

# Putting IFRS in motion\*

The impact of International Financial Reporting Standards (IFRS) on the Canadian retail and consumer sector



# Introduction



More than 100 countries have adopted the use of International Financial Reporting Standards (IFRS) by public companies. Publicly accountable enterprises will be required to adopt IFRS as Canadian generally accepted accounting principles (GAAP) for interim and annual financial statements for fiscal years beginning on or after January 1, 2011 with early adoption permitted by securities regulators on a case by case basis.

The move to IFRS will fundamentally change the way Canadian companies report their business results to analysts, investors and other stakeholders.

For some organizations, implementing IFRS may not be very complicated, but for others it will be a highly complex process that goes well beyond the finance and accounting functions. Other business operations such as human resources, investor relations, business development and information technology (IT) departments will likely be involved in the IFRS conversion plan.

Our experience in assisting global companies that have already adopted IFRS shows that for some, full conversion and adoption can take anywhere from two to five years, depending on the complexity of the organization. Are you on track?

Certain industries have a long and complex conversion process because significant accounting policy changes are required. It is often extremely difficult to extract the historical information necessary to make these changes, and the accounting processes and systems have to be modified on a go-forward basis.

One of the most significant challenges in converting from Canadian GAAP to IFRS is determining which Canadian GAAP differences will impact the organization. This publication outlines some of the significant accounting differences that arise between Canadian GAAP and IFRS in the retail and consumer sector. The background and context behind the decision to adopt IFRS and the key strategic issues you will face in converting to IFRS are outlined in our publication, *Putting IFRS in motion – Are you on track?* To obtain a copy, contact a PwC professional or visit [www.pwcifrs.ca](http://www.pwcifrs.ca).

Companies that have already implemented IFRS understand that the new standards may place a sizeable responsibility on management to communicate effectively to the market in the new IFRS language.

# Accounting under IFRS

Canadian publicly accountable enterprises must use IFRS to prepare interim and annual financial statements for financial years beginning on or after January 1, 2011 with early adoption permitted on a case by case basis by the Canadian securities regulators. The move to IFRS will change the way Canadian companies present their business results to analysts, investors and other stakeholders. The implementation of IFRS for Canadian retail and consumer companies may at first look like a complicated, expensive and difficult process. However, the size and complexity can be managed if companies plan ahead before the new accounting and reporting standards become effective.

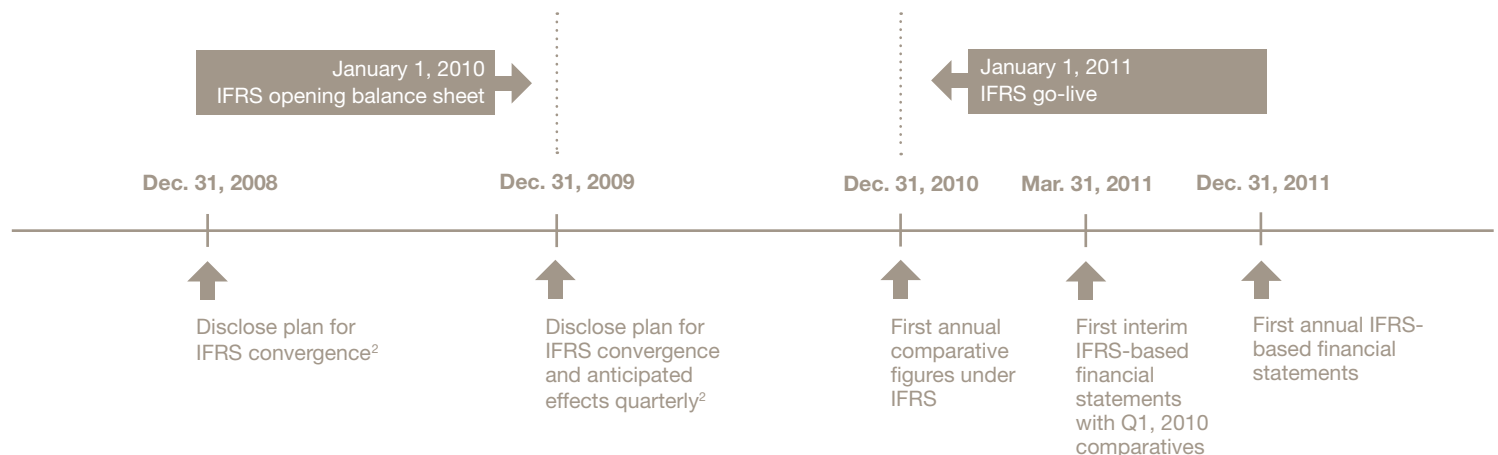
Many retail and consumer companies throughout Europe and Australia have completed their transition and have been applying IFRS since January 1, 2005. The transition to IFRS for retail and consumer companies in these countries has shown

there are some interpretation and application challenges unique to the retail and consumer industry.

