presently suggest any significant cause for concern that IFRSs will be unduly influenced by any one particular body, and the likelihood of this outcome diminishes as more and more countries adopt IFRSs.

The US Securities & Exchanges Commission (SEC) has issued a Proposed Rule to allow financial reports prepared by foreign private issuers in accordance with IFRSs to be filed without reconciliations to US GAAP. The SEC has also issued a Concepts Release proposing that it consider allowing US issuers to prepare their financial statements using IFRSs. An initial review of the comment letters in response to the Proposed Rule suggests considerable support for the proposal, although some academics and financial statement users suggest that it might be premature to remove the reconciliation requirements. Also, the FASB Chairman has recently called for development of a detailed plan for the US to move to the adoption of IFRSs. These developments all indicate growing support for the acceptance of IFRSs in the US.

Work also continues to enhance the mutual reliance on IFRSs through such work as the EU’s assessment of equivalence of IFRSs to Canadian, Japanese and US GAAP.

While there is considerable support for IFRSs as a single, internationally-accepted basis of accounting, some concerns about the quality of IFRSs include the following:

- Concerns about the role and extent of fair value accounting. It should be noted, in this regard, that the extent of fair value accounting required in IFRSs is not significantly greater than in other sets of accounting standards.
- Concerns that financial reporting in accordance with IFRSs results in more complex financial reports than in accordance with prior standards and is less connected to the operation of the business. This is a common concern from those who have faced the costs of implementing IFRSs but have yet

to see benefits. It also reflects the difficulty some have in accepting change from well-entrenched practices.

- Concerns regarding the degree of pragmatism in IFRSs, noting that IFRSs seem to be increasingly technically oriented, perhaps without sufficiently taking account of practical considerations.
- Concerns that IFRSs are not designed for all of the traditional uses of accounts, in addition to informing investors and creditors. These uses include computing tax liabilities, compliance with banking covenants and regulatory capital calculations. The AcSB has been explaining, for some time, that general purpose financial statements are not necessarily designed for all of these uses.
- Concerns about a stable and independent future funding base for the IASB. The IASC Foundation Trustees are continuing to work on establishing a more sound, independent and sustainable basis of funding for the IASB. To date, new funding arrangements have been put in place in several countries and there seems no significant, present concern regarding a future lack of funding.

There have been academic studies which have tried to measure the effect of adopting IFRSs on the cost of capital. AcSB staff will be reviewing these in more detail. Also, AcSB staff will be searching for additional studies on the effects of the switch to IFRSs on the global capital market.