

CSA Concept Paper 52-402**Possible changes to securities rules relating to
International Financial Reporting Standards**

February 13, 2008

Introduction

Staff of the Canadian Securities Administrators (the CSA or we) are publishing this concept paper to set out possible changes to securities rules on acceptable accounting principles for financial reporting and to solicit from market participants comments on those possible changes. The possible changes relate to the changeover in Canada to International Financial Reporting Standards (IFRS) which are issued by the International Accounting Standards Board (IASB).

CSA rules currently refer to Canadian GAAP (generally accepted accounting principles), which are established by the Canadian Accounting Standards Board (AcSB) and published in the CICA Handbook. Following a period of public consultation, the AcSB has adopted a strategic plan to move financial reporting for Canadian publicly accountable enterprises to IFRS as issued by the IASB. The AcSB's implementation plan proposes a mandatory changeover from existing Canadian GAAP to IFRS for years beginning on or after January 1, 2011. The appendix on page 9 provides a discussion, prepared by the Chair of the AcSB, of the rationale for the strategic and implementation plans.

National Instrument 52-107 *Acceptable Accounting Principles, Auditing Standards and Reporting Currency* (NI 52-107) sets out acceptable accounting principles for financial reporting under securities legislation by domestic issuers¹, foreign issuers, registrants and other market participants. Under existing NI 52-107, a domestic issuer must use Canadian GAAP with the exception that an SEC registrant has the option to use US GAAP. Under existing NI 52-107, only foreign issuers can use IFRS.

Given the AcSB's strategic plan, as well as recent developments in the US relating to acceptance of financial statements prepared in accordance with IFRS, we are considering possible amendments to NI 52-107 and are involved in other activities relating to the changeover to IFRS including:

- monitoring progress of the AcSB's implementation plan and market participants' preparations for the changeover
- identifying and developing necessary changes to CSA rules, policies and guidance that were developed on the basis that domestic issuers and registrants must use either existing Canadian GAAP or, in the case of SEC issuers, US GAAP

¹ The term "domestic issuer" in this paper refers to a reporting issuer that is not a "foreign issuer" as defined in NI 52-107. Most domestic issuers are incorporated or organized in a Canadian jurisdiction.

- developing guidance for issuers' disclosure of their transition to IFRS for filings during the years 2008 through 2010

This paper does not address all possible changes to securities rules relating to the changeover to IFRS, but focuses on three issues we think demand immediate attention. In the future, we may request comments on additional changes.

The three possible changes to securities rules addressed in this paper are:

1. Use of IFRS by domestic issuers before January 1, 2011,
2. Use of US GAAP by domestic issuers, and
3. Reference to "IFRS as issued by the International Accounting Standards Board" (IFRS-IASB) instead of "Canadian GAAP."

1. Use of IFRS by domestic issuers before January 1, 2011

The AcSB's strategic plan proposes mandatory changeover to IFRS for publicly accountable enterprises for financial years beginning on or after January 1, 2011.² However, some issuers might want to prepare their financial statements in accordance with IFRS for periods beginning prior to the changeover date. Issuers likely to consider doing this include the following:

- domestic issuers that are subsidiaries of entities based in a foreign jurisdiction that requires compliance with IFRS
- domestic issuers with significant foreign operations in jurisdictions where the operating subsidiaries must prepare financial statements in accordance with IFRS
- domestic issuers that are also SEC registrants and could therefore take advantage of the recently introduced opportunity to file IFRS financial statements with the SEC without a reconciliation to US GAAP³
- Canadian entities considering doing an IPO in both Canada and the US prior to the mandatory changeover date in Canada

A number of key factors, discussed below, are relevant in considering whether we should allow domestic issuers to adopt IFRS earlier than the mandatory changeover date.

a) readiness of preparers, investors, auditors, analysts and regulators

It appears that in-depth IFRS knowledge in Canada is just starting to develop. We expect that, over the next few years, market participants will face some IFRS education and resource challenges. The question is whether some issuers can adequately address those challenges before the mandatory changeover date. We expect that an issuer contemplating the possibility of adopting IFRS before 2011 would carefully assess the

² The AcSB has indicated it will confirm, or otherwise vary, the mandatory changeover date no later than March 31, 2008, as a result of its progress review.

