CFERF Executive Research Report sponsored by
PricewaterhouseCoopers LLP

IFRS Readiness in Canada: 2010

Survey Highlights

Key Highlights

- With only seven months remaining, half of public companies are less than 60% through their IFRS conversion
- With greater volatility expected in the changes to financial statements, companies will have to increase their communications to stakeholders
- Respondents are very aware of how IFRS can impact key stakeholders such as lenders
- Solid progress has been made on training of financial staff and boards
- Two-thirds of respondants have indicated an increased use of spreadsheets to address IFRS conversion needs

Attached are the highlights of the IFRS Readiness in Canada: 2010 Executive Research Report, prepared by the Canadian Financial Executives Research Foundation (CFERF). This follows the last report, which was released in June 2009.

I am pleased to provide you with this new survey, again sponsored by PricewaterhouseCoopers. After a year, much has changed and we are now able to provide more in-depth comparative analysis as Canadian companies transition to International Financial Reporting Standards (IFRS). This follow-up report also contains responses to a number of new topics that are more specific to the issues as we get closer to the January 1, 2011 deadline.

Since last year, companies are devoting more of their time to prepare for the conversion. This is a positive sign and I believe CFOs are feeling more confident that they will be able to meet the deadline with support from the right resources. However, there is still much work to be done and, based on our past experience, we believe it will be important to build in time for contingencies as companies get closer to the conversion date.

This report highlights some of the issues that will be more important for companies to prepare for during the upcoming months. For example, continued training will be required for financial staff. As well, communication with analysts, shareholders and other stakeholders will be one of the biggest areas of focus as IFRS impacts are more fully understood, both quantitatively and in formats and notes to financial statements. Other areas that also must be considered during conversion include the impacts on controls, lending arrangements and the use of End-User Computing Solutions (spreadsheets).

As the report states, the road to conversion is not necessarily a linear one. While many are devoting significant effort in 2010, others are lagging behind. We encourage you to avoid delays.

Highlights of the survey are summarized here for your review. The full report will be published this summer and we look forward to sharing it with you.

Regards,

Diane

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The IFRS Readiness in Canada: 2010 Executive Research Report was prepared by the Canadian Financial Executives Research Foundation (CFERF) and was sponsored by PricewaterhouseCoopers. It comprises the results of a survey of senior financial executives from across Canada and the insights obtained through an Executive Research Forum held in Toronto on April 22, 2010. The study is the third in a series of annual surveys covering conversion activities in Canada. The following are highlights from the survey component of the report. The full study will be available July 2010.

Purpose

The primary intent of the survey was to determine where Canadian companies of different types and sizes are in their IFRS transition process as well as to learn of particular strategies, practices, and challenges for companies along the way from the perspective of the senior finance executive within the firm. The results are based on responses from 146 individuals who completed the survey in the 18-day period from Thursday, March 25, 2010 to Monday, April 12, 2010.

Of these, 138 indicated that their company planned to convert to IFRS, and eight were undecided. Survey results were compiled and analyzed on the basis of industry classification (i.e. large SIC groups), corporate structure, and industry size based on revenue. Respondents were also categorized by position title. Eighty-six respondents were from public companies and 30 were from private companies. The remainder were from government enterprises, crown corporations, not-for-profits and "others."

Reasons for adopting IFRS

Most individuals responding to our survey indicated that their company was converting because they were publicly accountable and therefore it was mandatory (79%). However, a further 8% were converting because the company was a subsidiary of an entity that was already using IFRS. Others stated that they were adopting IFRS because it was a preferable reporting framework (6%); that they were adopting for competitive reasons (4%); that it was mandated by lenders (1%); that the company was planning to go public (1%); or for other reasons (1%).

State of conversion

The vast majority of survey respondents (77%) said they were at least 40% along the conversion path. More than half (54%) said their status of completion was 60% or higher. However, as expected, public companies are further along their conversion path than private companies that plan to adopt. Of the 86 executives responding from public companies, over half (53%) said their status of completion was 60% or higher. In comparison, one-third, or 33% of private companies, had completed 60% or more of the transition.

