

AcSB Publicly Accountable Enterprises Strategy

AcSB Implementation Plan for Incorporating IFRSs into Canadian GAAP

Progress Review – Preliminary Report, October 2007

Full Analysis

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

The AcSB's Implementation Plan for Incorporating IFRSs into Canadian GAAP, as of March 31, 2007, (the "IFRS Implementation Plan") notes that, throughout the transitional period, the AcSB will monitor Canada's progress in implementing the IFRS convergence strategy and the readiness of the investor and business communities.

The IFRS Implementation Plan calls for a "progress review" within 24 months of the publication of the Strategic Plan. 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.

An [Executive Summary](#) of this preliminary report was prepared 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 changeover date of January 1, 2011. Many stakeholders have urged the AcSB to confirm the changeover date as soon as possible, in order that they may finalize their plans to implement their transition to IFRSs with confidence in what the AcSB will do.

On July 31, 2007, the AcSB published a document setting out the nature and extent of the progress review. This preliminary report on the progress review

adopts the same structure as that document. It 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?

Section 1: Is sufficient progress being made in Canada in establishing the infrastructure for IFRS implementation?

Regulators, including the Canadian Securities Administrators (CSA) and Office of the Superintendent of Financial Institutions (OSFI), regarding their assessment of the impact on the markets and institutions that they regulate

In the last four months, the AcSB Chair and staff have met twice with the CSA Chief Accountants, as well as with staff from the OSFI Accounting Policy group. The CSA expect to issue a Concept Release in late 2007 to consult on matters within their jurisdiction, including the merits of referring listed companies directly to IFRSs rather than Canadian GAAP, the pros and cons of providing a free choice to early adopt IFRSs and the use of US GAAP by Canadian listed companies. Also, the CSA Chief Accountants expect to issue a Staff Notice setting out requirements for transitional disclosures to help financial statement users understand the effects of the adoption of IFRSs. The AcSB Chair and staff expect to meet with the CSA Chairs in the coming months, as well as to continue regular meetings with the CSA Chief Accountants, as the AcSB continues to evaluate the readiness for the changeover of the securities administrators and the markets that they regulate.

Some securities regulators and AcSB staff are working closely with the oil and gas industry (see later in this report). Also, the CSA Chief Accountants have highlighted the need for IFRSs to be readily available to all affected parties during the planning period. AcSB staff is working on arrangements with the IASB to facilitate this and in early 2008 expect to make the IFRSs in place in 2007 readily available to Canadian constituents (via an “omnibus” exposure draft) as part of the AcSB’s due process.

In August 2007, OSFI Accounting Policy staff noted that insurance companies seemed to have done little preparation to date. They also reported that banks have noted that their greatest challenges are likely to be with the accounting

for impairment and derecognition of financial instruments in accordance with IFRSs, as well as with undoing existing accounting for variable interest entities when adopting IFRSs. OSFI staff also expressed a strong preference not to have multiple sets of standards in effect at any one time during the transition period. The AcSB Chair and staff expect to continue to liaise with the Superintendent of Financial Institutions and OSFI Accounting Policy staff during the progress review period.

Also, the AcSB Chair and staff plan to liaise with representatives of the Canadian Public Accountability Board and with regulators of credit unions and utilities.

Financial analysts, including the AcSB's User Advisory Council

At the June 2007 User Advisory Council (UAC) meeting, UAC members expressed the view that analysts have not yet taken, and probably will not take, action to prepare for the changeover to IFRSs until closer to the date that IFRS financial statements are filed. While the primary focus of detailed training activities at present is directed at preparers, AcSB staff will continue to target significant groups of analysts and users.

We will follow up with the UAC in October 2007, and plan to invite representatives from the Calgary, Montreal, Toronto and Vancouver CFA Societies, the CFA Canadian Advocacy Committee, several bond rating agencies and the Canadian Coalition for Good Governance to participate in our future consultations.

Results of any surveys made by third parties of Canadian publicly accountable enterprises' awareness and preparedness for IFRSs

Standard and Poor's conducted a survey of 25 Canadian companies¹ and 25 stakeholders² from various backgrounds. The survey found that management is well aware of the anticipated changeover to IFRSs in Canada but users were relatively unaware. Also, in contrast, the survey found that, in management's opinion, analysts and users would have to significantly change the criteria for assessing a company's performance, but users did not expect that the switch to IFRSs would change their assessment of a company.

A survey by the Canadian Institute of Chartered Accountants (CICA), in May 2007, consulted 148 Chief Financial Officers (CFOs) and 34 auditors. This survey found that 66% of the CFOs were aware of the changeover to IFRSs but they had not begun to assess the impact on their organizations. However, only 20% said they were familiar with IFRSs. This result is not surprising to

¹ Companies included oil and gas, metals and mining, utilities, retail and telecom sectors.