³ Following its announced intention on November 15, 2007, the SEC released on December 21, 2007 a rule to allow foreign private issuers to file financial statements prepared in accordance with IFRS-IASB without having to reconcile those financial statements to US GAAP.

readiness of its staff, board of directors, audit committee, auditors, investors and other market participants to deal with the change.

b) comparability of financial statements

Under existing securities rules in Canada, a domestic issuer must file financial statements prepared in accordance with Canadian GAAP or, if the issuer is an SEC issuer, in accordance with US GAAP. Allowing early adoption of IFRS would introduce a third set of standards for domestic issuers for a limited period (until the mandatory changeover date), and therefore reduce the comparability of financial statements in our market. The extent of this disruption would be affected by the extent and timing of early adoption of IFRS.

c) experience in applying IFRS

Many countries have used IFRS for a few years only and several of the individual standards within IFRS are relatively new. Application practices continue to develop. Some interested parties have suggested that Canada should not adopt IFRS until application practices are further developed.

d) financial statement preparation costs

A domestic issuer that is a subsidiary of an entity based in a foreign jurisdiction, has significant foreign operations, or wants to avoid US GAAP reconciliation requirements might significantly reduce its costs of preparing financial statements and other filings if it could file in Canada earlier than 2011 financial statements prepared in accordance with IFRS.

e) impact on overall transition to IFRS in Canada

The overall transition to IFRS in Canada may be smoother if some issuers adopt IFRS before the mandatory changeover date. Issuers, investors, analysts and educators might increase their knowledge of IFRS earlier than they would if all domestic issuers had to wait until the mandatory changeover date. Issuers and investors could learn about IFRS and their impact on financial reporting from early adopters' disclosure. As well, early adoption by some reporting issuers may ease, albeit to a limited extent, the demand for IFRS expertise in 2010 and 2011.

f) changes to IFRS expected before the changeover date

Significant changes to IFRS during an early-adoption period would reduce the benefits of early adoption described in sections d) and e) above. In November 2007, AcSB staff estimated that 26 of the existing 37 individual standards within IFRS-IASB will remain essentially unchanged from their form as of January 1, 2007 and that, of the eleven standards expected to change, five will be amended only in respect of narrow aspects of the requirements.⁴

⁴ Per November 19, 2007 AcSB publication "Publicly Accountable Enterprises – the Road to IFRSs."

Tentative conclusion

CSA staff think that, on balance, the factors support permitting early adoption. Therefore, CSA staff's tentative conclusion is that we should allow a domestic issuer to adopt IFRS-IASB for a financial year beginning on or after January 1, 2009.

Question 1 Do you agree we should allow a domestic issuer to adopt IFRS-IASB for a financial year beginning on or after January 1, 2009? If not, why?

Question 2 Are there additional factors, not discussed in this paper, to consider in deciding whether to allow a domestic issuer to adopt IFRS-IASB before 2011?

2. Use of US GAAP by domestic issuers

NI 52-107 currently permits SEC issuers (including domestic issuers that are SEC registrants) to file with Canadian securities regulators financial statements prepared using US GAAP. The plan to converge Canadian GAAP to IFRS by 2011 and the SEC's recent decision to allow foreign private issuers to file financial statements prepared in accordance with IFRS-IASB without reconciliation to US GAAP raise a question about the appropriateness of the existing provisions in NI 52-107 relating to US GAAP. Specifically, should we retain or remove the existing option for a domestic issuer that is also a SEC issuer to prepare its financial statements using US GAAP? Further, some have argued we should allow all domestic issuers the option of using US GAAP. We have identified various factors relevant to this decision.

a) acceptance of IFRS in the Canadian market

The CSA supports the goal of a single set of high-quality accounting standards that are accepted and applied globally, namely IFRS-IASB. We think our rules should promote broad adoption of IFRS-IASB in Canada. Retaining an option for domestic issuers to file financial statements prepared in accordance with US GAAP could undermine this goal.

b) costs and complexity of multiple standards

Issuers, investors, and advisors in Canada currently must deal with both Canadian GAAP and US GAAP financial information. As discussed earlier in this paper, allowing domestic issuers to choose among two or three sets of standards for preparing their financial statements reduces the comparability of financial statements in our market, and increases costs and complexity for market participants.

c) SEC's acceptance of IFRS-IASB

A key rationale for the CSA's introduction in 2004 of the option for a domestic issuer that is also a SEC issuer to use US GAAP was the cost and burden of preparing both Canadian GAAP and US GAAP financial statements. That rationale has been largely eliminated by the SEC's recent decision to allow foreign private issuers to file financial statements prepared in accordance with IFRS-IASB without reconciliation to US GAAP.

