Are we In FoR a Market Shock?

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ABSTRACT

On January 1, 2011 Canadian reporting entities will be required to switch from Canadian Generally Accepted Accounting Principles ("GAAP") to International Financial Reporting Standards ("IFRS"). This paper examines whether the adoption of IFRS will have an impact on share values of Canadian public companies. The adoption of IFRS does not affect cash flows, but can provide new information that may impact an assessment of value. Evidence from other countries, suggests that the adoption of IFRS did have an impact on share values. The majority of Canadian investors and analysts may not be well prepared for IFRS. As a result, even though there may have been no fundamental change in a company's performance, until investors and analysts can determine otherwise, they may react as if there has been. The adoption of IFRS may impact share values for 35% - 40% of Canadian public companies.

Although this research was conducted on behalf of the Canadian Institute of Chartered Business Valuators the opinions expressed are those of the author.

1. INTRODUCTION

During the 1970's Canada joined the ranks of the international majority and converted from the imperial to the metric system of measurement. This was a significant change to the way we measured everything; height, weight, volume, distance, speed, and even temperature. The conversion process required Canadians to, almost overnight, learn a new system with new terminology, and even to calculate some things in a different way. A similar change in Canadian accounting will take place on January 1, 2011, when public companies convert from GAAP to IFRS. This move to IFRS is the most significant regulatory change in Canadian accounting history, unprecedented by the sheer number of accounting rules changing at one time. Accountants, analysts, and the entire investment community will need to learn a new accounting "measurement" system.

IFRS is the most significant regulatory change in Canadian accounting history. CBVs will need to understand the implications of IFRS on the valuations of shares.

The Accounting Standards Board of Canada ("AcSB") stated that adopting IFRS will help Canadian companies remain competitive within global capital markets. IFRS should provide more transparent and comparable financial information resulting in improved financial reporting in an increasingly international business environment.[1] IFRS and GAAP are both sets of accounting rules or standards that dictate how business transactions should be accounted for and reported. Although IFRS and GAAP are conceptually similar, there are a number of significant differences in how transactions are recognized, measured and disclosed. However, the use of one accounting standard over another, has no impact on the underlying transactions, and does not change the cash flows associated with the transactions.

The transition to IFRS is not limited to finance and accounting departments, and affects many other areas of an organization including IT, investor relations, legal and human resources. Most IFRS pronouncements stress the potential impact on companies, in terms of transition time and costs, and many even go on to suggest that the scope of the changes could *impact share values or price*. Will this in fact be the case? Will the adoption of IFRS have an impact on share values of Canadian public companies? Canadian Chartered Accountants ("CAs") seem to think so. In a 2008 survey, 46% of CAs polled said organizations should expect some impact on share prices.[2]

[1] Canadian Performance Reporting Board (2010)-The IFRS Changeover- A guide for users of financial reports.
[2] CAmagazine December 2008- from a poll of 273 CAs from public practice, government and industry conducted by Resources Global Professionals.

A 2006 survey in Europe found that the adoption of IFRS had changed fund managers' perceptions of company value, with 52% of fund managers stating that IFRS had an impact on their investment decisions[3]. But if IFRS is an accounting change with no impact on cash flows, how can IFRS impact share values? If an investor's perception of value has changed, but there has been no underlying change in the company, then the investor must have acquired new information about the company's existing conditions, expected future results or risks. For the adoption of IFRS to have an impact on share value or price, IFRS must in some way provide new information.

IFRS does not affect cash flows but can provide new information that may impact assessments of value.

Accounting standards can provide information in at least two ways; by how the transactions are measured and recorded on the actual statements (balance sheet, etc.) and by additional information disclosed in the notes to the financial statements. Another key source of financial information is the Management Discussion and Analysis ("MD&A") that Canadian securities regulators require public companies to provide on a quarterly basis. While IFRS does not dictate the content of the MD&A, the Canadian Securities Administrators ("CSA") has incorporated IFRS disclosure expectations into its MD&A guidance.

Differences between IFRS and GAAP accounting standards can bring to light information in a more timely or transparent way. For example, IFRS provides an option to account for investment properties at their fair value instead of historical cost. A company in the real estate industry, with an investment property that has increased in value since acquisition, could record the higher current value of the property in their financial statements. Under GAAP, the company would not have been able to record the increase in value until the property was sold. This revaluation option under IFRS can provide information to investors that, to the extent it is new information, may change the investor's assessment of risk.

IFRS permits the revaluation of certain assets at fair values, rather than historical cost, which may change assessments of risk.

Another example of a difference in accounting standards is in the determination of impairment. Under IFRS, if an indication of impairment is identified, the asset's carrying amount is compared

[3]PricewaterhouseCoopers (2006) European Survey- The results were based on responses from 187 fund managers. The Institute of Chartered Accountants in England and Wales ("ICAEW") study in 2007 posed a similar question and, based on responses from 51 investors, 41% stated that IFRS had influenced their investment decisions, although 31% stated by just a little. I have quoted the PricewaterhouseCoopers result as their survey was conducted closer to the adoption date and was based on a larger sample size.

to the asset's discounted cash flows. If the discounted cash flows are less than the carrying value, the asset is considered impaired. Under GAAP, the carrying value is compared to *undiscounted* cash flows. For longer term assets discounting can have a significant impact and, as a result, an impairment may be recognized sooner under IFRS than would be under GAAP, resulting in a more timely recognition of loss. The required note disclosures under IFRS are generally considered to be more extensive than GAAP and, therefore, may also provide new information.

An often cited economic benefit from adopting IFRS includes a potentially lower cost of capital for Canadian companies. To the extent IFRS facilitates cross-border investment, perhaps by expanding a company's following by international analysts or facilitating listings on other IFRS country's stock exchanges, a lower cost of capital may be possible. The potential, is however, universal for Canadian companies and would not likely affect an individual company's share value until the company actually seeks a listing on another exchange or succeeds in attracting new foreign investment. IFRS may facilitate the process, but the adoption of IFRS in itself, especially when it is mandatory, would not likely impact value. It is also unlikely that when IFRS become mandatory, all Canadian public companies will enjoy an across-the-board increase in share value for a potential lower cost of capital. A report by the ICAEW noted that previous research on reductions in the cost of capital for EU countries, after the adoption of IFRS, was inconclusive.[4]

The AcSB stated that "IFRS will ultimately prove more efficient and cost effective by eliminating the need for reconciliations of information reported under separate national standards[5]. While that may be the case for companies that already report in other countries, it is unlikely that the cost savings would be of such a magnitude as to have an impact on share value. As well, any cost savings would need to be considered in light of the costs incurred in transitioning to IFRS, which also are unlikely to be so significant as to impact share values.

Costs incurred to implement IFRS, and costs savings from doings so, are unlikely to be of a magnitude to impact valuations.

There are likely a number of other possible advantages and disadvantages of adopting IFRS that could have an impact on share values of individual companies over a longer term. Any impact long after the adoption date will be difficult to attributable to IFRS alone as other factors may also have had an effect by then. Since IFRS has no impact on cash flows, (other than the costs and cost savings associated with adoption as discussed above), the "value relevance" of IFRS is attributable to the new information it provides. The impact of this information will be easier to discern at the time it is provided to the market, during or prior to the adoption of IFRS.

[4] The research commissioned by the ICAEW focused on the short-term impact of IFRS at the time of transition and commented that further longer-term study would be required in order to reach a conclusion on the cost of capital issues.
[5] The CICA's Guide to IFRS in Canada.

For companies with a December 31st year-end, the first financial statements prepared under IFRS will be the 1st quarter interim results, due by mid-May 2011. Given the prevalence of December year-ends, thousands of companies will release their first IFRS financial statements at the same time. How will analysts and investors react to this sudden influx of financial statements prepared under a new set of accounting rules? While we cannot know with any certainty what will happen when the majority of Canadian companies adopt IFRS in 2011, we may find a hint of what to expect by studying the experience of those that have already done so. Companies in Canada can voluntarily elect to adopt IFRS early and some did. However, to see what happened upon a mandatory IFRS adoption, affecting the majority of public companies, we must look at what happened in other countries.

2. COMPARABLE COUNTRIES

Canadian companies will certainly not be the first to adopt IFRS; over 18,000 companies [6] throughout the world have already done so. Of the 153 jurisdictions with stock exchanges, 63% of these already require the use of IFRS for domestic listed companies[7]. Included in this group are several of world's major economies; Australia, Brazil, China[8], the European Union countries, GCC countries[9], Hong Kong, Russia and South Africa. With India, Mexico and Korea scheduled to adopt IFRS by 2012 and Japan by 2016, every major economy in the world, with the exception of the United States[10], will be using IFRS. It is interesting to note that the US is also one of only four countries in the world that have not adopted the metric system of measurement[11].

Several of the world's major economies have already adopted IFRS. The impact on share prices in other IFRS countries may be relevant to Canada.

