OSC STAFF NOTICE 52-718
IFRS TRANSITION DISCLOSURE REVIEW

Introduction

Recently staff of the Ontario Securities Commission conducted a review to assess the extent and quality of International Financial Reporting Standards (IFRS) transition disclosures made by issuers in light of the disclosure guidance provided in CSA Staff Notice 52-320 *Disclosure of Expected Changes in Accounting Policies Relating to Changeover to International Financial Reporting Standards* (SN 52-320).

SN 52-320 provides guidance on the requirement in Form 51-102F1 *Management's Discussion & Analysis* (MD&A) for an issuer's disclosure of the expected changes in accounting policies related to IFRS changeover for the three-year period prior to financial years beginning on or after January 1, 2011 (the changeover date). This disclosure is important to assist investors in assessing the readiness of an issuer's transition to IFRS and the impact the adoption of IFRS may have on the issuer.

Our review focused on reporting issuers' IFRS transition disclosure provided in 2008 annual and 2009 interim MD&A. We used a risk-based approach to select issuers, supplemented by a random selection of issuers across various industries. Generally, the criteria used in our selection process was designed to identify issuers whose disclosure was likely to be materially improved relative to the guidance set out in SN 52-320.

In 2008 MD&A, we expected issuers to have discussed the status of the key elements and timing of their IFRS changeover plan. As explained in SN 52-320, developing and implementing an IFRS conversion plan is not just an accounting exercise, since IFRS adoption will affect a wide variety of an issuer's business activities. SN 52-320 directs issuers to consider how the transition to IFRS will affect all business functions that rely on financial information and to communicate this to investors. We also expected issuers to have provided a status update in their 2009 interim MD&A against previously disclosed timelines so that readers of the MD&A could have assessed an issuer's transition progress.

Of the 106 reporting issuers reviewed, 60% discussed an IFRS changeover plan, while the remaining 40% did not provide any IFRS transition disclosure. Overall, our findings suggest that reporting issuers are not adequately discussing, in MD&A, the key elements of their IFRS changeover plan or their progress towards achieving this plan. We did not request, however, that issuers re-file MD&A to improve the quality of historical IFRS transition disclosure because the focus of this particular review was to raise awareness about the IFRS changeover and to educate issuers on our disclosure expectations related to transition. Issuers were asked to confirm that future MD&A filings would address the disclosure concerns identified by staff and contain enhanced disclosure of their IFRS transition plan, along with related progress updates. We will follow up on those commitments in our subsequent reviews.

The purpose of this notice is to summarize the results of our review and to provide additional guidance for issuers in filing future MD&A. Our findings do not reflect an assessment of any issuer's preparedness for IFRS transition as this assessment is best done by an issuer's management, board of directors and external advisors. Issuers and their management, directors and advisors, should take into account the issuer's level of IFRS preparedness when assessing the extent to which future MD&A disclosures meet the requirements of securities law and their investors' need for meaningful IFRS disclosure.

It is critical that investors are properly informed during the IFRS transition on whether reported changes in financial performance relate to the adoption of different accounting standards or relate to a change in the issuer's business. Issuers that provide sufficient information about their conversion process and its effects prior to the changeover will reduce the level of investor uncertainty. Ultimately, this should lead to a more stable and less disruptive transition to IFRS, which will be beneficial to both issuers and their investors.

As discussed in SN 52-320 issuers will need to provide more detailed information about the expected effects of IFRS as the changeover date approaches. Accordingly, we will conduct future targeted reviews of issuers' IFRS transition disclosures. While the focus of our current review was education and awareness, we caution issuers that we may request re-filings of MD&A in the future if disclosure obligations are not met.

Summary of Findings

Overall, we found that issuers are not adequately disclosing information related to their IFRS transition efforts. A summary of our findings is as follows:

- 40% of issuers received a letter from staff questioning whether a changeover plan was in place as it was not evident from reading their MD&A disclosure. Given the short time remaining before the changeover date this raises concerns that issuers may not be able to comply with future filing obligations.

- Of the 60% of issuers that discussed an IFRS changeover plan in their 2008 annual MD&A, approximately half simply provided a generic description of the plan without any direct application to their own circumstances. The most valuable information for investors is IFRS transition disclosure that is specific to the issuer.

- 80% of issuers that discussed an IFRS changeover plan failed to describe significant milestones and anticipated timelines associated with each of the key elements of the plan. It is important that issuers discuss the timing associated with key elements so that investors can readily assess whether the project is progressing in accordance with the changeover plan.