However, our data also indicates that for some companies, the conversion process is not necessarily a linear one. Of the 146 survey respondents, 45 (or roughly 31%) said they had not yet completed an initial diagnostic assessment. Of this subgroup, 14 respondents said they planned to complete their initial diagnostic by the end of the second quarter of 2010; two said Q3 and three said 2011. Twenty-six respondents said "other." This could be indicative of the fact that these companies have not started any IFRS conversion work.

Progress has certainly been made since last year when a similar survey showed that more than 12% of public company respondents and one in five of private companies had not yet taken the first step in starting their initial diagnostic assessments.

Size matters

Significant differences exist between the state of readiness of small and large companies. Survey results show that larger public companies are likely to be further along the conversion path than smaller companies or private companies, largely because these companies started early and have more resources than smaller companies to devote to the process.

IFRS conversion is often the responsibility of CFOs in small companies that are also charged with most other issues related to financial management in their firms, whereas large companies are more likely to be backed with more resources and staff devoted to the conversion. Similarly, managers in public companies tend to be more aware of the significant amount of work required in the transition, again having devoted more time and resources to the process.

We see this evidenced in the differences in the state of completion between large and small companies. For example, all the companies responding to our survey that had annual revenues of more than $20 billion, reported that they had completed more than 60% of their conversion process. Similarly, 80% of companies with revenues between $15 and $20 billion were more than 60% complete. This compares to 41% in the $50-$249 million range that had achieved rates of completion of 60-100%. Only one-third of private companies had completed 60% or more of the transition process.

The higher a company's revenue, the more likely it was to have sufficient resources for conversion. For example, 100% of companies with revenues of more than $5 billion said they had the resources available. In comparison, 71% of companies with revenues of less than $49 million said they had the resources they required to implement the conversion, and 29% said they did not have adequate resources.

The conversion will be made at considerable cost to Canadian companies. Thirty-two percent will spend between $100,000 and $500,000 while 36% will spend under $100,000. Not surprisingly, the conversion costs increase depending on the size, industry and complexity of the company. The study shows that 43% of companies with revenues between $1 billion and $5 billion will spend between $500,000 and $5 million in transitioning to IFRS.

Completion by industry

Differences in state of conversion are also dependent upon industry. Leaders are typically found in the rate-regulated sector, where companies have to report the impacts of conversion to provincial governments well in advance, particularly with respect to revenues and resulting impacts on utility pricing, as well as the financial services sector. Out of the top four industries responding to the survey (mining and oil and gas extraction, manufacturing, utilities and insurance), utilities is the most advanced, with 73% stating they were more than 60% through their conversions, and 100% showing a completion rate of more than 40%. This was followed by the insurance sector, with 62% stating they were more than 60% complete. This compares to 50% of mining and oil and gas extraction companies that were more than 60% finished. Similarly, nearly half, or 46%, of manufacturing respondents stated they were 60-100% done.

Opening balances

One year of comparative data is required to be presented on an IFRS basis in the year of adoption. The majority of finance executives (61%) expect their IFRS opening transition balance sheet (as at January 1, 2010 for calendar year companies) to be complete by the end of the second quarter of their 2010 fiscal year. Differences in the state of conversion between private companies and public companies are also reflected in the state of their opening balances. Seventy percent of public company finance executives say their IFRS opening balance sheet will be ready by the end of the second quarter of their 2010 fiscal year, compared to 37% of private companies. Additionally, 73% said they will be asking their auditors to audit the opening balance sheet on January 1, 2010 prior to the timing of their year-end 2011 audit.