² Stakeholders were large and small institutional investors, and buy and sell side analysts.

the AcSB at this stage of the transition. Auditors were found to be more aware than CFOs.

Results of an informal survey conducted by Resources Global Professionals at the CICA Financial Reporting and Accounting Conference in September 2006 and at the CICA IFRS Conference in June 2007 suggested that an increasing percentage of companies have moved towards the formulation of a strategic plan for implementation of IFRSs (78% of those surveyed in 2007). The level of awareness of the main differences between IFRSs and Canadian GAAP was also seen to be increasing. Challenges identified included finding enough skilled resources to ensure target dates and implementation goals are met and concerns that the AcSB will cease to be the primary standard setter for Canadian publicly accountable enterprises. Care must be taken with the results of this survey because a certain level of knowledge is automatically expected by virtue of the participants choosing to attend the conferences in the first place.

We plan to review any follow-up studies completed by these groups, and search for further such studies conducted within Canada.

Major industry groups such as real estate, oil and gas and extractive, financial services, retail, and technology (e.g., biotechnology, software, etc.)

Oil & gas companies have expressed concerns over the extent to which the current Canadian GAAP standard for full cost accounting (the accounting method used by most oil and gas companies in Canada) might be inconsistent with IFRSs. In May 2007, AcSB staff met with the Canadian Association of Petroleum Producers (CAPP) and the Small Explorers Association of Canada (SEPA), in Calgary. The AcSB Chair and staff have also participated in several other meetings with representatives of oil & gas companies. The AcSB Chair and staff have encouraged the industry to fully evaluate how they might apply IFRSs and what the specific resulting concerns would be. The AcSB understands that an industry task force has been established with this objective and AcSB staff is supporting this initiative. The AcSB Chair and staff will continue to work with the industry to fully evaluate their concerns and what might be done to alleviate them.

Also, entities with rate-regulated operations have expressed concerns about the application of IFRSs to rate-regulated activities. The AcSB Chair and staff have discussed these concerns with other national standard setters and are collaborating with the European Commission's Roundtable for the Consistent Application of IFRS to evaluate whether there are issues that should reasonably be brought to the attention of the International Financial Reporting Interpretations Committee for possible interpretation.

In June 2007, the AcSB Chair and staff met with the Chief Accountants from the Canadian Bankers' Association (CBA). They expressed a preference for the adoption of IFRSs to follow a phased-in approach and for new standards that would require a second change shortly after the changeover date to be delayed. To some extent, a phased-in approach is being followed, although this will not be as prolonged as the CBA might like. The AcSB will continue to monitor whether there might be new IFRSs published shortly after the changeover date that might result in two changes in a short timeframe. However, the AcSB is also cognizant of the fact that an entity can use the significant transition relief in IFRS 1, *First-time Adoption of International Financial Reporting Standards*, only when it first adopts IFRSs fully.³

We have met with staff from the Forest Products Association in September 2007. To hear the views of other major industries, AcSB staff plans to conduct roundtable discussions in late November and early December 2007 in Calgary, Montreal, Toronto and Vancouver.

Financial statement preparer groups, such as the Financial Executives Institute

The AcSB Chair and staff met with the Financial Executives Institute's Committee on Corporate Reporting in October 2007. It was noted that companies are only just beginning to focus on the issues and because of a present focus on new regulatory requirements on financial reporting controls, many companies will not actively focus until 2009. Education and resources are additional challenges, as is clarity regarding such matters as whether US GAAP will continue to be allowed for some or all enterprises.

In September 2007, AcSB staff met with a group of investor relations officers of major companies, who generally seemed to be aware of the AcSB's plans, but had not yet done much evaluation of the impact on their activities. Some officers from income trusts noted that they would need to co-ordinate their planning with trust restructuring as a result of tax changes in 2011 and, as such, would not be contemplating potential early adoption of IFRSs.

Smaller publicly accountable enterprises

To hear the views of smaller publicly accountable enterprises, AcSB staff plans to invite representatives from organizations who have previously expressed an interest in standard setting, such as the Loan Underwriting Centre of Scotiabank, Smythe Ratcliffe, Spector and Associates, and Taylor Leibow, to participate in the roundtable consultations in late November/early December 2007. AcSB staff is consulting with representatives of the TSX Venture Exchange on the best way to involve more constituents involved with smaller enterprises.

³ It also seems likely that access to the US markets without reconciliation will be permitted only for entities using full IFRSs as promulgated by the IASB.

Major accounting firms in Canada

We plan to invite representatives of major accounting firms to participate in the roundtable consultations in late November/early December 2007. The biggest six Canadian accounting firms are also represented on the AcSB's IFRS Advisory Committee, where they have provided advice on the readiness for IFRS changeover (see below).