Studying the effect on share prices for those countries that have already adopted IFRS ("other IFRS countries"), may provide some insight into what to expect in Canada in 2011. Nonetheless, the relevance to Canada of these other IFRS countries' experiences depends on several factors, including the following;

1. the capital market structure of other IFRS countries in comparison to that of Canada,
2. the degree of convergence of the other IFRS countries' prior national GAAP with IFRS, prior to the adoption of IFRS, in comparison to that of Canada, and

[6] From Appendix 1-Total 21,698 less 3,700 for Canada =17,998
[7] IAS-Plus- Use of IFRS by Jurisdiction
[8] Substantially converged in 2007
[9] Gulf Cooperation Council including Bahrain, Kuwait, Qatar, Oman, Saudi Arabia, and the United Arab Emirates
[10] The United States is working to substantially complete the convergence of US GAAP to IFRS by June 2011, however, an IFRS adoption date has not been officially set.
[11] Wiki.answers.com. The US, Liberia, Myanmar and the UK use the imperial system of measurement, although the UK is officially metric.

3. the specific information that was required to be disclosed upon the conversion to IFRS, and the timing of such disclosures, in comparison to the Canadian requirements.

First, I identify the other IFRS countries that are most comparable to Canada for the first two criteria; capital market structure, and degree of convergence of prior national GAAP and IFRS ("comparable countries"). The IFRS adoption experience of the comparable countries will likely be more relevant to Canada than other IFRS countries. Secondly, based on a review of the available literature, I discuss the effect on share prices from adopting IFRS, for the comparable countries. Lastly, I consider the potential impact of the 3rd point, the specific disclosures and their timing.

Comparable Capital Markets

A study by Nichols (2006) examines the "distinctive characteristics of Canada's capital markets (or, more precisely, Canada's equity markets)" and identifies the principal features to include, among others[12], the following;

1. Canadian issuers constitute a small fraction of total world market capitalization.
2. The market capitalization of Canadian public companies is high relative to GDP, a measure indicative of relatively well developed capital markets.
3. Canada's public equity markets are characterized by a small number of large issuers and a far greater number of small issuers.
4. A significant percentage of Canada's public companies operate in a handful of key sectors, specifically mining, oil and gas and financial services.

With respect to the first characteristic above, the market capitalization of Canadian issuers of US$ 1.68 trillion represented 3.5% of total world market capitalization at the end of 2009[13]. Excluding countries with a market capitalization greater than 100% (US$ 3.36 trillion), or less than 50% (US$ .84 trillion) of that of Canada, a relatively broad range, as not comparable leaves only seven countries; Australia, France, Germany, Hong Kong, Spain, Switzerland and the UK.[14] (See Appendix 1 for additional details.)

For the second characteristic, the market capitalization of Canada relative to GDP was 125%, indicating a relatively well developed capital market. Excluding countries with a market capitalization relative to GDP greater than 100%, or less than 50% of that of Canada, as

[12] The Nichols study identified three other principal features; larger and smaller public companies vary by region, significant number of issuers also listed on US exchanges, and a significant percentage of non-financial public companies with controlling shareholders. I have made the assumption that excluding consideration of these three features would not have a significant impact on the countries that I consider to have comparable capital markets, for this purpose.

[13] See Appendix 1 footnote

[14] Applying this criterion, the only country with a market capitalization greater than Canada that was excluded was China which had a market capitalization of US$3.57 trillion, significantly larger than that of Canada. China also failed to meet the criteria for the 3rd and 4th characteristic.

significantly different eliminated France and Germany[15] as comparable countries. For the 3rd characteristic, Canada has over 3,700[16] listed companies, more than any other IFRS country. Excluding countries that did not have a significant number of listed companies[17], eliminated Hong Kong and Switzerland.

With respect to industry sectors, none of the remaining three countries (Australia, UK and Spain) are as heavily concentrated in the same sectors as Canada; specifically mining, oil and gas and financial services, comprising in total 77% of the Canadian market capitalization. Still as shown in Table 1, these industry sectors do comprise, from 52% to 71% of these three countries respective market capitalizations.

Table 1
Determination of Comparable Countries

Country	IAS Convergence Score[18]	Market Cap. $US Trillions[19]	Market Cap. as a % of GDP[20]	Number of Listed Companies[21]	Sector % Energy/Materials/ Finance[22]
Canada	5	$1.676	125%	3,700	27/20/30=77
Australia	4	$1.262	127%	1,966	7/25/39=71
UK	1	$2.796	128%	2,792	18/12/22=52
Spain	16	$1.435	98%	3,472	22/9/35=66

GAAP Comparability

The Bae et al. (2008) study examined the degree of convergence between the prior national GAAP and IFRS of 49 countries. The study identified a list of 21 important accounting rules and benchmarked the local accounting standards in the various countries against IFRS, focusing on rules in place as of December 31, 2001.[23] Of the 49 countries examined in the study, 30 of these have already adopted IFRS. Appendix 1 shows the convergence score for these 30 countries, and for comparative purposes, Canada. With one point assigned for each accounting standard for which the country differs from IFRS, the lower the score, the higher the degree of convergence.

[15] France and Germany also failed to meet the criteria for the 3rd and 4th characteristic.
[16] See Appendix 1
[17] Market capitalization/number of listed companies greater than 100% or less than 50% of that of Canada's.
[18] See Appendix 1
[19] See Appendix 1
[20] See Appendix 1
[21] See Appendix 1
[22] Canada- S&P TSX Composite Index, Australia- S&P ASX 300, UK-S&P United Kingdom Index all as of June 2010. For Spain the data is as of December 2009 and classification categories differ; energy includes power and materials includes construction. The percentages for Spain were calculated excluding foreign shares.
[23] The study relied on "GAAP 2001: A Survey of National Accounting Rules Benchmarked against IFRS". In this survey, partners in large accountancy firms from more than 60 countries benchmarked the local accounting standards in their country against IFRS, focusing on rules in place as of December 31, 2001. The Bae et al. (2008) study goes on to study the impact on financial analysts from international GAAP differences. Although our focus is different, the degree of convergence with IFRS portion of the Bae et al. (2008) study provides information useful for our purposes.

For example, a score of zero would imply that the respective country's national GAAP was identical to IFRS, with respect to the accounting standards benchmarked. The minimum and maximum convergence score possible would be zero and 21 respectively. The convergence score for Canada in 2001was 5 points.

As the Bae et al. (2008) study is based on accounting standards as of 2001, it is reasonable to assume that the various countries national GAAP may have changed between 2001 and their respective IFRS adoption dates. As the adoption date for the majority of these countries was four years later in 2005, it is likely that any changes to their prior national GAAP would have been to bring it closer to IFRS. The convergence score for each country could, therefore, have been even lower at the IFRS adoption date. Canadian GAAP has moved closer to IFRS since 2001 and a current convergence score would be approximately 3 points[24].

Comparable Countries

After applying the capital markets criteria only three countries remain, Australia, the UK and Spain. As show in Table 1, the GAAP/IFRS convergence scores for Australia (4 points), the UK (1) and Canada (5) are less than the average of 9 points for other IFRS countries. Spain with 16 points is significantly higher than the average and, therefore, less comparable to Canada in this regard. As a result, the impact of the adoption of IFRS on share prices in Spain may be less relevant for Canada, and Spain has been excluded from further study.[25]

The IFRS experience of Australia and the UK are most relevant to Canada, given the similarities in their capital markets and prior GAAP.

3. OTHER COUNTRY EXPERIENCE

Australia

Australian public companies were required to adopt IFRS for annual reporting periods *commencing* on or after January 1, 2005. The majority of Australian companies have June 30th year-ends and are required to report interim results half-yearly. For companies with a June 30th year-end, the IFRS reporting period commenced on July 1, 2005 (the first annual period

[24] An updated convergence score of 3 points was arrived at by excluding the use of LIFO for inventory as a GAAP/IFRS difference since the use of LIFO in Canada is rare. In addition goodwill and long lived intangibles are required to be tested for impairment. Other GAAP/IFRS differences appear to remain valid.

[25] While there were a few studies of the effect on share prices from adopting IFRS for EU countries as a group, and for Australia and the UK, I did not come across any for Spain alone.

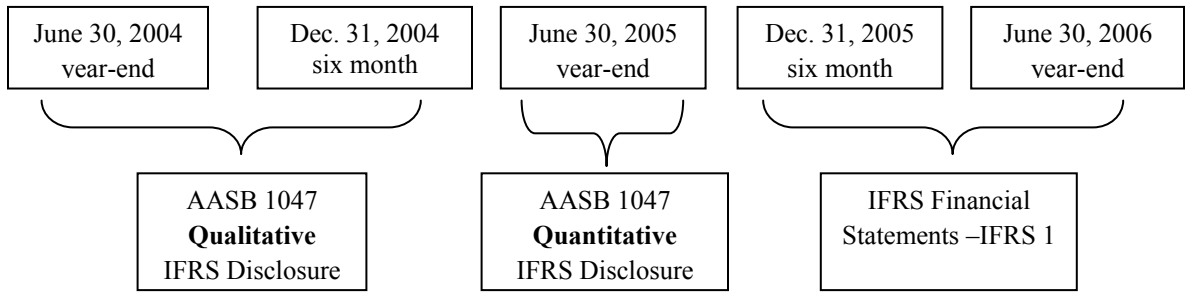
commencing after January 1, 2005) and companies prepared their first IFRS financial statements for the six-month period ended December 31, 2005.