Spreadsheets and controls

The survey indicates that close to two-thirds of respondents believe that the IFRS conversion will leverage End-User Computing (EUC) solutions (i.e. spreadsheets) on a more substantial basis. Spreadsheets are widely used tools in most organizations, due to their flexibility, functionality and low cost of implementation. In the short term, however, these advantages can be accompanied by risks to organizations. Companies that place excessive reliance on spreadsheets for managing their financial reporting and the close process under IFRS may find themselves being exposed to additional risks since the level of control over spreadsheets may not mirror organizations' controls over their core technology environment.

Respondents were also asked about control certifications and where they are with respect to considering impacts on the control environment resulting from IFRS conversion. Almost 50% of respondents stated that their management teams were extremely or generally aware of the IFRS implementation impact on controls. However, almost 27% said their management team was either somewhat or not at all aware of the potential implications of IFRS, which shows that more communication and work in this area are required.

Lenders as key stakeholders

Lenders are a key stakeholder group to be communicated with as companies convert to IFRS due to the importance and focus on financial statements, management reports and key metrics, which impact lending arrangements and related debt covenants. The survey showed that only 6% of respondents did not have awareness of IFRS implications on their debt covenants. This included 31% of respondents who said they were extremely aware of the impacts, and 32% who were generally aware, showing a good knowledge of how IFRS can impact this key external stakeholder group.

Parallel accounting systems and IT

Seventy-two percent of companies were planning to run parallel IFRS and Canadian GAAP accounting systems during the 2010 financial year, while 23% said they did not. (The remainder didn't know.) Again, of the four largest industry groups represented in the survey, relatively more utility companies would be running parallel systems (87%), than mining and oil and gas extraction (72%), insurance (7%) or manufacturing (40%).

Companies with higher revenues were also more likely to be planning technology changes or upgrades that could be streamlined to incorporate IFRS change requirements than companies with lower revenues. For instance, 39% of companies (or 19 of 49) with revenues over $1 billion were planning upgrades, compared to 23% (21 of 91) companies with revenues under $1 billion.

Impacts on reported values

Adopting IFRS is expected to result in an increase in asset values in 29% of responding companies and a decrease in asset values in 22% of responding companies. At the same time, 28% of companies anticipate a decrease in the reported net income, 22% expect earnings per share to fall, and 28% expect an increase in pension liabilities.

Companies with higher revenues were more likely to have begun to plan for the potential tax impacts of IFRS on Canadian income tax compliance than smaller companies. For example, nearly all companies with revenues greater than $15 billion had started their Canadian income tax planning process, compared to 48% of companies with revenues between $50 and $250 billion, and 24% of companies with revenues less than $49 million. As well, 24% have considered foreign income tax compliance, 39% have discussed tax planning and 23% have considered transfer pricing.

Training

Ninety-three percent of companies have begun IFRS training for their finance staff and 80% have started training for its audit committee. Board training lags behind at 65% as some companies may be waiting to first provide training to their management teams. There is clearly improvement from last year's survey results although continued effort and communication with boards are required as the impacts of IFRS are more fully understood during the remainder of 2010.

Disclosure

Seventy-two percent of public companies disclosed a qualitative assessment of the impacts of the IFRS conversion in their 2009 financial statements, while 5% of public companies had disclosed both qualitative and quantitative assessments of the impacts. In comparison, 37% of private companies had disclosed qualitative assessments of the impacts in their 2009 financial statements (no private companies did both).

Disclosures, both qualitative and quantitative, should be a continued area of focus for companies throughout the remainder of 2010.

Conclusion

Overall, the survey results show that significant progress has been made in Canada in working towards the January 2011 implementation date but there is still work to be done with seven months remaining. IFRS can have significant implications on IT systems, processes within the finance department, and many other areas, such as training, communications and the business. Companies need to leave enough time in the transition to prepare for contingencies should they run into unanticipated issues as they complete the conversion. Enhanced communications with key internal and external stakeholders, coupled with continued focus on conversion activities backed by robust project plans are fundamental to getting to the finish line.

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