d) future role of US GAAP in Canada

Despite the SEC's recent decision to no longer require US GAAP reconciliation of a foreign private issuer's financial statements prepared in accordance with IFRS-IASB, some domestic issuers who currently use US GAAP might want to continue doing so for other reasons, including comparability to competitors who use US GAAP.

e) uncertainty about IFRS

We are aware that some issuers, particularly in certain industries, are concerned about the uncertainty of IFRS implementation and the content of future standards within IFRS. These issuers might prefer to continue with or change to US GAAP rather than adopt IFRS. However, any possible advantages of continuing with or changing to US GAAP should be weighed against uncertainty about the content of future standards within US GAAP and the possible acceptance by the SEC from US issuers of financial statements prepared in accordance with IFRS, matters that are currently the subject of extensive debate in the US.

Tentative conclusion

CSA staff believe that, on balance, the factors discussed above support eliminating our current provisions relating to the use of US GAAP by domestic issuers. Specifically, CSA staff's tentative conclusion is that we should not allow a domestic issuer to use US GAAP for a financial year beginning on or after January 1, 2009, with the exception that a domestic issuer filing US GAAP financial statements in Canada for its most recent financial year ending on or before December 31, 2008, could continue doing so for five years (i.e. 2009 to 2013).

Question 3 Do you agree we should not allow a SEC issuer to use US GAAP for financial years beginning on or after January 1, 2009, with the exception that a SEC issuer filing US GAAP financial statements in Canada for its most recent financial year ending on or before December 31, 2008, could continue doing so until 2013? If not, why do you disagree, and how, if at all, would you modify existing rules?

Question 4 Are there additional factors, not discussed in this paper, to consider in deciding whether to allow a SEC issuer to use US GAAP?

Question 5 Is the proposed transitional period of five years from 2009 to 2013 appropriate?

3. Reference to "IFRS-IASB" instead of "Canadian GAAP"

The AcSB's strategic plan proposes to import IFRS into Canadian GAAP and continue using the term "Canadian GAAP." The strategic plan indicates that this approach to terminology is necessary because many federal, provincial, and territorial laws, regulatory rules and other such requirements specifically refer to Canadian GAAP. The strategic plan says that despite this practical issue, the ultimate objective is for enterprises to be able to report compliance with IFRS.

CSA staff believe it may be possible to implement prior to 2011 a change in securities rules to refer to IFRS rather than Canadian GAAP, even without all other laws and requirements in Canada having been changed. In considering the possibility of referring in securities rules to IFRS-IASB rather than Canadian GAAP, CSA staff identified three issues discussed below.

a) transparency of the relationship between Canadian GAAP and IFRS-IASB

If, after the mandatory changeover date, reporting issuers' financial statements refer to Canadian GAAP only, many market participants, both within and outside Canada, might not understand that Canadian GAAP requires full compliance with IFRS-IASB.

b) jurisdictional modifications to IFRS

As we implement a changeover to IFRS in Canada, we can learn from other countries' experiences. In particular, some countries have adopted their own "version" of IFRS containing limited or extensive modifications from IFRS as issued by the IASB.

Continued use of the term Canadian GAAP might unintentionally give the impression that Canada is adopting a jurisdiction specific version of IFRS. Development of jurisdictional modifications to IFRS detracts from the ultimate objective of a single set of high-quality accounting standards that are accepted and applied globally. The Technical Committee of the International Organization of Securities Commissions (IOSCO) and others, including SEC staff, have expressed concern about a proliferation of references to "IFRS as adopted in a particular jurisdiction". The SEC's recent elimination of GAAP reconciliation requirements for foreign private issuers applies to financial statements prepared in accordance with IFRS-IASB only.

c) French translation of IFRS-IASB

The IASB issues IFRS-IASB in English only. The International Accounting Standards Committee Foundation has published French translations of a significant portion of IFRS-IASB. However, before changing securities rules to require a domestic issuer to prepare its financial statements in accordance with IFRS-IASB, we must ensure the timely availability on an ongoing basis of an appropriate French translation of IFRS-IASB.

Tentative conclusion

Based on the objective of transparency and concerns about jurisdictional modifications to IFRS, we prefer reference in securities rules to IFRS-IASB rather than Canadian GAAP. We are also hopeful that the French translation issue will be appropriately resolved. Based on these views, CSA staff's tentative conclusion is that we should require a domestic issuer to prepare its financial statements in accordance with IFRS-IASB and require an audit report on such annual financial statements to refer to IFRS-IASB. Under this approach, an issuer could disclose that its financial statements comply with both IFRS-IASB and Canadian GAAP, but we propose that NI 52-107 refer to IFRS-IASB only.