Accountancy bodies, including CICA, CGA, CMA, and ACCA

We plan to send letters offering to meet with the Canadian accounting bodies listed above, as well as to include them in the roundtable consultations in late November/early December 2007.

Academics, including the AcSB's Academic Advisory Council, and those developing primary and continuing professional education

In May and June 2007, AcSB staff participated in the Canadian Academic Accounting Association (CAAA) Annual Conference. Subsequently, AcSB staff has led educational forums for academics in Nova Scotia, Ontario and Quebec. Also, the AcSB Chair and staff met with the AcSB's Academic Advisory Committee (AAC) in February 2007 and will do so again in November 2007. At the CAAA Conference the following matters were highlighted:

- the magnitude of the upcoming changes to Canadian GAAP;
- implications for Canadian academics of the move to IFRSs, including the need for academics to increase their familiarity with IFRSs and the major differences from Canadian GAAP as it exists today; the ability of students to access IFRSs during the transition period; the availability of affordable IFRS training materials; and the optimal timing for the incorporation of IFRSs into textbooks and course curricula to meet the needs of students graduating in an "IFRS world;"
- CICA plans for incorporating IFRSs into the Uniform Final Examination syllabus; and
- auditing and assurance implications.

Those present at these sessions seemed well aware of the changeover and were keen to start evaluating what it means for their educational and research efforts. Many educators are 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.

The AAC meeting discussed what needs to be done in the way of IFRS education, which focused on identifying the available IFRS resources and what should be taught.

Quebec academics raised questions regarding the continued availability of standards in French and were assured that it is the AcSB's intent to maintain its bilingualism policy.

AcSB's IFRS Advisory Committee⁴ (IAC)

The IAC has an open forum at its meetings to allow IAC members to discuss their experiences in the Canadian environment with the implementation of IFRSs. At IAC's meeting on September 13, 2007, members were asked to comment on the ability of Canadians to be prepared for the convergence to IFRSs on January 1, 2011 based on their observations of the state of preparedness of their clients, constituents and organizations. The general consensus was that awareness of the adoption of IFRSs has definitely risen in Canada since the spring of 2007. There is more discussion of IFRSs but there is still concern that publicly accountable enterprises have yet to take action. Once the AcSB's omnibus exposure draft of IFRSs is issued and the progress review confirms the changeover date, more targeted action by companies is expected.

IAC members noted that 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. It was noted that audit committee members should make the planning for IFRSs a top priority in their enquiries of management. Members agreed that Canada seems to be doing a better job of planning the transition than other countries that have adopted IFRSs. While there is still concern over smaller, listed companies being ready, delaying the changeover date was not considered to be of assistance to these companies.

IAC members noted that any delay in the changeover date is more likely to delay the date at which constituents begin to prepare for the changeover, rather than facilitating a better changeover. It is notable that many other jurisdictions (including Europe and Australia) completed a successful changeover to IFRSs in a much shorter time period than has been planned in Canada.

⁴ The AcSB's IFRS Advisory Committee was formed to advise the AcSB on matters associated with the adoption of IFRSs in Canada. Its membership comprises representatives of academia, financial statement preparers and accounting firms. Representatives of the Canadian Securities Administrators and Office of the Superintendent of Financial Institutions, as well as a former IASB Board member also participate in the meetings.

None of the challenges mentioned above are contrary to AcSB's expectations. They do not appear insurmountable in the time available, nor do they suggest the need for delay of the changeover date.

Other constituents

Meetings with Practice Advisors and Inspectors from the Provincial Institutes of Chartered Accountants have been scheduled in October 2007. AcSB representatives also plan to meet representatives of the Canadian Institute of Chartered Business Valuators in October 2007.

Section 2: 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?

Studies completed by professional firms, regulators, other market participants and academics

The Financial Reporting Review Panel (FRRP), an authoritative UK body, reviewed the annual reports of UK companies for the first year of implementation of IFRSs. In general, the annual reports were well prepared, but the major weakness was the use of boilerplate disclosures in a number of areas. In its preliminary report, the Panel urged companies to spend more time focusing their disclosures to be more informative and thoughtful.

The European Commission's Internal Market Directorate-General commissioned the Institute of Chartered Accountants of England and Wales (ICAEW) to study the implementation across Europe of IFRSs. AcSB staff understands that the preliminary report (not yet published) indicates that the transition was generally successful and that the majority of people consulted thought that the application of IFRSs improved the quality of reporting. Investors agreed that the reports were generally easier to understand, but there is still a lot of difficulty in understanding the treatment of financial instruments and hedging (a change that was more significant for Europe than it will be for Canadian companies). This review found a similar problem of boilerplate disclosures to that highlighted in the FRRP review.

A report from the Odette School of Business, University of Windsor, summarizing a review of academic literature available regarding progress review issues has recently been received. AcSB staff has received an oral presentation on the findings in this report and plan to review the written report, as well as pertinent academic papers presented at the American Accounting Association Annual Meeting in August 2007.