- 48% of issuers that discussed IFRS transition in 2008 annual MD&A failed to provide quarterly updates in 2009 interim MD&A on the progress related to their changeover plan. Investors need progress updates to assist them in assessing the likelihood that the issuer will be able to complete its IFRS conversion on time.

Findings

This section discusses the results of our review in detail.

No Disclosure of a Changeover Plan

While many of the issuers reviewed identified that they already had or were going to have a changeover plan in place, 40% of issuers did not discuss an IFRS changeover plan at all in their MD&A. In our view, the fact that an issuer has not provided any disclosure about an IFRS changeover plan implies that the issuer has not begun to prepare for the IFRS transition or does not believe it is necessary to do so. If an issuer does not have a changeover plan, we generally believe this to be material information that should be disclosed in MD&A.

In response to our comment letters, many of these issuers explained that the reason for the absence of an IFRS changeover plan was due to such factors as the lack of complexity of business operations or resource constraints. These reasons should have been disclosed in the MD&A so that investors could have assessed the potential impact that the absence of a transition plan may have on the issuer.

Given the short time remaining before the changeover date, we are concerned that issuers without a plan may be at greater risk of not meeting their future filing obligations. We asked issuers without a changeover plan to provide us with their assessment of how they intend to meet future reporting obligations in the absence of a comprehensive plan. Management and audit committees need to carefully consider this issue and the impact on their investors if they are unable or unwilling to plan for the IFRS transition. We will continue to monitor these issuers during the period leading up to the changeover date.

Disclosure of an IFRS Changeover Plan

For the 60% of issuers that discussed an IFRS changeover plan, approximately half simply provided generic or boilerplate disclosure of the transition. We assessed disclosure as boilerplate when it reflected the following two characteristics:

- The disclosure consisted of a brief description and timeline for Canada's transition to IFRS, accompanied by a statement that the impact on the issuer's financial statements could not be determined at this time; and

- The disclosure lacked entity-specific information that would have allowed a reader to assess the current status of an issuer's conversion efforts.

Example of Boilerplate Disclosure:

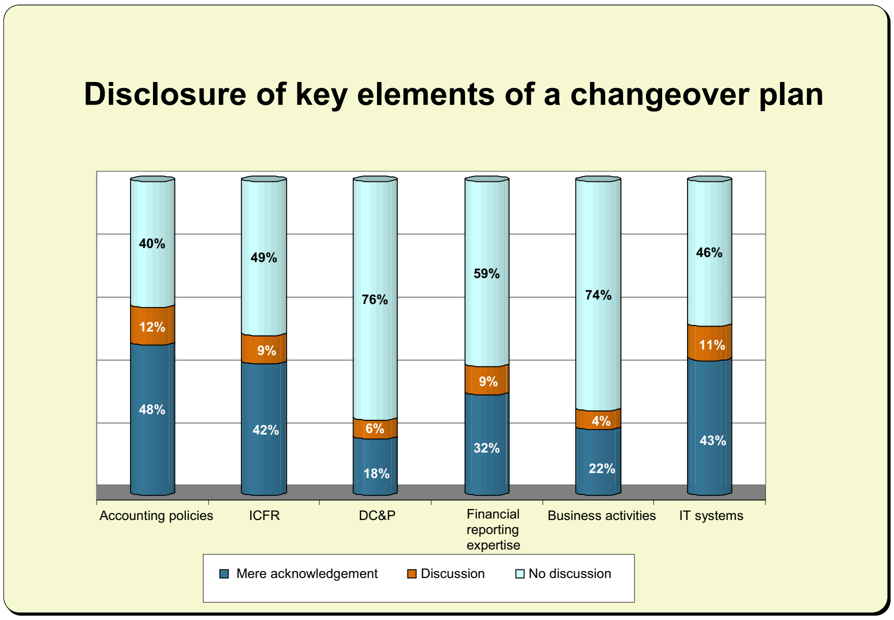
Accounting standards in Canada are to converge with International Financial Reporting Standards (IFRS). The Company is required to begin reporting under IFRS by the first quarter of 2011 with comparative data also reported under IFRS. The Company is assessing the impact on accounting policies, data systems, internal controls over financial reporting, and business activities, such as financing and compensation arrangements during the period leading up to the transition date.

This type of disclosure does not allow an investor to even begin to assess the readiness of an issuer to transition to IFRS and the possible impact that IFRS adoption may have on the issuer. To have provided meaningful information to investors and market participants, reporting issuers should have discussed in reasonable detail the key elements of their IFRS changeover plan, including the applicability of each element to the issuer's specific circumstances. In addition, issuers should have described the significant milestones and anticipated timelines for each of the elements in the plan.