Prior to the adoption of IFRS, companies were subject to Australian Accounting Standard AASB 1047. Under AASB 1047, for reporting periods ending on or after June 30, 2004 (one year prior to adoption), companies were required to include, in their financial statements, a narrative description of the key differences in accounting policies that were expected to arise from adopting IFRS. The intent of this *qualitative* narrative was to provide information to users of financial reports to enable them to make judgments on the impact that adopting IFRS would likely have on the future financial performance and position of the company.

For interim or annual reporting periods *ending on* or after June 30, 2005 (the last period prior to adoption), AASB 1047 required companies to disclose the *quantitative* effect on the financial results and position had the financial statements been prepared using IFRS. As companies' June 30, 2005 year-end financial statements would have still been prepared under GAAP, this requirement was generally met with a reconciliation of net income under GAAP to what net income would have been under IFRS (a "GAAP/IFRS reconciliation").

Upon the adoption of IFRS, Australian companies were no longer subject to AASB 1047 and instead applied accounting standard IFRS 1 "*First-time Adoption of IFRS*". IFRS 1 requires GAAP/IFRS reconciliations of total comprehensive income and equity for the latest period in the entity's most recent annual financial statements. The first IFRS financial statements, for the six-months ended December 31, 2005 would have included GAAP/IFRS reconciliations for June 30, 2005 (the latest period in the most recent annual financial statements). These reconciliations were effectively the same GAAP/IFRS reconciliations already required under AASB 1047 for the June 30, 2005 financial statements. Therefore, the effect of AASB 1047 was to require companies to provide quantitative GAAP/IFRS information several months prior to the adoption of IFRS.

Figure 1
Timing of IFRS Reporting in Australia
(For a company with a June 30th year-end)



The disclosure requirements above resulted in a qualitative disclosure period from June 30, 2004 to December 31, 2004, and a quantitative disclosure period from January 1, 2005 onwards. During the qualitative disclosure period it is possible that some sophisticated investors and analysts *may have* been able to determine the impact that IFRS would have on companies' financial results. However, it is during this latter quantitative disclosure period that ordinary investors and the market in general, would have first received information that explicitly detailed the impact of IFRS on Australian public companies.

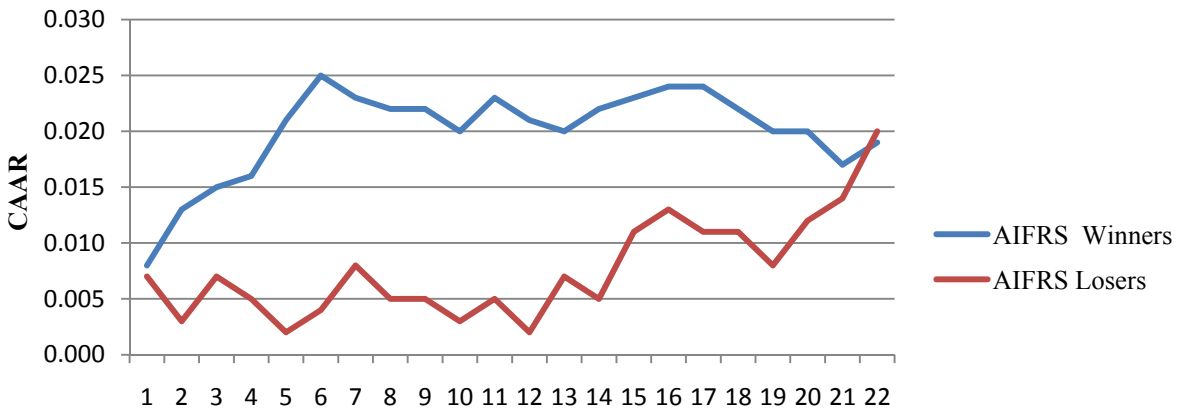
Becis, Tan and Welker (2006) ("the Becis study") studied the effect of IFRS on Australian public company share prices. The Becis study sample of 113 companies was drawn from the Australian Stock Exchange ASX 300[26] as at September 28, 2005 [27]. Based on GAAP/IFRS reconciliations provided for June 30, 2005, 65% of sample companies reported a large increase in net income (after tax) under IFRS in comparison to GAAP ("IFRS winners"), with the balance reporting small increases or decreases ("IFRS losers").[28]

65% of sample Australian companies were "IFRS winners" (large increase in net income under IFRS compared to GAAP.)

The short term window test of the Becis study focused on the twenty-two trading days (approximately one calendar month) following the sample companies' release of this quantitative IFRS information. As shown in Figure 2, *despite the adoption of IFRS having no cash flow impact*, IFRS winners produced a cumulative average abnormal return ("CAAR")[29] averaging 2.0%. In order to produce a positive abnormal return, a company's share price would need to increase by an amount sufficient to produce a return greater than the market (assuming no dividends). With the sample further stratified, the highest CAAR observed was 3.7% on days sixteen and seventeen for the biggest IFRS winners (IFRS increases in the fourth quartile). As shown below, although IFRS losers also produced a positive CAAR averaging .76% during the twenty-two trading day period, with the exception of the 22nd day, this was consistently less than the CAAR of the IFRS winners.

[26] The ASX 300 includes the 300 largest companies in Australia based on market capitalization and as at that date represented 95% of the total market capitalization of the ASX.
[27] Excluded from the study sample were newly listed or restructured companies (10), non-AGAAP reporters (15), companies that did not have a June 30 year-end (102) and those that did not provide the GAAP/IFRS reconciliation (60). It is interesting to note how many companies did not comply with the AASB 1047 requirement to provide the reconciliations.
[28] The median and mean increase in net income after tax (as a percentage of GAAP) for the IFRS winners was approximately 4.2% and 7.1%. With respect to equity, 29% of sample reported higher equity, 65% lower equity and the balance unchanged. The median and mean decrease in equity was approximately 1.1% and 5.3%.
[29] The cumulative abnormal return (CAR) is the sum of the differences between the expected return on an individual stock (systematic risk multiplied by the realized market return) and the actual return and is often used to evaluate the impact of news on a stock price. CAAR is the average of the CARs for a group of stocks.

Figure 2
Australia
Post IFRS Adoption CAAR for 22 Trading Days

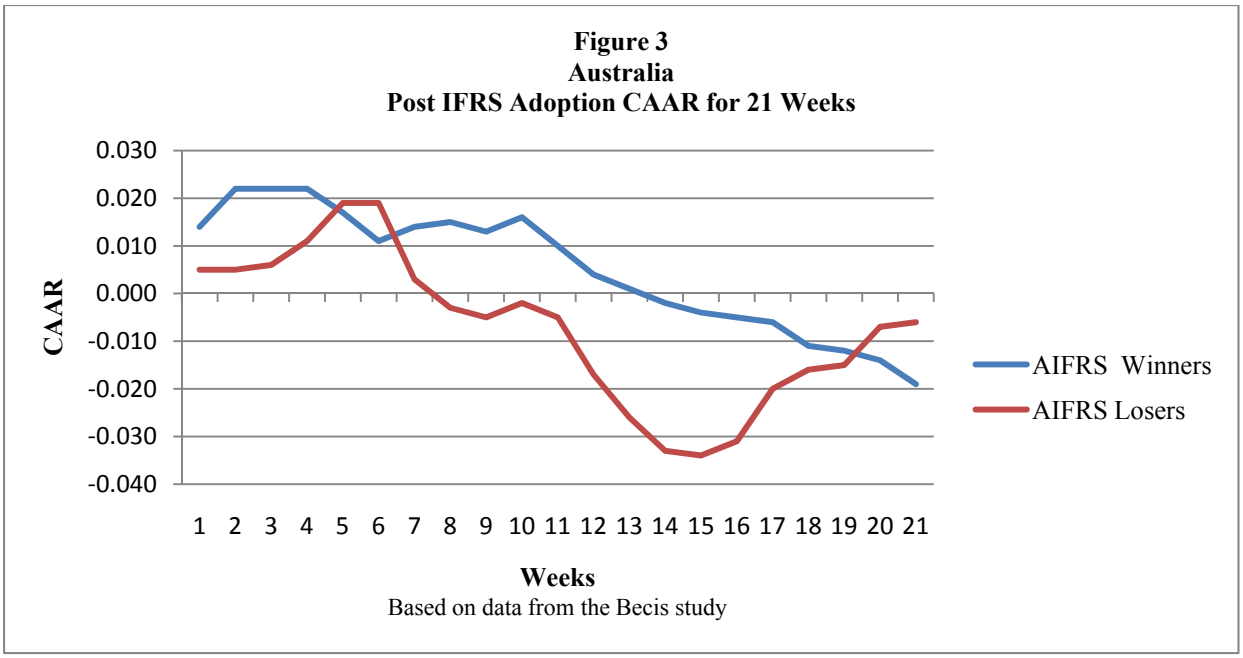


Based on data from the Becis study

The average CAAR of the IFRS winners as a whole peaked at 2.5% on the sixth trading day, 2.0% higher than that of the IFRS losers. The efficient market hypothesis states that new information is immediately reflected in share prices. The results of the Becis study challenge this hypothesis and suggest that the market reaction was not immediate, instead taking six trading days to fully react to the IFRS information.