The US Securities and Exchange Commission (SEC) staff published a report in July 2007, "Staff Observations in the Review of IFRS Financial Statements." The SEC staff reviewed the annual reports of more than 100 foreign private issuers containing financial statements prepared for the first time in accordance with IFRSs. The report includes principal areas of staff comment and some general observations about the application of IFRSs. The report also notes that SEC staff has not yet reached any comprehensive conclusions about companies' overall compliance with, or consistency in application of, IFRSs.

The SEC staff noted concerns with consistency in the application of IFRSs – i.e., companies based in the same jurisdiction and companies in the same industries sometimes use different income statement formats and there was a range of accounting treatments for common control mergers, recapitalizations, reorganizations, acquisitions of minority interests and similar transactions. The SEC staff also noted substantial variation in accounting for insurance contracts and in the reporting of extractive industry exploration and evaluation activities. The IASB is currently working on developing comprehensive standards on both these topics.

The SEC report raised concerns regarding whether various banks complied with IAS 39, *Financial Instruments: Recognition and Measurement*, in determining loan impairment. Also, a number of companies were asked to provide additional information or disclosure about:

- revenue recognition;
- intangible assets and goodwill;
- policies for identifying and evaluating impairment, the circumstances resulting in recognized impairment, or the circumstances surrounding impairment reversals of long-lived assets including goodwill;
- leases, including their terms and the future minimum payments under operating and financial leases;
- contingent liabilities, including their nature and estimated financial effects; and
- the significant terms of financial instruments, including derivatives, their effect on future cash flow and the recognition and measurement criteria the company applied.

The issues highlighted in the previous paragraph appear to focus primarily on compliance with, rather than a deficiency in, the existing IFRS standard.

Other surveys, including one prepared by KPMG, *The Application of IFRS: Choices in Practice*, looking at the first wave of reports produced in accordance with IFRSs, note that the application of IFRSs often differs from country to country. These practices reveal, as Mary Tokar, head of the KPMG international financial reporting group puts it: "their lineage of previous national standards, training and culture." In some ways, this is no

surprise. People tend to stick close to what they know best when change is required.

Papers prepared for the twenty-fourth session of the United Nations Conference on Trade and Development in October/November 2007 include a review of practical implementation issues of IFRSs. These papers focus on case studies of implementation in Pakistan, South Africa and Turkey. The South African situation is probably closest to that of Canada. The studies demonstrate the importance of a national co-ordination system and engaging stakeholders early in the IFRS implementation process, as well as the need for companies to communicate the impact on financial reporting of adopting IFRSs. The papers also highlight the need to avoid the undesirable effects of any discrepancies between “IFRSs as promulgated by the IASB” and the standards in force in a particular country at a point in time, because of the need to follow additional approval or translation processes at a national level. The papers also stress the importance of active engagement with the IASB’s International Financial Reporting Interpretations Committee (IFRIC) to resolve interpretation matters, rather than creating local interpretations, as well as engagement with the IASB on practical implementation issues associated with IFRSs in the early stages of the standard-setting process. The papers highlight the need for training, and for enforcement authorities to share their findings and enforcement decisions in order to assist financial statement preparers in avoiding the wrong application of IFRSs by learning from the experience of other preparers.

General business media reporting

The AcSB staff has reviewed daily press clippings from media sources dealing with financial reporting issues for the period from January 1, 2007 to August 28, 2007.⁵ Many issues dealt with by the media are similar to those mentioned elsewhere in this report. In addition, the following matters were noted regarding the application of IFRSs.

- The European Union (EU) is not satisfied with the proposal by the SEC to end the reconciliation requirement for foreign private issuers, based on the use of IFRSs as promulgated by the IASB. The EU is concerned that in accordance with the current SEC proposals, entities in the EU preparing financial statements using IFRSs as approved by the European Commission,⁶ would not be exempt from the SEC’s US GAAP reconciliation requirement. However, others favour the SEC proposed position. The comment letter deadline for the SEC proposal has only recently expired and it remains to be seen what stance the SEC will take.

⁵ We intend to complete a review of media for 2006, as well as from August 29, 2007 to date, in due course.

⁶ That is, without the current EU “carve-outs” from IAS 39, and any other such carve-outs or other modifications made by the EU in the future.

The SEC proposal intentionally discourages the application of national versions of IFRSs.

- There continues to be much discussion of the merits of standards based at a “principles” level versus those that incorporate more detailed guidance in the form of “rules”. Much of this debate focuses on the difference between IFRSs (considered to be at a more principled level) and US GAAP (considered to incorporate more rules). Essentially, the debate is about the amount of detail included in a body of accounting standards and required in financial statements. The debate highlights the greater desire for additional guidance in the US legal environment, although commentators note also that additional guidance does not necessarily provide ready protection to those who might seek to rely on the rules to protect them from exposure to litigation.