Key Elements of an IFRS Changeover Plan

As outlined in SN 52-320, key elements of a plan may address the impact of IFRS on accounting policies, internal control over financial reporting (ICFR), disclosure controls and procedures (DC&P), financial reporting expertise, business activities and IT systems.

For the 60% of issuers that included IFRS transition disclosure in their MD&A, the chart below shows the extent to which each of the key elements of an IFRS changeover plan, as described in SN 52-320, was specifically addressed. While many of the issuers with a plan acknowledged some key elements, most did not provide a comprehensive discussion of the impact that IFRS would have on each element affecting the entity.



We discuss each of these key elements in more detail below and provide examples of entity-specific disclosures that may assist issuers in filing future MD&A. These examples form only one part of a complete IFRS transition plan and are for illustrative purposes only. Accordingly, they may not be sufficient for any particular issuer given its complexity and the needs of its investors.

Accounting policies

An IFRS changeover plan should address the impact of IFRS on an issuer's accounting policies, including choices among policies permitted under IFRS and implementation decisions such as whether changes will be applied on a retrospective or prospective basis. For those issuers that disclosed an IFRS changeover plan, more than half identified that IFRS would affect their accounting policies. This is not surprising since the accounting policy choices available under IFRS will likely result in differences in recognition, measurement and disclosure in an issuer's financial statements upon conversion. Changes in accounting policies may significantly impact other elements of a changeover plan, such as information technology and data systems.

Most issuers identifying this element simply acknowledged that differences between Canadian GAAP and IFRS were being considered but did not provide any further discussion on accounting policies that were of specific interest to the issuer or its industry. Enhanced, entity-specific disclosure would have provided information about the identified accounting policy differences and the potential impact on an issuer's future balance sheet, income statement and key performance metrics. Below is an example of this type of entity-specific accounting policy disclosure for a real estate company.

Entity-Specific Accounting Policy Disclosure:

The following paragraph describes the expected impact of a significant difference between Canadian GAAP and IFRS for the Company's investment properties. Under International Accounting Standard 40 *Investment Property* (IAS 40), investment property includes land and buildings held primarily to earn rental income or for capital appreciation or both, rather than for use in the production or supply of goods or for sale in the ordinary course of business. While under both IFRS and Canadian GAAP investment property is initially measured at cost, IFRS will allow investment property to subsequently be measured using the fair value model. The Company will use the fair value model when preparing its IFRS financial statements and expects the fair value of its investment properties to be greater than the properties' previous carrying value under Canadian GAAP. The Company will determine the fair value of each investment property based upon net rental income from current leases combined with projected net rental income from future leases that best reflect market conditions at the reporting date.

Internal control over financial reporting

Internal control over financial reporting (ICFR) is another key element of an issuer's changeover plan given that the conversion from Canadian GAAP to IFRS will require the implementation of a new set of accounting standards. Depending on the nature and complexity of the issuer's business, the financial reporting effects of this conversion may be significant. Issuers will therefore need to ensure that their ICFR is sufficiently robust to address the changes resulting from IFRS transition. ICFR will need to address the initial reporting of IFRS financial statements, including related note disclosures, as well as on-going financial reporting. As well, a non-venture issuer's periodic MD&A must also disclose any material changes made to these internal controls.

We noted that many issuers acknowledged that ICFR would be assessed once accounting policy choices have been finalized. Those issuers that discussed ICFR in more detail also described the activities required to ensure that proper controls would be designed to support the initial reporting under IFRS, including appropriate management oversight. Some issuers provided a discussion of their plan to test controls throughout 2010 to facilitate certification in 2011. An example of entity-specific ICFR disclosure is included in the related section below.

Disclosure controls and procedures

An issuer's changeover plan should also consider the impact of IFRS on disclosure controls and procedures (DC&P). As discussed in National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*, DC&P should provide reasonable assurance that the information required by securities legislation to be disclosed by an issuer, including interim and annual financial statements and MD&A, is recorded, processed, summarized and reported within required deadlines. It is particularly important for issuers as they progress through their IFRS changeover plan that DC&P be updated to ensure that accurate information about the conversion process is communicated in MD&A in a timely manner. This communication is critical throughout the IFRS transition so that investors will be able to identify whether reported changes in financial performance relate to business activities or result from the adoption of different accounting standards.

While DC&P is one of the key elements that an issuer's plan should address, we noted that it was acknowledged less frequently than any other element. This lack of disclosure was surprising given that SN 52-320 specifically identifies investor relations and external communication plans within DC&P. Most issuers simply disclosed that consideration would be given to their key metrics, but did not discuss whether this consideration would include the on-going application of the IFRS standards or the application of the one-time transitioning standard IFRS 1 *First-time Adoption of International Financial Reporting Standards*. It is important that issuers provide external stakeholders with enough information to assist them in assessing the impact of the issuer's IFRS policy choices prior to transition. Below is an example of disclosure that addresses the ICFR and DC&P plans of an issuer.