The intermediate term window test of the Becis study focused on the twenty-one weeks following the sample companies' releases of IFRS quantitative information. As shown in Figure 3, the CAAR of the IFRS winners exceeded that of the IFRS losers for all but two of the twenty-one weeks, peaking at a difference of 3.1% in the 14th week. Nonetheless, the advantage enjoyed by the IFRS winners gradually eroded after the 14th week. The Becis study suggests that quantitative IFRS information did have an impact on share prices in the short and intermediate term (up to 14 weeks post-announcement), but not over the longer term. The IFRS winners experienced a positive CAAR for up to 13 weeks, followed by a negative CAAR to the end of the 21 week period. It is possible that the effect of a period of negative CAAR would have returned the share price to a "normal" level. The IFRS losers experienced a negative CAAR from the 8th week, peaking at a low of negative CAAR of 3.4% in the 15th week, with a gradual improvement until the end of the 21 week period.

In Australia, the CAAR of the IFRS winners, exceeded that of the IFRS losers, for 14 weeks.



While the correlation between IFRS net income and CAAR was positive for the sample as a whole, the results by company size (as determined by market capitalization) differed, with a negative result for large companies, and a positive result for medium and small companies. The Becis study notes that the result for larger companies may be accounted for by the sophisticated analysis a larger analyst following provides, and that smaller and medium size companies may have reacted unduly to a cash flow neutral change.[30]

Given the sample size of the Becis study, not all industry sectors were represented in a statistical meaningful way. Based on industries for which there were at least seven or more companies represented in the sample, the IFRS winners were Financials and Healthcare, and IFRS losers were Energy and Materials (includes mining). However, neither the Energy nor Materials sector net income was positively correlated with a change in share price, indicating that the IFRS information may not have had an impact on these sectors. This is consistent with valuations for these sectors often based on other factors, such as commodity reserves and prices.

The UK

European Union ("EU") publicly listed companies, including those of the UK, were required to adopt IFRS for annual *and interim* reporting periods commencing on or after January 1, 2005. Upon the adoption of IFRS, UK companies were also required to comply with IFRS 1 and

[30] The Becis study also notes that the inclusion of financial institutions in the sample may confound results by company size, but does not provide further analysis in this regard.

include with their first interim financial statements a GAAP/IFRS reconciliation for the latest period in the entity's most recent annual financial statements. As UK public companies file interim financial statements half-yearly and the majority have December 31st year-ends, the first GAAP/IFRS reconciliations required would have been for the six month period ended June 30, 2005. Unlike Australia, UK companies were not required by an accounting standard to provide a GAAP/IFRS reconciliation prior to their first IFRS reporting period. However, a directive from the Committee of European Securities Regulators did *recommend* that companies provide quantitative information before the publication of their first IFRS interim financial statements.

The time frame to do so was not specified and a study by Horton et al. (2008) ("the Horton study") found that companies published their GAAP/IFRS reconciliations, on average, three months after their last annual UK GAAP statements, which would be *before* their first IFRS interim reporting period. The reconciliations where generally published as a disclosure separate from financial statements or other announcements. This group of early reconciliation disclosing companies provides a unique opportunity to assess the "pure" impact of adopting IFRS on share prices, as the market would likely already have reacted to the previously issued financial results.

The Horton study sample was drawn from London Stock Exchange FTSE 350[31] companies as at December 31, 2006 and was comprised of the 182 companies that published their GAAP/IFRS reconciliations separately. Of the companies in the study sample, 73% reported IFRS earnings that were higher than UK earnings (IFRS winners), and 27% reported IFRS earnings that were lower (IFRS losers).[32]

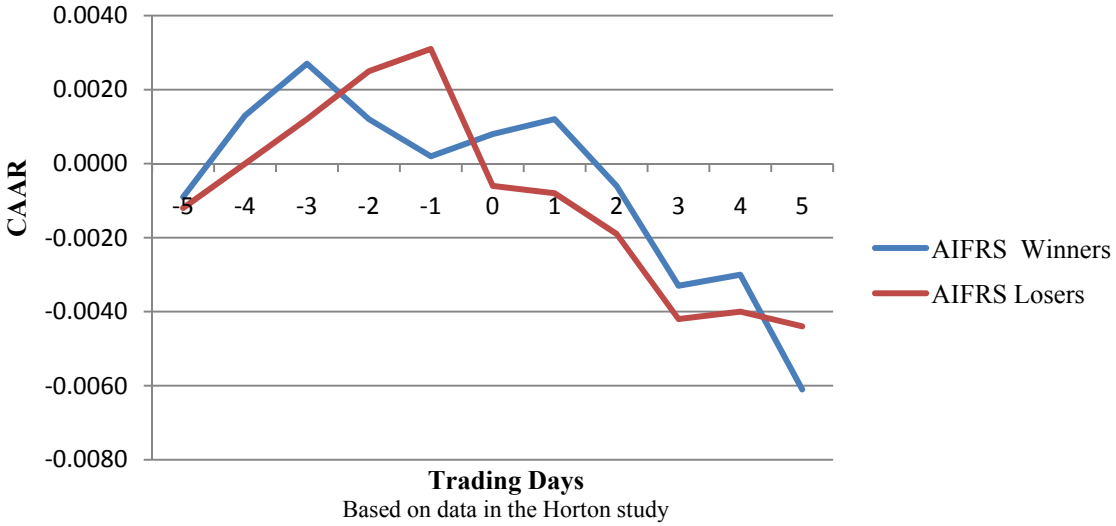
The Horton study focused on an eleven day window; the five days preceding the companies' disclosure of their UK GAAP/IFRS reconciliations, the day of, and the five days following. The study concluded that IFRS winners did not experience a statistically significant change in CAAR. The IFRS losers, on the other hand, experienced a negative[33] CAAR up to .44% on the 5th trading day following the disclosure. As shown in Figure 4, the CAAR of the IFRS winners is also negative commencing on the 2nd trading day after the disclosure of the GAAP/IFRS reconciliation. Nonetheless for all but the last of the 5 trading days after the

In the UK, IFRS winners did not experience a significant change in CAAR, however, the IFRS losers did.

[31] The FTSE 350 includes the 350 largest companies in the UK based on market capitalization.
[32] The median and mean increase in earnings (as a percentage of UK GAAP) for the study sample as a whole (i.e. not separately by IFRS winners and losers) were 6% and 246%. The median and mean decrease in equity for the study sample companies were 1% and 3%.
[33] If the market average performs better than the individual stock then the abnormal return will be negative.

release of the GAAP/IFRS reconciliations, the CAAR of the IFRS winners exceeds that of the IFRS losers.

Figure 4
UK
IFRS Adoption CAAR for 11 Trading Days



Based on data in the Horton study

The Horton study suggests that "positive news embedded in positive earnings reconciliations had already been communicated to the market, bad news had not." This is consistent with other studies indicating that managers delay communication of bad news relative to good news. The study also comments that "positive earnings adjustment may signal opportunistic behaviour and therefore investors are reluctant to trade upon it." The market reacted to negative news conveyed by the IFRS losers but not to the positive news of the IFRS winners. IFRS losers also experienced an abnormal increase in trading activity of 10.8% on the date of disclosure, while IFRS winners did not experience a significant change in trading activity.

Given the sample size of the Horton study, not all industry sectors were represented in a statistical meaningful way. However, based on industries for which there were at least ten or more companies represented, the IFRS winners were Financial Services, Industrial Goods and Services, Insurance, and Travel/Leisure. The only industry that was predominately an IFRS loser was Healthcare. However, given that the Healthcare industry was represented by only 4 companies this result may be valid but not statistically relevant.

The Horton study analyzed the impact on earnings resulting from changes in specific accounting standards. On average, earnings increases resulted from adopting IAS 38 (reversal of amortization of goodwill) and IAS 39 (financial instruments). On average, earnings decreased

from adopting IFRS 2 (expensing stock options) and IAS 12 (deferred taxes). The changes in respect of goodwill and deferred taxes were found to be positively associated with changes to CAAR, with goodwill impairment significantly associated with a negative abnormal return. The study suggests that the market reaction to the GAAP/IFRS reconciliations, even though they were cash flow neutral, arose due to new information being released to the market that changed investor's beliefs about future cash flows. For example, a reversal of goodwill amortization may have revealed new information to the market; i.e. a reaffirmation that goodwill was not impaired.

Christensen et al. (2009) noted that with the disclosure quality of UK GAAP comparable to IFRS prior to adoption, it was unlikely that the adoption of IFRS in itself would provide information about future cash flows. Yet the Christensen et al. (2009) study also observed a market reaction to GAAP/IFRS reconciliation announcements, albeit more pronounced with smaller companies and companies with lower ratios of interest coverage. They attribute these findings to the greater likelihood that these types of companies may be affected by debt covenants. Increases in reported earnings ease restrictions in debt covenants and decreases in reported earnings increase the risk of technical default. Although lenders can waive defaults arising solely from the adoption of IFRS, Christensen et al. (2009) suggest that it may be costly for lenders to assess whether the violation is due to accounting changes or loan quality. Share price reactions to IFRS disclosures may be attributed to the inability of the market to fully assess the impact of IFRS on earnings and, in particular, on the technical changes to earnings calculations under debt covenants.