Representative groups of preparers

In July 2007, AcSB staff met with the Deputy President of the Association of Chartered Certified Accountants (ACCA) and the head of the ACCA’s Canadian branch. This included discussion of the ACCA global education programs to disseminate IFRS knowledge and some of the practical challenges of implementing IFRSs. The discussion confirmed comments received from other sources, including that the primary effect of the first year of adopting IFRSs was that it made it more difficult for CFOs to explain their results to the financial markets.

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.

National standards setters and regulators in major capital markets

National standards setters

In April 2007, the AcSB Chair and staff met with the Chair of the Australian Financial Reporting Council (FRC). The FRC Chair explained the initial decision of the Australian Accounting Standards Board to eliminate choices in IFRSs and modify disclosures, in order to protect Australia's national interest by anticipating changes it thought that the IASB might make. As such reductions and additions have not been proposed by the IASB, the Australian Board has subsequently reversed that decision in order to promote competitiveness of Australian IFRS preparers by providing them the same choices available to other global preparers. The discussion also confirmed the type of adoption concerns previously heard from other sources. The AcSB Chair and staff plan to meet again with the FRC Chair in November 2007.

In September 2007, the AcSB Chair and staff participated in the IASB's World Standards-Setters Conference. A part of this conference focused on implementation experiences in several jurisdictions. Many of the experiences were ones of which the AcSB was previously aware and included the following matters that are likely to be relevant to Canadian adoption of IFRSs.

- Australia first made modifications to IFRSs but has since reversed that decision (as explained above). Their experience suggests that even minor wording changes cause interpretation difficulties. However, the Australian Accounting Standards Board has retained prior guidance dealing with insurance and extractive activities (to the extent it is IFRS-compliant), as well as its prior standard dealing with materiality.
- Australia rewrote the introduction to IFRSs (not part of the authoritative text) to focus on changes from prior Australian GAAP, rather than prior IFRSs.
- A comprehensive education programme is an important part of preparation. Australia included in its educational materials a comparison between IFRSs and Australian GAAP. (The UK followed a similar approach and the AcSB staff has already published comparisons of IFRSs and Canadian GAAP, which they plan to update as IFRS adoption nears.)
- Advance preparation is important, including being prepared to restate comparative numbers and to disclose the impacts of adopting IFRSs ahead of time. The latter disclosure requirements caused some concern among auditors in Australia because of the risk that disclosures about expected impacts might not be validated in the future. In Canada, it is expected that the CSA will require such disclosures in management discussion and analysis, thus reducing this concern.

- Encouraging industry groups to 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. In some cases, companies had not focused as closely on the need to gather information to support such disclosures as on matters affecting recognition and measurement in the primary financial statements.
- 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. This has led to some complaints from financial statement preparers.
- Questions have arisen as to the authority within IFRSs of the reasons given by the IFRIC for not addressing a particular issue — for example, because the answer is considered to be obvious from the standard — and whether such decisions may lead to retrospective restatement.
- 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 IFRIC to resolve interpretation matters is important, rather than creating local interpretations.
- “Version control”— i.e., the need for different versions of IFRSs when new standards are being issued and early adoption is permitted — is a significant challenge.

Regulators

AcSB representatives met with several members of the staff of the SEC in April 2007. The SEC is focused on compliance with “IFRSs as promulgated by the IASB” and not on modified versions of IFRSs. With regard to the number of years for which comparative figures are needed in the year of transition to IFRSs, a question of concern to Canadian SEC registrants, the SEC staff noted that this is more than just a Canadian issue. To date, no major problems with adoption of IFRSs have been identified. A September 24, 2007 speech by the SEC Deputy Chief Accountant highlighted the need for a clear and uniform statement by preparers and auditors that financial statements have been prepared in accordance with IFRSs; (it would be acceptable to refer also to conformity with local requirements, such as Canadian GAAP). The speech also stressed the importance of sharing of information about troublesome areas of IFRS application with the IASB and the challenges of preparing standards capable of robust application while avoiding unnecessary complexity.

AcSB representatives have also met with a senior official at the United Kingdom Financial Services Authority who is familiar with activities of the Committee of European Securities Regulators (CESR). He reiterated many of the same matters noted elsewhere in this report. In addition, he noted:

- Some in the UK erroneously assumed that UK GAAP was very similar to IFRSs and hence did not plan early enough.
- Although “national flavours” of IFRSs have been observed, prior national GAAP has no authority once IFRSs are adopted and, therefore, cannot be used for enforcement.
- CESR is resisting attempts by some to seek interpretations through CESR rather than through IFRIC.
- EU non-endorsement, particularly of interpretations, is a concern. If an interpretation is not endorsed, it can seem to question the standard which it is interpreting itself.
- In considering the effects of delays in adoption of IFRSs as local GAAP, standard setters need to be cognizant of interim financial reporting requirements as well as those relating to annual reports. It might be necessary to allow anticipatory adoption of requirements in interim financial statements (i.e., adoption before the standards are formally part of local GAAP).
- CESR expects to publish a review of first-year adoption experiences in mid-October, which will identify no big issues or problems.
- The European Federation of Accountants published guidance on IFRIC rejections indicating that restatements as a result of such rejections should be applied retrospectively but should not be treated as errors. (In some jurisdictions use of the word “error” triggers automatic regulatory attention.)