Entity-Specific ICFR and DC&P Disclosure:

As the review of accounting policies is completed, appropriate changes to ensure the integrity of internal control over financial reporting and disclosure controls and procedures will be made. For example, any changes in accounting policies could result in additional controls or procedures being required to address reporting of first time adoption as well as ongoing IFRS reporting requirements.

At this point, the Company has determined that it will adopt an accounting policy to revalue its manufacturing plants in accordance with IAS 16 *Property, Plant & Equipment*. This new policy differs significantly from the existing policy, and additional controls will need to be designed and implemented to ensure that the recorded balance is fairly stated at each reporting period. It is anticipated that such controls will include the use of independent valuators, senior management oversight on the development of key assumptions and additional accounting system changes. The certifying officers plan to complete the design, and initially evaluate the effectiveness of, these controls in the third quarter of 2010 to prepare for certification under IFRS in 2011.

The Company will also ensure that its key stakeholders are informed about the anticipated effects of the IFRS transition. In the current year, the Company provided IFRS information as part of its investor day presentations to highlight such anticipated effects on the Company.

Financial reporting expertise

One of the most critical elements of an IFRS conversion plan is technical training for an issuer's board, management and employees. An issuer's management and its employees need the technical knowledge to lead the IFRS conversion and implement the accounting policy changes throughout the organization. Similarly, board and/or audit committee members will need to be sufficiently knowledgeable about IFRS in order to evaluate management's selection of accounting policy choices permitted under IFRS and to consider the impact of IFRS conversion on the various aspects of the issuer's operations.

Our review found most issuers simply acknowledged that the financial reporting management team would obtain the appropriate training to prepare IFRS compliant financial statements. Some issuers, however, provided disclosure about the involvement of their board of directors and audit committees and the deployment of internal and external resources to prepare for the IFRS transition. A limited number of issuers also disclosed they do not have sufficient resources in-house and would be relying on external advisers to assist with the transition. This type of entity-specific disclosure allows investors to understand the extent of resources the issuer is dedicating to the conversion process and the level of involvement of the audit committee or board of directors of the issuer. An example of disclosure around planning for an entity's IFRS reporting expertise is provided below.

Entity-Specific Financial Reporting Expertise Disclosure:

The Company has identified resource requirements to establish appropriate IFRS financial reporting expertise at all levels of the business. Training of key finance and operational staff is to be delivered starting in the second quarter of 2009. Educational information regarding IFRS implications will be issued to external constituents, such as rating agencies, during the third quarter of 2010.

The Company also held an IFRS information session with members of the Board of Directors (including Audit Committee members). During this session, management and external consultants provided the Board with a review of the timeline for implementation, the implications of IFRS standards to the business and an overview of the impact to the financial statements (as experienced in Europe by comparable companies).

As a result of the information session, the Audit Committee members will review the Audit Committee Charter and make the necessary changes to reflect the requirements for IFRS financial expertise. The Audit Committee will continue to receive quarterly presentations and project status updates from management.

Business activities

Issuers will also need to plan for the impact of IFRS on their business activities. This is a wide ranging element and may include foreign currency, hedging activities, debt covenants, compensation arrangements and risk management practices. It is important to note that any activity that relies on financial information will need to be considered in the context of the broader consequences of IFRS conversion.

Most issuers that acknowledged this element identified debt covenants and executive compensation as arrangements that would be considered. Many issuers also discussed the need to review contracts for IFRS impact as part of the changeover plan but very few provided entity-specific information that would be useful to investors. Where entity-specific information was provided, one issuer identified certain material contracts and explained, in detail, the process required to amend the contracts before the changeover date. This disclosure enabled users to understand the IFRS impact of the contracts on the issuer’s operations and how the matter was being addressed in advance of the transition. Below is an example of disclosure related to the impact of IFRS on an issuer’s business activities.

> **Entity-Specific Business Activities Disclosure:**
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> The Company is required to meet its financial covenants included in the Declaration of Trust and the debenture agreement. Within each of the previously mentioned documents, the Company’s debt cannot exceed 65% of gross book value (GBV). As discussed above, an accounting policy choice exists which would allow the Company to record its investment properties at fair value resulting in the Company’s debt being significantly less than 65% of GBV, which provides less protection to stakeholders. As a result of this expected change, the debenture agreement has already been revised to state that the indebtedness percentage will decrease to 55% from the current 65% when the Company elects to report the fair value of its investment properties in accordance with IFRS. This change ensures that the financial covenant is still addressing the concerns of the stakeholders and similar revisions are expected in the other documents.

