NO SURPRISES

Keeping stakeholders in the loop

Shifting smoothly to IFRS depends on effective communication with all concerned, experts advise

Get out and communicate with key stakeholders! That's a message that Canadian publicly accountable enterprises are hearing as they shift to International Financial Reporting Standards (IFRS) for fiscal years beginning on or after January 1, 2011.

Public entities in some 100 other countries around the globe that have already moved to IFRS—including members of the European Union—long ago discovered the importance of being on top of the communications game.

"The evidence from Europe has shown that if preparers don't ready the market for the impact of changes to IFRS, which can be significant, oftentimes the market can be surprised, and perhaps unnecessarily so," says Peter Chant, FCA, a partner in the national office of Deloitte & Touche LLP.

A key concern is that changes in financial reports will be misinterpreted by interested third parties. "You may see entities writing down assets, and charging significant amounts to their retained earnings as a consequence of the change," says Mr. Chant. "Without sufficient understanding, these adjustments may be incorrectly interpreted as a signal there has been some deterioration in the business that the market did not understand before."

Mr. Chant draws an analogy to Canada's metric conversion in 1975. Switching from the Fahrenheit scale to Centigrade involved a relocation of scale, including resetting the freezing point from 32 degrees Fahrenheit to zero Celsius, with the result being that different numbers under the old and new scales meant the same thing—similar, he says, to what is occurring as a result of the IFRS transition.

"What happens in the conversion to IFRS is we have different ways of measuring assets—in many cases, some different dynamics. For example, a transaction we reported one way under Canadian generally accepted accounting principles (GAAP) resulting in an asset on the balance sheet might result in an expense under IFRS. It's the same transaction, but gives out quite different signals," he notes.

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IFRS adopters need to ensure that all their external stakeholders, including shareholders, market analysts, auditors, regulators, bankers and creditors, are kept apprised of IFRS developments. Those parties need to understand, for instance, that while financial reporting under IFRS might present the organization's financial position in a new light, this in itself is not indicative of a change in its underlying business performance.

There are a number of accounting decisions that need to be made as part of the IFRS transition that could have a significant impact on the financial statement presentation of assets, liabilities, revenues or expenses. This could, in turn, affect the firm's lending arrangements if there are covenants attached based on the maintenance of certain financial ratios.

If changes to reported financial performance are entirely attributable to a different measurement basis, "then the preparers should let the market know 'there is a change coming; it doesn't signal that our business has deteriorated; it just signals that we've got a different way of measuring things,'" says Mr. Chant.

If investors and potential investors don't adequately understand IFRS and its impact on financial reporting, "it could affect their investment decisions," agrees Anthony Scilipoti, CA, CPA, executive vice-president of Veritas Investment Research Corp., and a member of the Accounting Standards Board. Some may miss out on trading opportunities based on an inaccurate reading of the reported financial results, he says.

"The reporting entities need to take the time to communicate information as early as possible so investors feel they are being kept informed," adds Mr. Scilipoti. "Investors will have more trust in the financial information because of those disclosures."

Educating investors about the impact of IFRS involves more than self-interest; it also constitutes part of regulatory compliance. "The Canadian Securities Administrators have requested entities to disclose their progress, and the likely quantitative impact of any change in their financial statements that will incur upon IFRS, on a quarterly basis," notes Mr. Chant.

Companies that are adopting IFRS should be engaging their investor relations staff to help educate the market about how IFRS will affect their financial reporting.

"We've been encouraging our members to get involved in their companies' IFRS transition teams early into the process, so they are part of the discussions about making the necessary changes," says Tom Enright, president and chief executive officer of the Canadian Investor Relations Institute. "This way they are best prepared for talking to the street about IFRS and helping analysts through that learning curve about the changes happening in their company or industry," says Mr. Enright.

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Saskatchewan-based PotashCorp, often recognized for excellence at the Corporate Reporting Awards presented annually by the Canadian Institute of Chartered Accountants, has made communication with external stakeholders a priority throughout its IFRS preparations. "We have made a concerted effort to keep people up to speed throughout the process," says Denita Stann, senior director of investor relations. "Quite honestly, we have not received any queries from users of our financial statements above and beyond the information we have made available."

If the transition is to go smoothly, both preparers of financial statements and the investment community have work to do. "The investment community needs to familiarize itself with the differences, so they can ask the appropriate questions to be able to discern between financial impacts that are based on operating results versus accounting choices," says Mr. Scilipoti.

Investors also need to understand the impact that some accounting measurement changes, such as those for mergers and acquisitions, might have on an organization's financial reporting on an ongoing basis. "Those are the ones that are going to take a little more work," Mr. Chant says. "They won't just happen once upon conversion. They will continue to affect the reporting of an enterprise's financial position and income."

"The interesting part when you talk to analysts on the street or you talk to the business media, is that their level of knowledge of IFRS is actually quite limited at this point," says Mr. Enright. "This a good opportunity for investor relations people to educate about IFRS. They need to introduce it in a very real, tangible way—so [everyone is] really well prepared when the reporting transition starts, which is just around the corner."