IFRS desks of major accounting firms and senior IASB staff

AcSB representatives have heard presentations by, or met with, leaders of several of the IFRS desks of major accounting firms. Matters noted but not dealt with so far in this report, include:

- Few, if any, issues seem to have arisen in the second year of reporting. This suggests that first-year adoption was rigorous.
- Some underestimated the task of conversion.
- Disclosure considerations were often left to the end.

AcSB staff regularly discusses accounting issues with senior IASB staff and will check with them before finalization of the progress review. A recent meeting between the AcSB Chair and Director, Accounting Standards, and the Chair of the IASB discussed issues being encountered in Canada regarding

adoption of IFRSs by oil and gas companies and rate-regulated operations, among other matters.

Financial analysts, including their experience when countries limited IFRS options or added modifications on adoption

We have yet to review material regarding the experience of financial analysts in other jurisdictions.

Section 3: Does the IASB continue to develop high-quality standards that are accepted as contributing to the improved functioning of global capital markets?

Commentaries about the quality of IFRSs in the worldwide media to consider whether any valid, pervasive concerns are arising

We have reviewed daily press clippings from media sources dealing with financial reporting issues for the period from January 1, 2007 to August 28, 2007.⁷ There continues to be commentary on the inevitability and appropriateness of IFRSs becoming the global benchmark for financial reporting. For example, John Hegarty, manager of financial management for Europe and Central Asia at the World Bank highlighted in a recent article,⁸ “increasingly, the default position globally is that IFRS should become the benchmark for countries.”

Less favourable reports on the quality of IFRSs include the following.

- Concerns about the role and extent of fair value accounting. In particular, some articles have referred to fair value accounting as one cause of the recent turmoil in the US subprime mortgage market. In response to this criticism, it might be noted that, in this particular situation, impairment testing would have resulted in consideration of fair values regardless of the use of fair value accounting in other aspects of accounting standards. In any case, the extent of fair value accounting required in IFRSs is not significantly greater than in other sets of accounting standards.
- “[IFRS] has added complexity to reporting... and it is less connected to the operation of the business.” Ken Lever, finance director at Tomkins, the UK engineering group, and chair of the financial reporting committee of the 100 Group noted this in a Financial Times article by Robert Bruce.⁹ 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.

⁷ We intend to complete a review of media for 2006, as well as from August 29, 2007 to date, in due course.

⁸ Financial Times, Accountants of the World Uniting in IFRS Revolution, June 21, 2007.

⁹ Financial Times, Accountants of the World Uniting in IFRS Revolution, June 21, 2007.

- 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, John Cullinane noted in the Financial Times.¹⁰ For some time, the AcSB has been explaining that GAAP is designed for general purpose reporting and doesn't necessarily meet special purpose reporting needs.

Whether the standards and interpretations are being unduly influenced by particular political considerations or special interests

Concerns about political or special interests revolve around concerns of many in Europe that IFRSs are unduly influenced by US GAAP. For example, Paul Boyle, head of the UK Financial Reporting Council states that "there is a growing fear among many in the UK that 'convergence' will mean acceptance of US standards."¹¹ Concerns have also been raised in the European Parliament and elsewhere that the convergence process will end up with the principles-based IFRSs being "Americanized" by a more rule-based system. 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, and there has been some recent discussion about adopting IFRSs in the US in place of US standards.

The other primary area of concern in this regard revolves around the involvement of the EU in the standard-setting process with its "carve-out" of aspects of IAS 39, as well as questions around the EU endorsement of standards such as IFRS 8, *Operating Segments*, and IFRIC-12, *Service Concessions*. Some are concerned that the EU might have undue influence on IFRSs as a result of its process for endorsing standards.

IASB/FASB convergence activities and external commentary on those activities to assess the prospects for continued co-operation

The AcSB is monitoring the progress of the IASB and FASB against their commitments made in the Memorandum of Understanding and will report later whether they are on track, including the results of a literature review regarding their convergence activities. The first major standard developed jointly by the IASB and FASB, *Business Combinations*, is scheduled for release in the fourth quarter of 2007 and other activities set out in the Memorandum of Understanding are well on track. 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

¹⁰ Financial Times, IFRS Contains a Note of Farce for AIM, April 19, 2007.