IT systems

Another key element issuers should consider in transition planning is the impact of IFRS on IT systems (IT). Any changes made to accounting policies for the recognition, measurement and disclosure requirements of IFRS may necessitate system changes to accurately support these new requirements. These changes will generally need to be made prior to the changeover date to ensure the issuer’s systems can generate the comparative 2010 IFRS data required for its first interim IFRS filing in 2011. While system changes for IFRS will likely impact the general ledger, an issuer’s changeover plan may also consider any implications for other applications such as, treasury, payroll and risk management systems.

Most of the issuers that addressed IT acknowledged systems changes would be needed the year before the changeover date to capture the comparative data required for their first IFRS financial statements. Issuers that discussed IT in more detail provided further, entity-specific information requirements that would arise from the adoption of IFRS. As described below for example, some issuers with investment properties disclosed that system changes would be needed to track additional fair value information for their properties. This type of disclosure allows investors to assess the extent to which an issuer's systems will be impacted by transition.

> **Entity-Specific Information Technology and Data Systems Disclosure:**
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> A significant IT initiative is underway in anticipation of the implementation of IFRS standards on January 1, 2011. The initiative relates to the development of a fixed asset module that will be used to track all assets within the organization. This system will allow the Company to track all assets as required under current Canadian GAAP (requirement from now until January 1, 2011), under IFRS (required as at January 1, 2011) and for the compilation of a comparative year of financial information beginning January 1, 2010. In addition to tracking the cost basis of all the Company's real estate assets, it will track the fair value of each the Company's properties as required under IAS 40.

Milestones and Timelines

For each key element of an IFRS changeover plan discussed in MD&A, issuers should describe the significant milestones and anticipated timelines. This provides users of the financial statements with the information necessary to assess an issuer's readiness to meet the changeover to IFRS.

Our review found that only 20% of the issuers that discussed an IFRS changeover plan also described the significant milestones and anticipated timelines for each of the key elements comprising the plan. It is important that issuers discuss the timing associated with key elements so that investors can readily assess whether the project is progressing in accordance with the changeover plan.

Quarterly Updates

SN 52-320 sets out an incremental approach to disclosure of the impact of IFRS changeover leading up to 2011. Issuers should provide quarterly MD&A updates on the status of their changeover plan, along with an assessment of their progress in relation to expected milestone completion dates. Alternatively, disclosure should confirm that no progress has been made during the quarter.

We found only approximately half of the issuers that discussed IFRS transition in 2008 annual MD&A provided quarterly updates in 2009 interim MD&A on the progress related to their changeover plan. In our view, if an issuer does not provide updated information on the status of its IFRS transition in interim MD&A, this suggests the issuer has not made any progress in relation to its changeover plan. It is important for investors that an issuer communicate its progress towards IFRS conversion in a timely manner.

Future Action

As described in SN 52-320, we expect issuers to provide more detailed information about the expected effects of IFRS as we move closer to the changeover date. Specifically, an issuer's 2009 annual MD&A disclosures should provide a progress update on their conversion plan, along with a description of the major identified accounting differences between the issuer's current accounting policies and those the issuer expects to apply when preparing its IFRS financial statements. In 2010, we expect issuers to provide significant details of their changeover plan and information about key decisions on policy choices under IFRS 1 *First-time Adoption of International Financial Reporting Standards*. As well, if an issuer has quantified information about the impact of IFRS on key financial statement line items when it prepares MD&A in 2010, the issuer should include this information in its MD&A.

We will conduct reviews of selected 2009 and 2010 annual and interim MD&A filings. We will also follow up on the commitments made by issuers during this review to improve future MD&A disclosure. While the focus of our current review was to increase issuer awareness and prospectively improve IFRS disclosures, issuers should anticipate staff requests for re-filings of MD&A in the future if an issuer has not met its disclosure obligations. As well, staff may consider other regulatory action as circumstances warrant.

Questions

Questions may be referred to:

Kelly Gorman
Manager, Corporate Finance
E-mail: kgorman@osc.gov.on.ca
Phone: 416-593-8251

Heidi Franken
Senior Accountant, Corporate Finance
E-mail: hfranken@osc.gov.on.ca
Phone: 416-593-8249

Kelly Mireault
Accountant, Corporate Finance
E-mail: kmireault@osc.gov.on.ca
Phone: 416-595-8774