The following sections of this publication highlight some of the significant differences between Canadian GAAP and IFRS that will specifically impact retail and consumer companies.

Even though the Canadian changeover to IFRS is scheduled for 2011, the scale of the transition means there are decisions to be made today. Accounting information will need to be converted to IFRS starting January 1, 2010 for comparative financial statements that will be reported for the first quarter of 2011. In addition, once a company commences a changeover plan, it is expected to provide quarterly disclosures in its Management Discussion and Analysis related to expected changes in accounting policies as a result of the changeover to IFRS.

## The Canadian IFRS conversion timeline: Key dates and milestones<sup>1</sup>



<sup>1</sup> The table assumes a calendar year in which a company first reports under IFRS in 2011 and presents a single year of comparatives as well as an opening IFRS statement of financial position as at the date of transition to IFRS.

<sup>2</sup> Canadian Securities Administrators Staff Notice 52-320 requires quarterly disclosures in Management's Discussion and Analysis starting in 2008 on the plan for IFRS convergence and, starting in 2009, the expected impact of the adoption of IFRS. Quantification of the impact of adoption of IFRS will be required in 2010 in the annual Management's Discussion and Analysis at the latest.

## First-time adoption of IFRS

Under IFRS 1, the underlying principle on adoption of IFRS is retrospective application of all IFRS standards (with certain optional exemptions and mandatory exceptions) at the entity's first reporting period.

The International Accounting Standards Board (IASB) acknowledged that in some cases it may be too difficult, too costly or maybe not even possible to accumulate information on an IFRS basis. The IASB, therefore, decided to allow preparers of financial statements to select alternatives to retrospective application in certain areas. The IASB considered that retrospective application may be too subjective in certain areas and therefore decided to prohibit retrospective application in certain areas.

Where differences exist and there is no exemption available, companies may have to put in significant effort to remeasure various historical transactions under IFRS. Early identification of Canadian GAAP differences and consideration of the exemptions are very important for a successful conversion.

## Property, plant and equipment

Property, plant and equipment would initially be recorded at cost. However, IAS 16, *Property, Plant and Equipment*, provides entities with the option to revalue property, plant and equipment. The revaluation adjustment is recorded directly to equity if the revaluation results in an increase in the carrying value of the property, plant and equipment. If the revaluation adjustment results in a decrease in the carrying value of the property, plant and equipment, it is first recorded in equity to the extent of previous valuation adjustment increases, with any additional decrease recorded in the income statement. The use of the revaluation method requires regular valuations of entire classes of assets.

IAS 16 requires that the cost of property, plant and equipment be broken down into its major component parts, which are separately measured and amortized over their respective useful lives. As a result, there may be significantly more tracking required for the individual major component parts. Although Canadian requirements are similar, application of the IFRS model may require greater rigour than traditionally applied under Canadian GAAP.

### Impairment

IAS 36, Impairment of Assets, differs significantly from the current Canadian GAAP standards for the impairment of long-lived tangible and intangible assets. Under IAS 36, at each reporting date, companies are explicitly required to assess whether there are any indications of impairment. Both Canadian GAAP and IFRS require assets to be tested for recoverability whenever events or circumstances indicate that the carrying amount may not be recoverable.

Under IFRS, there is no initial assessment of an asset's recoverability based on undiscounted cash flows as there is under Canadian GAAP. Rather, the carrying value of the asset is compared to the higher of the asset's "value in use"<sup>3</sup> and its "fair value less costs to sell" in determining whether an impairment charge is required and, if so, the amount. This accounting difference may result in companies requiring writedowns under IFRS to assets that were previously considered recoverable using the initial undiscounted cash flow test under Canadian GAAP.

Another significant difference from the current Canadian standards is that IFRS requires the reversal of previous impairment losses where there is an indication that the loss may no longer exist or may have decreased. This requirement may lead to volatility in the income statements of retail and consumer companies with impairments recorded and reversed in response to changes in economic conditions.

### Leases

Lease classification concepts under IAS 17, Leases, are similar to those under Canadian GAAP. A substance rather than legal form analysis is applied under both Canadian GAAP and IFRS, however under Canadian GAAP, there are certain quantitative thresholds or bright-line tests used to assess the classification between operating and finance (i.e. capital) leases. Under IFRS, there are no similar bright-line tests; rather, the classification is determined using qualitative guidelines and professional judgment. Upon review of the specific fact pattern for each lease agreement, a different conclusion on the lease classification could result under IFRS.