¹¹ Financial Times, Rethink is Urged Over Accounting Proposals, July 11, 2007.

IASB and FASB, as evidenced by the resources provided to it by both Boards and recent commitments to the programme expressed by the Chairs of both the IASB and FASB in speeches in late September 2007.

The 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 Chair 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.

Recently, Jesse Westbrook of The Washington Post quoted SEC Chair Christopher Cox as saying in a speech in Washington "We are committed to this process, and we are not looking back." Cox was accompanied by Charlie McCreevy, the EU's internal market commissioner.¹²

The continued effective functioning of the oversight role of the Trustees, in accordance with the IASB Constitution, including the prospects for ongoing funding of the IASB's work and any imminent fundamental change in circumstances that could affect the strategic direction

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. The Trustees are also working to enhance their oversight of IASB activities, including the recent establishment of additional arrangements for the Trustees and the IASB to keep the work programme under joint review.

AcSB representatives plan to consult with the Chair of the Trustees and with Paul Tellier, Canadian Trustee, as the progress review proceeds, in order to assess whether any fundamental changes in arrangements are imminent.

The basis of adoption by countries in major capital markets that have adopted IFRSs, including whether they have made modifications or provided interpretations in addition to those of the IFRIC

The basis of adoption of IFRSs varies in different jurisdictions, with some adopting IFRSs as published by the IASB and others modifying IFRSs or adopting them in part. AcSB staff has yet to evaluate the aspects of IFRSs not adopted in particular jurisdictions or the reasons for such non-adoption. That

¹² The Washington Post, U.S., E. U. Agree to Recognize Each Other's Accounting Rules, March 7, 2007.

evaluation will be undertaken before the progress review is completed. However, it seems clear there is an increasing call for adoption of IFRSs as promulgated by the IASB (i.e., without modification), as is the intent of the AcSB for Canadian enterprises. Of note in this regard, is the reversal by the Australian Accounting Standards Board of its initial decision to modify IFRSs to remove options, add disclosure requirements and modify wording.

Sir David Tweedie, IASB Chair, recently noted his worry that if enough countries seek to tailor standards to their liking, there could be “hundreds of different versions of IFRSs instead of one set of international rules, which is the whole point. We have to nip this in the bud.”¹³

The acceptance in major capital markets of information provided in financial statements prepared using IFRSs

Since the AcSB approved the strategy in 2006, more countries have adopted or agreed to adopt IFRSs including the following.

- The Accounting Standards Board of Japan agreed to accelerate convergence, with major differences from IFRSs being removed by 2011. The proposed 2011 convergence does not include any major new standards currently being developed by the IASB.
- The Council of the Institute of Chartered Accountants of India announced in July 2007 that it would adopt IFRSs with effect from April 1, 2011.
- China will require its state-owned enterprises and large to mid-scale companies to adopt their new accounting standards that comply with IFRSs by the end of 2009.
- In March 2007, the Korean government (Financial Supervisory Commission) and the Korean Accounting Standards Board announced a roadmap for Korea to adopt IFRSs. The roadmap provides that by 2009 all companies in Korea (excluding financial institutions) will be permitted to apply IFRSs as adopted by Korea, and by 2011 financial reporting based on IFRSs will become mandatory for all listed businesses.
- Brazil will require its openly-traded Brazilian companies to prepare their consolidated statements in accordance with IFRSs by 2010, with earlier adoption allowed.

The SEC’s Proposal Release and Concepts Release described above indicate further support for the acceptance of IFRSs in the US.

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.

¹³ The Economist, Speaking in Tongues, May 19, 2007.

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. Mutual reliance on related infrastructure is also advancing. For example, EU Commissioner, Charlie McCreevy and Mark W. Olson, chairman of the U.S. Public Company Accounting Oversight Board, have agreed that accounting regulators will seek "full reliance" on each other's work within two years.¹⁴

A survey published in June 2007 by Financial Executives International (FEI) and Baruch College¹⁵ highlighted that over half of the 148 Chief Executive Officers polled said they would support the SEC's plan to allow entities a choice between statements prepared under IFRSs and US GAAP, although almost 45% of the 148 Chief Executive Officers polled said they were opposed to it. FEI's President and Chief Executive Michael Cangemi is quoted as stating, "At this point, US financial executives need to become more familiar with IFRS."

Work will continue to monitor the activities in the US and other countries making a choice to adopt IFRSs.

Securities regulators' experience with issuers' financial reporting in accordance with IFRSs

This report discusses the SEC's initial experience with IFRS financial reports in Section 2. No significant concerns with the quality of IFRSs have been identified at this time. The AcSB will continue to monitor activities of the SEC and other securities regulators in this regard in the coming months.