Conclusions from Other Countries' Experiences

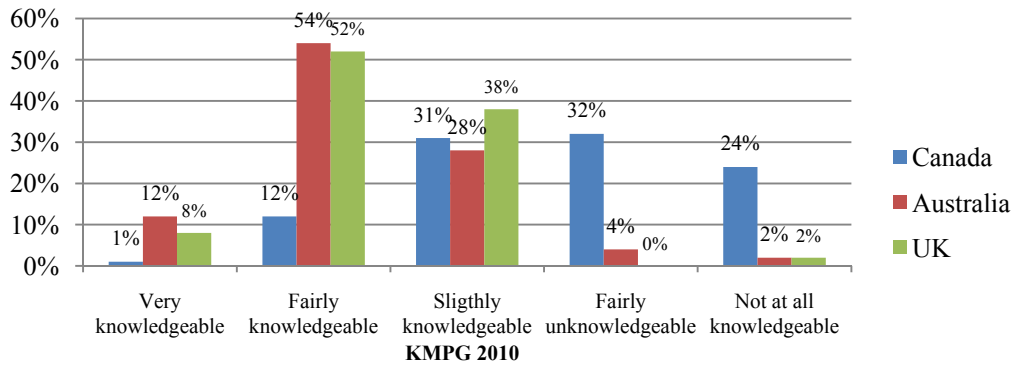
What can we take from the experience of Australia and the UK? In both countries, researchers commented that analysts and investors found it difficult to assess the impact of IFRS prior to a company's disclosure of their GAAP/IFRS reconciliations. Christensen et al. (2009) noted that "if the equity market does not fully anticipate how IFRS will impact earnings …then the stock price should react to announcements of IFRS reconciliations." With Canada adopting IFRS six years later than Australia and the UK, are analysts and investors better able to anticipate the potential impact?

KMPG (2010) commissioned a survey of financial analysts 18 months before the first IFRS financial statements will be issued by Canadian companies with December 31st year ends. Of the 122 analysts surveyed, 56% rated their level of IFRS knowledge as *fairly*

Only 44% of Canadian analysts considered themselves knowledgeable about IFRS.

unknowledgeable or *not at all knowledgeable*[34]. Based on a similar KMPG survey prior to the adoption of IFRS in Australia and the UK, only 6% of Australian and 2% of UK analysts rated their knowledge level accordingly. It appears that Canadian analysts are not as well prepared for IFRS as were their counterparts in Australia and the UK.

Figure 5
How would you rate your knowledge of IFRS?
(15 to 18 months before first IFRS financial statements)



KMPG 2010

Studies from both countries concluded that the adoption of IFRS did have an impact on share prices, however, the results differed. In both Australia and the UK the majority of companies (65% and 73% respectively) were IFRS winners (increase in net income under IFRS). In Australia, IFRS winners as a whole experienced an increase in share price, indicated by the positive CAAR that prevailed for 14 weeks. This result was concentrated with the medium to smaller sized companies. In the UK, the IFRS winners did not experience a statistically significant increase in share price. However, the Horton study in the UK extended only to the 5th trading day following the release of the reconciliations. The Becis study in Australia observed the largest increases in CAAR for IFRS winners on the 6th trading day. Therefore, the results from both countries are not necessarily inconsistent with each other. We do not know what the result would have been if the Horton study had been extended for a longer period of time.

The different results observed for the IFRS winners, could also be attributed to the size of companies included in the study sample for each of the countries. With the significantly larger UK capital market of US$2.90 trillion compared to US$1.26 trillion for Australia, all of the UK sample companies would likely have been "large" companies. If the UK sample had included a larger proportion of medium and small companies, the results may have been similar to Australia.

[34] The PWC 2009 survey found that 5.5% of CFAs said that they had a very good to excellent knowledge of IFRS. The KMPG 2010 comparative of 13% suggests an improvement in the level of knowledge since 2009.

With Canada's public equity markets characterized by a small number of large issuers and a far greater number of small issuers, Canada is more similar to Australia than the UK in this regard.

In both Australia and the UK, IFRS losers experienced a statistically significant decrease in share price. In the UK, the Horton study observed a negative CAAR up to .44% by the 5th trading day. The Becis study in Australia did not observe a negative CAAR initially, but by the 8th week, the CAAR of the IFRS losers was negative, peaking at a low of negative 3.5% by the 15th week. While the time period studied in both countries differs, making comparisons difficult. In both cases *IFRS losers experienced a negative impact* from the adoption of IFRS and that the CAAR of the IFRS losers was less than that of the IFRS winners for most of the period studied.

While Australia and the UK both required GAAP/IFRS reconciliations, the timing of the disclosure of the reconciliations differed. For Australian companies the first GAAP/IFRS reconciliations were for the June 30, 2005 year-end and were released concurrently with the results for the 2005 year. For UK companies the first reconciliations were for the December 31, 2004 year-end and were released, on average, three months after the results for the year-end. It is possible that the UK market did not react as strongly to GAAP/IFRS reconciliations since they were in respect of results released three months previously rather than for the most current results.

In Canada, in accordance with IFRS 1, companies will be required to include in their first interim financial statements for 2011, GAAP/IFRS reconciliations for the latest period in their most recent annual GAAP financial statements. A company with a December 31 year-end would be required to include the reconciliations for December 31, 2010 with their first quarter March 31, 2011 financial statements. With a filing requirement of 90 days for annual financial statements and 45 days for interim ones, the first GAAP/IFRS reconciliations will be issued by mid-May, 45 days after the annual results. This would put Canadian companies' first releases of GAAP/IFRS reconciliations between those of Australia (concurrently with the annual financial statements), and the UK (three months after the annual financial statements). As discussed later, the Canadian Performance Reporting Board and the CSA recommend even earlier disclosure of the quantitative impact of IFRS, potentially moving the timing even closer to that of Australia.

It is interesting to note that in both Australia and the UK the market took five to six days to react to the IFRS reconciliations, challenging the efficient market hypothesis that new information is immediately reflected in share prices. It is reasonable to expect that investors need time to absorb the IFRS change. In Australia, Cotter, Tarca and Wee (2009) found that in the year prior to IFRS adoption ("the transition year"), analyst forecast error increased over prior years. However, in the year of adoption forecast error declined. The conclusion reached was that companies provided very limited information in the year prior to adoption with more disclosure of IFRS impact in the adoption year. However, the Becis study found that the majority of Australian companies provided GAAP/IFRS reconciliations at the end of their transition year. Another possible explanation is that analysts did not anticipate the IFRS impact, resulting in forecast errors in the

transition year. The subsequent decline of forecast error in the year of adoption could be due to analysts having time to absorb and incorporate IFRS information into their forecasts.

The different result observed between Australia and the UK, could also be attributed to the degree of convergence between the prior national GAAP and IFRS. Daske et al. (2008) found that "the effects of mandatory adopters are smaller in countries that have fewer differences between local GAAP and IFRS and a pre-existing convergence strategy towards IFRS." Australia's convergence score (4), compared to that of the UK (1), could explain, in part, the stronger market reaction experienced in Australia. Canada, with a current convergence score of approximately three, may be more similar to Australia.

Canada is more closely aligned to Australia than to the UK with respect to a number of the factors discussed above; more small and medium size public companies, GAAP convergence status and the timing of release of quantitative disclosures. Canada is more likely to see a market reaction akin to that of Australia than the UK; i.e. an increase in share price for IFRS winners and a decrease for IFRS losers, primarily for small and medium size companies, for a period of 14 to 15 weeks. Where Canada differs significantly from both Australia and the UK is in the state of preparedness of analysts, potentially extending the period of impact for a longer period of time.

> In Canada IFRS winners may see an increase in share price, and IFRS losers a decrease, primarily for small and medium size companies.

4. EARLY ADOPTION OF IFRS IN CANADA

Canadian public companies, with the exception of financial institutions, were permitted to "early adopt" IFRS for financial years beginning on or after January 1, 2009, subject to the approval of securities regulators. By June 30, 2010 only 20 (See Appendix 2) of the 3,700 public companies in Canada had chosen to do so. Canada's early adoption rate is significantly less than that of some other IFRS countries. Daske et al. (2008) found that the average early adoption rate for other countries was 8.7%. Included in this average, however, are countries such as Germany that had a very high rate of adoption (36%). Canada's early adoption rate of .5% is between that of Australia (.9%) and the UK (.1%).

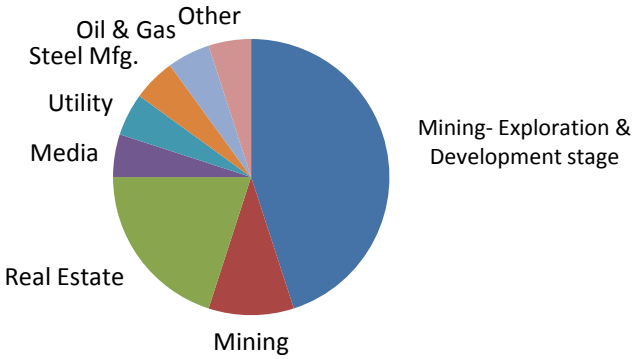
> Only 20 of the 3,700 public companies in Canada chose to adopt IFRS early, limiting conclusions that can be drawn for the remaining companies adopting in 2011.