Question 6 Do you agree that we should require a domestic issuer to prepare its financial statements in accordance with IFRS-IASB and require an audit report on such annual financial statements to refer to IFRS-IASB? If not, why?

Question 7 Are there additional factors, not discussed in this paper, to consider in deciding whether securities rules should refer to IFRS-IASB rather than Canadian GAAP?

Conclusion and next steps

The CSA supports the goal of a single set of high-quality accounting standards that are accepted and applied globally. We believe the possible changes to securities rules in Canada described in this paper relating to early adoption of IFRS, removal of the US GAAP option for domestic issuers and reference to IFRS-IASB are appropriate in light of that goal. We expect that these changes, if implemented, would affect many market participants in Canada. Therefore, we invite you to participate in the process of developing the changes by providing us your comments on the issues set out in this paper. Please refer to instructions below on submitting comments.

Following a broadly based consultation concerning the issues raised in this concept paper, CSA staff will consider what, if any changes to NI 52-107 should be proposed. CSA staff will also consider the best way to implement, if appropriate, an option for domestic issuers to use IFRS before the mandatory changeover – either through changing NI 52-107 or through exemptive relief. We plan to publish for comment in mid 2008 any proposed changes to NI 52-107 with a view to implementing final changes in time for application to financial statements beginning on or after January 1, 2009.

Submitting comments

We invite you to send us your comments on the issues identified in this concept paper in electronic form. Please send them in writing on or before April 13, 2008.

Please address your comment letter to the CSA members listed below in care of Carla-Marie Hait, Chief Accountant, Corporate Finance, British Columbia Securities Commission and Sylvie Anctil-Bavas, Chef comptable, Autorité des marchés financiers.

We cannot keep submissions confidential because securities legislation in certain provinces requires us to publish a summary of written comments received during the comment period.

Questions

Please refer your questions to any of the following people:

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Appendix

The Case for Changeover to International Financial Reporting Standards

by Paul Cherry, FCA, Chair of the Canadian Accounting Standards Board

International Financial Reporting Standards (IFRS) will soon become the basis of reporting for public companies in Canada. The Canadian Accounting Standards Board (AcSB) announced this change in January 2006, after two years of extensive consultation and public discussions across this country. The changeover date is January 1, 2011. The strategy is supported by a well-developed, comprehensive implementation plan (see www.acsbcanada.org).

Why change? Canada cannot stand in isolation from the growing acceptance of a common financial reporting language. Capital markets have gone global and Canada's share is less than 4%. If every country speaks a different accounting language, investors have difficulty comparing companies and investors ultimately bear the costs of translation. A global accounting language is the best solution for both public companies and investors.

In 1998, the Task Force on Standard Setting comprehensively examined the future direction of standard setting in Canada. It endorsed the objective of a single set of global accounting standards and, as an intermediate step, harmonization with US standards.

Why IFRS? Since 1998, views have changed. The overwhelming consensus view is that US GAAP is not a viable proposition in Canada, especially with our extensive junior capital markets. At the same time, IFRS has now progressed to the point where it can serve as the single set of global standards. The consensus is that the standards are comprehensive, robust and capable of consistent interpretation and application. Many in Canada and abroad have been urging their adoption in the major capital markets.

With businesses increasingly making decisions in a global context, the move to IFRS will place Canada with more than 100 other countries, including the United Kingdom and other European Union nations, as well as Australia, that have already made the move. Japan, China, India, Brazil, South Korea and Israel, to name a few, are now in the process of converging with IFRS.

Even the United States is signaling acceptance of IFRS. Foreign SEC registrants reporting using IFRS are no longer required to reconcile their financial statements to US GAAP – a significant cost saving. In addition, there is a formal agreement and work program to converge US GAAP and IFRS, and significant progress has already been made. Most recently, the United States is considering whether to adopt IFRS for its domestic issuers.

The AcSB believes that IFRS will provide more opportunities for Canadian businesses and investors in those businesses by reducing the cost of capital, increasing access to international capital markets and reducing costs by eliminating the need for reconciliations. By making the decision now to adopt IFRS, Canada is in a better position to influence the future evolution of IFRS and thereby avoid excessive reliance on detailed rules. The AcSB believes that the long-term benefits of a changeover to IFRS outweigh any short-term challenges. IFRS will provide a sound basis for high quality, clear and consistent reporting that serves investors' needs.