Literature regarding effects of the switch to IFRSs on global capital markets

There are a number of studies of the effect of adopting IFRSs. The more qualitative surveys include one by PWC/Ipsos MORI that surveyed Senior Finance Executives of seventy eight FTSE350 companies. They found that 54% of the executives expressed confidence that the IASB's standard-setting regime would produce high-quality, enforceable global standards (in 2006 it was 38%), but they also found that 74% opposed greater use of fair values in IFRSs, which is up from 52% in 2006. This study, unlike that conducted by the FRRP (see Section 2, above), found that 62% of respondents didn't think that introducing IFRSs resulted in better information in the marketplace (81% of UK companies and 78% of European businesses).

¹⁴ The Washington Post, "U.S., E.U. Agree to Recognize Each Other's Accounting Rules" March 7, 2007.

¹⁵ Reuters News, US CFO's Mixed on International Accounting Choice, June 27, 2007.

The other study AcSB staff has reviewed, to date, was done by Standard and Poor's, which surveyed 50 European corporate entities and their move to IFRSs. This study found that the transition to IFRSs had little impact on ratings. They also found that the migrations to IFRSs did not lead to problematic technical breaches of loan covenants.

Academic studies have tried to measure the effect of adopting IFRSs on the cost of capital. AcSB staff will be reviewing these in more detail as well as searching for additional studies on the effects of the switch to IFRSs on the global market.

Other

Some have expressed concern regarding the degree of pragmatism in IFRSs, noting that IFRSs seem to be increasingly technically oriented, perhaps without taking sufficient account of practical considerations. This causes some to call for greater consideration of the views of those who have to apply IFRSs in the development process.

Selected Bibliography

- Accountancy, "Financial Reporting – IFRS – Whither US GAAP?"
July 10, 2007
- Associated Press Newswires, "The SEC May Ease Foreign Accounting Regs,"
June 20 2007
- Associated Press Newswires, "US Securities Regulators Propose International
Changes," July 3, 2007
- The Bottom Line, "Chorus Growing," Mid-May 2007
- The Economist, "Speaking in Tongues," May 19, 2007
- Financial Reporting Review Panel, "Preliminary Report on the
Implementation of IFRS," December 2006
- Financial Times, "Making Sense of Counting Beans Across the Globe,"
January 8, 2007
- Financial Times, "War of Words Sparked Over New Standards,"
March 21, 2007
- Financial Times, "IFRS Contains a Note of Farce for AIM," April 19, 2007
- Financial Times, "SEC in Surprise Move to Global Filing Benchmark,"
April 26, 2007
- Financial Times, "US GAAP's Decline," April 27, 2007
- Financial Times, "SEC May Ease Foreign Accounting Regs," June 20, 2007
- Financial Times, "Accountants of the World Uniting in IFRS Revolution,"
June 21, 2007
- Financial Times, "America Will Prefer to Rely on Rules, Not Principles,"
July 6, 2007
- Financial Times, "EU Sees World Accounting Rules Aligning," July 16, 2007
- Financial Times, "Rethink is Urged Over Accounting Proposals,"
July 11, 2007
- Financial Times, "Pursuit of Convergence is Coming at Too High a Cost,"
August 23, 2007
- Institute of Chartered Accountants of England and Wales, "IFRS Roundtables:
Selected Preliminary Findings From the ICAEW Study" (unpublished)
- Investment Executive Online, "SEC Considers Change to Financial Filing
Requirements," July 3, 2007
- The New York Times, "Accounting Rule is Eased for Foreign Companies,"
June 21, 2007
- PricewaterhouseCoopers/Ipsos MORI, Has the Dust Settled Yet?, June 2007

Reuters News, "US, UK Accounting Regulators to Share Information,"
April 25, 2007

Reuters News, "EU Lawmakers Warn Over Accounting Convergence,"
June 22, 2007

Reuters News, "US CFO's Mixed on International Accounting Choice,"
June 27, 2007

Reuters News, "US SEC Issues Report on Foreign Co's Accounting,"
July 3, 2007

Reuters News, "EU Says Accounting Convergence with US on Track,"
July 12, 2007

Standard and Poor's, "More Clarity Needed In IFRS Accounts of European
Corporates," *CreditWeek*, Vol. 27, no. 5, January 31, 2007 pages 39-44

Standard and Poor's, "An Added Twist to the Globalization of Canada's
Capital Markets," *CreditWeek*, Vol. 27, no. 5, January 31, 2007 pages 20 – 25

The Toronto Star, "Regulators Soften Rules on Foreign Firm Reports,"
June 21, 2007

The Wall Street Journal, "SEC Ponders Global Accounting Rules,"
March 7, 2007

The Wall Street Journal, "SEC to Mull Letting US Companies Use
International Accounting Standards," April 25, 2007

The Wall Street Journal, "What's Better in Accounting, Rules or Feel?,"
April 30, 2007