It appears that few Canadian companies found compelling reasons to early adopt. German public companies, on the other hand, had more incentive; German GAAP was significantly different from IFRS or US GAAP as to hinder raising capital outside of Germany. Canadian public companies often raise money in the US and are able to meet US reporting requirements with Canadian GAAP financial statements (supplemented with a US GAAP reconciliation). In Germany, regulatory bodies accepted financial statements prepared under IFRS for seven years prior to mandatory adoption, while in Canada early adoption has been permitted for only two years prior.

With a sample size of only 20 companies voluntarily adopting IFRS early, a statistically relevant conclusion cannot be drawn for Canadian public companies that will be subject to mandatory adoption. Nonetheless, even if not statistically relevant, the experience of the early adopters may shed some insight on what is to come for those companies yet to adopt. Companies that choose early adoption are by nature a self-selected group; they expect the benefits of doing so to exceed the costs. Their reasons for adopting early may indicate which types of companies will benefit most from the adoption of IFRS and whose share values may be most impacted.

Six of the 20 early adopters are large companies that are included in the S&P/TSX Composite Index, with the balance comprised of smaller companies. The predominate industry represented is mining (55%) including both operating and exploration and development stage ("E&D") companies, followed by real estate (20%) and the balance in a variety of other industries (see Figure 6). Two of the companies have historically used IFRS, seven adopted IFRS in 2009, and the balance in 2010.

Figure 6
Early Adopters Industry



The reasons stated for early adoption include;

1. The option under IFRS to use fair values rather than historical cost for certain assets (4 companies)
2. Simplifying consolidation with a parent or subsidiary company already using IFRS (7)

3. Eliminating the need for a US GAAP reconciliation given the SEC's recent acceptance of IFRS financial statements (4)
4. Newly public and had not previously prepared GAAP statements (3)
5. IFRS statements required for existing or upcoming listings on other country's stock exchange (3)

With the exception of the first reason above, all of the other reasons serve to reduce accounting and reporting costs. However, it is unlikely that cost savings in these areas would be of such a magnitude as to have a significant impact on share values. The ability to list on another stock exchange, that only accepts IFRS financial statements, could result in a lower cost of capital and have a positive impact on share value over the longer term. Adopting IFRS could facilitate the process, however, since a company could choose to prepare IFRS financial statements in addition to GAAP ones, it is essentially an accounting cost saving decision as well.

The option to use fair values for certain assets rather than historical cost may provide new information but also may increase costs involved to determine such fair values. For companies in certain industries such as real estate, where there can be a significant difference between current values and historical cost, the adoption of IFRS can provide new information to investors. One of the companies in the group, that adopted IFRS early for this reason, stated that net asset value per share is the most important metric for the company, and that IFRS accounting shows the appreciation in value of their investments that was not previously reflected in financial results until the assets were sold, if ever[35]. Although this company adopted IFRS in the first quarter of 2010, quantitative disclosure on the impact of IFRS was first disclosed with the year-end financial statements for 2008. Although, the impact as noted in the first disclosure was significant; an increase of $9 billion (274% increase) in equity, there was no discernable impact on share price. The market may not have reacted to the IFRS disclosures if they did not convey new information. The company, with a market capitalization of $13.8 billion (as of June 30, 2010), has a large, sophisticated analyst following and a history of providing in-depth financial information. It is likely that analysts already had a good idea of the value of underlying assets based on their own forecasts of cash flow. For companies with a smaller analyst following and more limited previous financial disclosures, from which current values are not as readily determinable, the adoption of IFRS may have more impact on share values.

For companies with a smaller analyst following, the adoption of IFRS may have more impact on share values.

[35] Brookfield Asset Management Inc. –Annual Report 2009

The GAAP/IFRS reconciliations included in either the financial statements or MD&A and share price history for 12 of the early adopters[36] ("sample companies") were reviewed. Four of the seven E&D mining companies reported no significant difference in net income or equity under IFRS, three were IFRS winners (IFRS net income (after tax) 5% greater than under GAAP) and none were IFRS losers (IFRS net income 5% less than under GAAP). For one of the IFRS winners, the decrease in net loss of 15% and increase in equity of 143% was due to the company's decision to capitalize, rather than expense, exploration costs upon the adoption of IFRS. Since Canadian GAAP also allows the capitalization of exploration costs, the change was not a requirement, but rather an opportunity for the company to change a significant accounting policy along with other more minor changes brought about by IFRS.

For the second E&D mining company IFRS winner a decrease in net loss of 115%, and an increase in equity of 565%, was attributable to the deconsolidation of its interest in a limited partnership. Under GAAP the partnership was considered to be a variable interest entity with the company as the primary beneficiary, whereas under IFRS the company was considered to have joint control and elected to apply the equity accounting method. As the partnership had significant accumulated losses, the impact of the change was to reduce current and accumulated losses in equity. This type of change is one that could potentially provide new information to the market. In this case, the company moved from reporting a loss to positive net income and from a deficit to positive equity. The company's share price increased subsequent to the release of their first quantitative IFRS disclosures, but as the IFRS release was concurrent with the 2008 year-end information, which contained other positive information, it is not possible to ascertain if the adoption of IFRS had an impact on share price.

For the third E&D mining company IFRS winner, a decrease in net loss of 11% was attributable primarily to different rules under IFRS for the translation of foreign operations. This type of change was unlikely to have conveyed new information to the market, and therefore, have an impact on share values. In general, since E&D mining companies are typically valued based on the potential of their mining properties, the adoption of IFRS is not likely to have a significant impact on share values.

The two mining companies in the production stage were both IFRS losers. One of the companies reported an increase in net loss of 12% attributable primarily to the different treatment for the conversion option of a debt transaction. Under GAAP the conversion feature is recorded as a component of equity, while under IFRS a portion is fair valued each reporting period and recorded in income. The treatment under IFRS does have the potential

IFRS does have the potential to increase earnings volatility. Analysts need to look through the transaction to the cash flow impact.

[36] I excluded those companies that were either; newly public, already using IFRS, using US GAAP, or have only preferred shares publicly listed

to increase earnings volatility and could potentially impact share values if analysts do not look through the transaction to the non-cash flow impact.

The second production stage mining company reported a loss of $226 million under IFRS compared to net income of $13 million under GAAP. This significant difference is primarily attributable to recording an impairment of a mining property. An impairment charge would not have been required under GAAP as the undiscounted cash flows were greater than the carrying value. IFRS, however, requires the use of discounted cash flows, which were lower than the carrying value, resulting in the impairment. The quantitative impact of the impairment was reported prior to the adoption of IFRS in the MD&A for the prior year-end. Although, the impairment was significant, and this may have been new information to the market, the share price did not appear to react. The company explained in its MD&A that performance measured in accordance with IFRS is not indicative of future cash flow and also provided non-IFRS measures such as EBITDA (earnings before interest, tax, depreciation and amortization), and cash operating costs per ounce of metals produced. These additional disclosures may help explain why there was no impact on share price. The company adopted IFRS voluntarily in early 2009, at a time when markets had experienced a recent downturn. Recording an impairment at that time, rather than in 2011 upon mandatory adoption, may have been a strategic decision.

Impairment may be recognized earlier under IFRS than GAAP.

One of the non-mining companies reported a 6% decrease in net income attributable primarily to changes in accounting for employee benefit plans ("pension expense"). With the transition to IFRS the pension expense was significantly lower in the prior year; but was expected to be significantly higher in future years. As a result, the company may experience more volatility in future reported net income. The company also made several changes in presentation format that affected operating profit, some that may or may not have been required by IFRS.

With respect to the impact on reported net income from adopting IFRS, there was no clear trend for early adopters. The sample companies were almost evenly divided between IFRS winners, IFRS losers and those that had no significant change, often even within the same industry. For those companies for which IFRS did have an impact on net income, this was due to a variety of reasons, with no common thread. Given the small number of early adopters and the large number of changes brought about by IFRS, this is not surprising and highlights the enormous task facing analysts when they start to analyze IFRS financial statements.

None of the sample companies experienced a discernable impact on share price upon the adoption of IFRS. However, many were proactive in explaining that the changes brought about by IFRS did not impact cash flow. As well, with so few companies choosing early adoption, analysts would have had time to understand the changes. The early adopters may see some

impact on share values after the mandatory adoption date. Horton et al. (2009) noted with respect to early adopters, "Before the mandatory adoption, these firms are the outliers in the economy but after they are leaders with an established record of IFRS numbers towards which analysts can evaluate the impact of IFRS."

Many companies took the opportunity to make other accounting policy or reporting changes under the "guise" of IFRS. This occurred in other IFRS countries as well with Daske et al. (2008) finding that voluntary adopters are more likely to make significant changes to their reporting practices, perhaps as part of a broader strategy. As a result, the impact on share values may, in some cases be difficult to attribute to IFRS alone.

Many companies took the opportunity to make other changes under the "guise" of IFRS, making trend analysis more difficult.

5. PRE-IFRS DISCLOSURE IN CANADA

As shown in research from Australia and the UK, the critical date is not the IFRS adoption date, but the date on which the market is provided with information that enables investors to determine the potential impact of IFRS on future results. Prior to the release of quantitative information, investors have difficulty determining the impact of IFRS. The first quantitative IFRS disclosures can, and often do, precede the release of the first IFRS financial statements.

The Canadian Performance Reporting Board ("CPRB") suggests providing quantitative IFRS disclosures by the end of the 3rd quarter of 2010. The CSA guidance suggests even earlier disclosures. CSA Staff Notice 52-320 issued in 2008 states that "if an issuer has quantified information about the impact of IFRS on the key line items in the issuer's financial statements available when it prepares its interim and annual MD&A for the financial year beginning one *year before an issuer's changeover date*, an issuer should include this information in its MD&A." However, the directive does say "if" and is, therefore, guidance and not a requirement.

The CPRB suggests companies provide *quantitative* IFRS disclosures by the 3rd quarter of 2010. The quality of pre-IFRS disclosure to date, has been poor.

In February 2010, the CSA expressed some concerns regarding the quality of IFRS disclosures they had reviewed by that date. In a subsequent news release on July 23, 2010, the CSA noted an improvement in the quality of the disclosures with 82% of reporting issuers identifying significant accounting differences between GAAP and IFRS. Nonetheless, the CSA commented further that issuers could improve the disclosures to better help investors understand

the implications of IFRS *specific to the issuer*. How well did the early adopters do in adhering to the suggested disclosure? Only two of the 12 sample companies met the suggested timing of providing quantitative disclosures in the 3rd quarter prior to the adoption year. Six of the companies did so by the year-end prior to adoption and the remaining four in the 1st quarter of the adoption year.

With only a few months to go until 2011, what is the status of quantitative IFRS disclosures for the Canadian public companies that did not early adopt? Have investors received information that would enable them to determine the potential impact of IFRS? A review of the IFRS disclosures for a random sample of 143 of the S&P/TSX Composite Index companies [37] ("study sample") as of June 30, 2010, uncovered only one company that provided quantitative disclosures [38]. This is not surprising given that the CPRB suggests providing quantitative disclosures in the 3rd quarter, but does highlight how little quantitative information has been provided to date.

Based on the study sample 43% (see Figure 7) of the S&P TSX Composite companies stated that they expect IFRS to have a significant impact on reported financial results or position. As 29% have not yet determined the impact, the percentage of companies expecting a significant impact could be as high as 72%[39]. Only 18% of companies stated that they expect no significant impact. However, a significant impact on reported results does not necessarily lead to a significant impact on value, as the nature of the changes would need to be taken into consideration.

What is surprising is the number of companies that do not plan to adopt IFRS. CSA Staff Notice 52-321 retained the option for a domestic issuer that is also an SEC issuer to continue to use US GAAP and 10% of companies plan to do so. With a significant number of Canadian companies not adopting IFRS, future comparisons between companies may be more difficult.

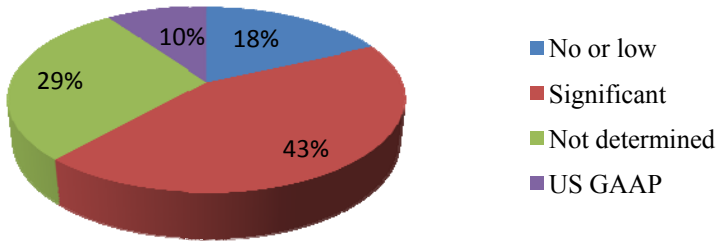
10% of companies do not plan to adopt IFRS and will continue to use US GAAP. Future comparisons between companies may be more difficult.

[37] The S&P TSX Index comprises 95% coverage of the Canadian market based S&P/TSX Composite based on market capitalization as per the S&P TSX fact sheet as of June 30, 2010. A sample size of 143 provides a 95% confidence level with a confidence interval of 5. The sample excludes early adopters.

[38] I am aware of one other company that provided quantitative IFRS information but it did not fall into the random sample of companies selected.

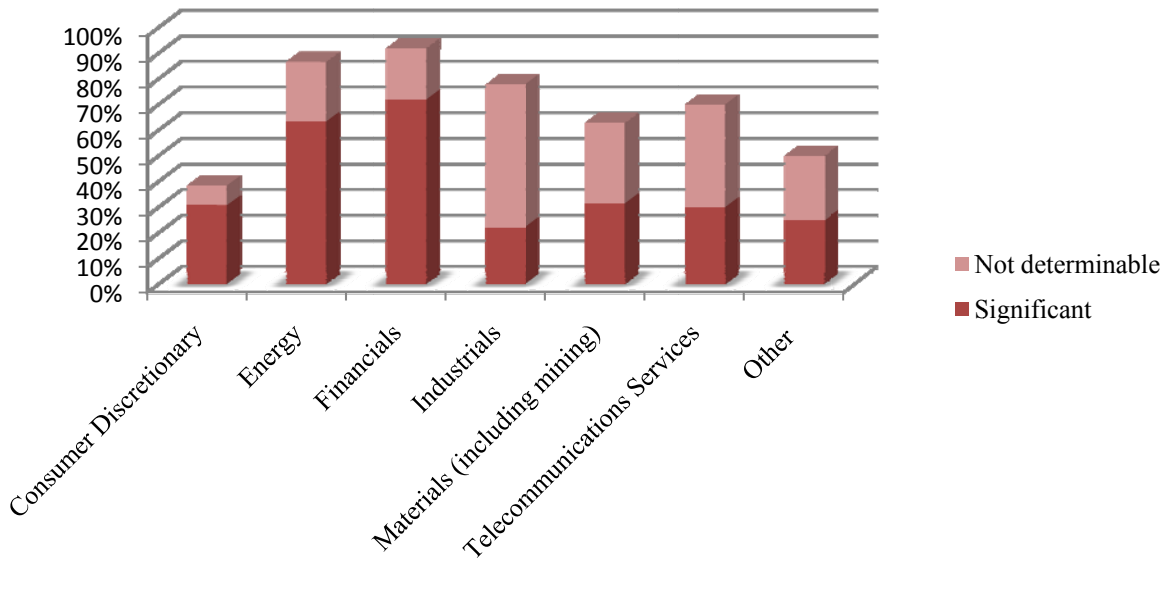
[39] I note that a poll of 273 CAs from public practice, government and industry conducted by Resources Global Professionals found 87% of CAs surveyed believe that a company's reported financial results will change due to IFRS. The results of the poll, however, do not differentiate between the magnitudes of change. In addition, the CAs surveyed were not limited to those in industry and their comments may be general rather than in respect of specific companies.

Figure 7
Stated Expected Impact of IFRS by S&P TSX Composite Companies



The breakdown, by industry, of companies expecting a significant impact is show in Figure 8 below[40]. The industries that have the highest percentage of companies expecting a significant impact are energy (63%) and financials (72%). With a significant percentage of companies in some industries not yet having determined the impact, there may be other industries which could have percentages even higher. Information technology (included in other) is the only industry in which no company stated that there would be a significant impact. However, the sample is represented by only five information technology companies[41].

Figure 8
Significant IFRS Impact by Industry



[40] Included in the "other" category are the consumer staples, healthcare, information technology and utilities industries for which our sample had less than ten companies. See Appendix 3 for complete results.
[41] Of the five; one stated the impact is not yet determinable, three will continue to use US GAAP and one stated no impact is expected.

Accounting policies that were most frequently mentioned by the study sample as potentially having an impact were; property, plant and equipment, employee benefits, impairment testing, share based payments, exploration and evaluation expense, depletion expense, asset retirement obligations, investment properties, financial instruments and accounting for joint ventures and business combinations.

Based on the low level of early adoption and the limited IFRS quantitative information provided to date, the financial impact of IFRS for most public companies has not yet been communicated to analysts and investors. As a result, the impact of IFRS on share values of Canadian public companies is yet to come.

6. CONCLUSION

Will the adoption of IFRS have an impact on the share values of Canadian public companies? For 60% to 65% of public companies there will likely be little or no impact. This includes companies in the following categories;

- Continuing to use US GAAP (10%)[42]
- Have already adopted IFRS (.5%)
- Have already determined that there will be no significant impact (18%)[43]
- Companies in the extractive industries (e.g. oil & gas and mining), excluding those already included above (30% - 35%)[44]

Typically companies in the extractive industries are valued using discounted cash flow ("DCF") models with reference to commodity reserves and prices. Net income is typically not a good proxy for cash flow in this type of industry nor is reported equity usually indicative of value. As IFRS does not affect cash flows, the impact on DCF models should be minimal. There are other industries for which this may also be the case that could have been included in the above percentage. As the industry categories in Appendix 3 are relatively broad, an attempt to estimate a percentage for these other industries was not done. By using the whole Energy and Materials sectors to represent the extractive industries, undoubtedly, there will be companies in these sectors that could have been excluded.

IFRS should have less impact on valuations that do not use net income as a proxy for cash flow.

[42] See Figure 7.
[43] See Figure 6- companies that stated they expected no or low impact.
[44] Calculated as the total of 47% (Energy (27%) and Materials (20%) sectors) as shown in Table 1, less the percentage in categories above of 12% (see Appendix 3) for a net of 35% .

For the remaining 35% to 40% of public companies there may be an impact on share price. There will be companies for which IFRS provides new information, either positive or negative, that has an impact on underlying value. For companies for which this is not the case, the impact will depend on how successful they are in telling their "IFRS story". As noted in several CSA Staff Notices and news releases "Reporting issuers that provide sufficient information about their conversion process and its effects *prior* to the changeover to IFRS will assist in reducing investor uncertainty as Canada transitions to IFRS in 2011."

35% to 40% of public companies may see an impact on their share price.

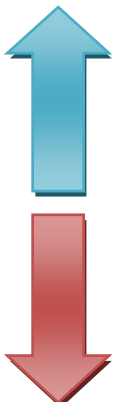
Even good explanations may not be enough if analysts do not have sufficient time or understanding to absorb the IFRS information. Based on research in Europe, Aubert & Dumontier (2009) noted that "analysts are not as precise as we could think when a switch to another conceptual framework occurs, even though that change in accounting rules is a major accounting evolvement...analysts were not able to correctly anticipate the effect of IFRS adoption on earnings...".

If IFRS reported financial results differ from expected results and analysts cannot distinguish between differences due to IFRS accounting changes and underlying business performance, there may be a tendency for analysts to assume the later. As a result, even though there may have been no fundamental change in performance, until analysts can determine otherwise, they may react as if there has been. To the extent analysts rely on non-GAAP measures such as EBITDA as a proxy for cash flows, the impact may be exacerbated as there are several differences between IFRS and GAAP that could have an impact on EBITDA. IFRS winners may see an increase in share price and IFRS losers a decrease, with the degree of impact dependent on the magnitude of the differences between IFRS and GAAP reported results. Based on the Australian experience, changes in share prices could prevail for 14 to 15 weeks.

If analysts cannot distinguish between differences due to IFRS accounting changes and underlying business performance, there may be a tendency to assume the later.

Figure 9
IFRS Impact on Share Value

No- 60% to 65%



Maybe- 35% to 40%

Likely **little or no** impact if;

- ✓ Continue to use US GAAP
- ✓ Adopted IFRS early
- ✓ Value not determined by financial statements- e.g. extractive industry
- ✓ No significant difference in net income or equity under IFRS and GAAP

Possibly **minimal** impact if;

- ✓ Provide quantitative IFRS disclosure prior to adoption
- ✓ Thoroughly explain non-cash flow impact of IFRS

Significant impact if:

- ➢ IFRS provides new information –e.g. impairment, asset fair value
- ➢ IFRS impacts debt covenants or contracts
- ➢ Analysts and investors are not prepared for IFRS

Undoubtedly, there will be a learning curve with IFRS and there may be some mishaps and misread signals by the market. However, they are unlikely to be as severe as an incident that occurred after the conversion to the metric system. In 1983 an Air Canada plane with 61 passengers ran out of fuel at 7,920 meters (26,000 feet), halfway through its flight from Montreal to Edmonton, via Ottawa. The crew was able to glide the plane safely to an emergency landing in Gimli, Manitoba. The incident was attributed to a measurement error in fuel loading due to a misunderstanding of the recently adopted metric system. [45]

The impact on share values from the adoption of IFRS should be no different than the conversion to the metric system; in the short term expect some misreading as companies and the investment community learn a new system. But in the long run it doesn't matter whether you take the temperature in Fahrenheit or Celsius, it's either hot or it's not. Just like some stocks.

IFRS may have an impact on share values in the short-term. Over the longer term, intrinsic value based on underlying business performance should prevail.

[45] Wikipedia "Gimli Glider" July 23, 1983

Appendix 1
Other IFRS Countries

Country	Convergence Score GAAP/IFRS Differences[46]	Equity Market Cap. $US Trillions[47]	Market Cap. as a % of GDP[48]	Number of Listed Companies[49]	Market Cap. as a % of Num. of Listed Co.
Australia	4	1.262	127%	1,966	.06%
Austria	12	0.114	30%	115	.10%
Belgium	13	0.172	37%	171	.10%
Canada	5	1.676	125%	3,700	.05%
Chile	13	0.231	143%	236	.10%
China	9	3.573	120%	1,700	.21%
Denmark	11	0.180	58%	125	.14%
Egypt	9	0.091	48%	313	.03%
Estonia	7	0.025	13%	92	.03%
Finland	15	0.188	79%	141	.13%
France	12	1.521	57%	673	.23%
Germany	11	1.292	39%	783	.17%
Greece	17	0.113	34%	288	.04%
Hong Kong	3	2.305	120%	1,319	.18%
Hungary	13	0.030	23%	46	.07%
Ireland	1	0.061	27%	64	.10%
Israel	6	0.189	97%	622	.03%
Italy	12	0.656	31%	296	.22%
Luxembourg	18	0.105	20%	267	.04%
Netherlands	4	0.402	51%	211	.19%
New Zealand	3	0.036	31%	165	.02%
Norway	7	0.227	59%	238	.10%
Peru	1	0.071	56%	241	.03%
Poland	12	0.151	35%	486	.03%
Portugal	13	0.057	25%	55	.10%
Slovenia	9	0.012	2%	76	.02%
South Africa	0	0.799	278%	396	.20%
Spain	16	1.435	98%	3,472	.04%
Sweden	10	0.441	109%	310	.14%
Switzerland	12	1.065	215%	339	.31%
UK	1	2.796	128%	2,792	.10%
Average or Total	9			21,698	

[46] Totals determined from the Bae et al (2008) study which indentified 21 key accounting standards. Each accounting item on the list to which the countries did not conform to IFRS received one point. The minimum and maximum points possible are zero and 21, with zero points indicating the closest match to IFRS.

[47] Equity market capitalization and number of listed companies are based on figures published by the World Federation of Exchanges for the 2009 year-end. For countries included in the NYSE Euronext (Europe) and the NASDAQ OMX Nordic Exchanges the market capitalization attributable to each individual country was calculated based on additional information published in 2009 statistics of the respective exchanges.

[48] Market capitalization column divided by GDP from Wikipedia (based on International Monetary Fund, World Economic Database for 2009).

[49] Refer to footnote above. The total number of NASDAQ OMX Nordic Exchange countries reported by the exchange was 668. The breakdown by country; Sweden, Finland, Denmark and Estonia was estimated based on information in Wikipedia.

Appendix 2
Canadian Public Companies Adopting IFRS Early

	Company[50]	Industry	Adoption Year	Adoption rationale[51]
1	Almaden Minerals Ltd.	Mining-E&D	2010	Eliminate US GAAP reconciliation
2	Anooraq Resources Corp.	Mining-E&D[52]	2009	Eliminate US GAAP reconciliation, subsidiary uses IFRS
3	Brookfield Asset Management Inc.	Real Estate	2010	IFRS better reflects asset values, some subsidiaries use IFRS
4	Brookfield Office Properties Ltd.-Pref.	Real Estate	2010	IFRS better reflects asset values
5	Brookfield Properties Corp.	Real Estate	2010	IFRS better reflects asset values
6	Brookfield Renewable Power Ltd.-Pref.	Utility	2010	IFRS better reflects asset values
7	Eastern Platinum Limited	Mining	2009	Operating subsidiary uses IFRS
8	Everclear Capital Ltd.	Other	2010	Newly public
9	Gerdau Ameristeel Corp.	Steel Mfg.	2010	Parent company uses IFRS
10	Heatherdale Resources Ltd.	Mining-E&D	2010	Newly public
11	Homburg Invest Inc.	Real Estate	2005	Already using IFRS for other country listing
12	Jinshan Gold Mines Inc.	Mining-E&D	2010	Operating subsidiary uses IFRS
13	Nevsun Resources Ltd.	Mining-E&D	2010	Operating subsidiary uses IFRS
14	Northern Dynasty Minerals Ltd.	Mining-E&D	2009	Eliminate US GAAP reconciliation
15	Orca Explorations Group Inc.	Oil & Gas	2004	Already using IFRS
16	Platmin Limited	Mining-E&D	2009	Operating subsidiary uses IFRS
17	SouthGobi Resources Ltd.	Mining	2009	IFRS required for secondary listing on Asian exchange
18	Tahoe Resources Inc.	Mining-E&D	2009	Newly public
19	Thomson Reuters Corp.	Media	2009	Eliminate US GAAP and IFRS reconciliation
20	U308 Corp.	Mining-E&D	2010	Avoid the rush. No significant impact anticipated.

[50] The list of companies is based on information provided by the various provincial securities regulators. An additional four companies were granted permission to early adopt but as of June 30, 2010 had not yet done so.
[51] As noted in the MD&A or news release.
[52] The company commenced mining production subsequent to the adoption of IFRS.

Appendix 3
S&P TSX Composite Pre-IFRS Disclosures
Sample Companies[53] Stated Impact

S&P Industry Classification	Low or No IFRS Impact	Significant IFRS Impact	IFRS Impact not determined	Using US GAAP not IFRS	Total
Consumer Discretionary	5	1	4	3	13
Consumer Staples			1		1
Energy	2	7	19	2	30
Financials	2	5	18		25
Healthcare			1	1	2
Industrials	2	10	4	2	18
Information Technology	1	1		3	5
Materials (includes mining)	11	11	11	2	35
Telecommunications Services	3	4	3		10
Utilities		2	1	1	4
Total number of companies	**26**	**41**	**62**	**14**	**143**

[53] The sample size of 143 companies was randomly selected (using a random number generator) from the 223 S&P TSX Composite companies as of June 30, 2010 that had not already adopted IFRS. The sample size provides a 95% confidence level with a confidence interval of 5.

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