The IASB and the Financial Accounting Standards Board (FASB) have commenced a joint project to review the overall accounting for leases, as it relates to lessees and have announced that it is planning to release a discussion paper on leases during the fourth quarter of 2008 followed by an exposure draft on leases in 2011. It is anticipated that the exposure draft will require that lessees capitalize all leases on the balance sheet.

If adopted, this standard will have a significant impact on the balance sheets of retail and consumer companies that currently have operating leases for their retail locations off-balance sheet.

<sup>3</sup> Value in use, is estimated cash flows derived from an asset, and then discounted using a pre-tax market rate, which reflects the risks specific to the asset.

## Asset retirement obligations

The Canadian standard differs from IFRS in two important ways. First, IFRS requires the use of current interest rates at each reporting date to determine the obligation, as opposed Canadian GAAP which uses the interest rate when the liability was initially measured under Canadian GAAP. Second, IFRS uses a concept of determining management's best estimate of cash outflows related to the retirement obligation, while under Canadian GAAP a fair value measurement approach is used. In addition, IFRS introduces the concept of recording obligations for constructive obligations as well as legal obligations whereas the Canadian standard only refers to the concept of legal obligations. Accordingly, obligations measured under IFRS may therefore be subject to greater volatility.

## Business combinations and subsidiaries

The IASB and FASB recently completed their joint project on business combinations to develop new requirements for accounting for purchases and the new standards were released late in 2007 for US GAAP and in early 2008 for IFRS. This new IFRS standard also included an amendment to IAS 27, *Consolidated and Separate Financial Statements*. The new IFRS standards are effective for calendar years commencing in 2010. The AcSB in Canada has indicated that it expects to incorporate

the new IFRS standards into Canadian GAAP in 2008 and to have them take effect in 2011, with early adoption permitted in 2010. The joint project will largely align IFRS with Canadian GAAP and US GAAP.

The revised IFRS standards have significantly different requirements than current Canadian GAAP, which will need to be considered for all business combinations. These revised new standards affect:

- The determination of the consideration paid and fair values of assets acquired;
- Measurement and presentation of non-controlling interests in the balance sheet and income statement;
- Accounting for contingent consideration and contingencies;
- Accounting for transaction costs; and
- Transactions with non-controlling interests.

In addition, the distinction between an asset purchase and a business combination is particularly important under IFRS as deferred tax is generally not recognized on an asset acquisition (due to the "initial recognition" exemption<sup>4</sup>) but is recognized for a business combination. In contrast, under Canadian GAAP, when an asset is acquired in a means other than through a business combination, and the tax basis of that asset is different than its cost, the future income taxes recognized at the time of acquisition should be adjusted against the cost of the asset.

<sup>4</sup> Thus any difference in tax and book values would be treated as a permanent difference.



Adoption of the new financial instruments standards in Canada has closely aligned Canadian GAAP with IFRS. There are, however, certain subtle differences in the standards applicable to derivatives and hedging that will require consideration on transition.

## Derivatives and hedging

The recent adoption of the new financial instruments standards in Canada has closely aligned Canadian GAAP with IFRS. There are, however, certain subtle differences in the standards applicable to derivatives and hedging that will require consideration on transition. This is a complex area that affects many retail and consumer companies that use financial and non-financial derivatives to hedge cash flows and the value of assets and liabilities. Careful analysis will be required to identify potential differences in derivatives and hedging activities.

The IASB has recently issued a discussion paper proposing to simplify the accounting for hedges which would make hedge accounting much simpler than the current requirements under Canadian GAAP.

## Inventories

The recent adoption of the new inventories standard in Canada has substantially eliminated the differences between Canadian GAAP and IFRS.

## Revenue recognition

Under IAS 18, Revenue, is the general revenue guideline for companies to follow. The IFRS standard is substantially the same as current Canadian GAAP, where the following principles are followed for recognizing revenue:

- Significant risks and rewards of ownership have been transferred;
- Continuing managerial involvement and effective control are not retained;

- The amount of revenue can be reliably measured;
- The costs incurred or to be incurred can be reliably measured; and
- It is probable that the economic benefits will flow to the entity.

The IASB and FASB have commenced a joint project to develop additional guidance on revenue recognition and have announced that it is planning to release a discussion paper during the fourth quarter of 2008 followed by an exposure draft in 2009. Careful analysis will be required to track the proposed changes and assess the impact on the current revenue recognition policies of retail and consumer companies.

## Employee benefits

The accounting for employee benefits is a complex area that is governed by IAS 19, *Employee Benefits*, which applies to both short-term and long-term employee benefits. Although many aspects of Canadian GAAP are aligned with IFRS on this topic, there are several areas where differences may arise. The following are some of the key areas where differences exist between the IFRS standard and Canadian GAAP as it relates to defined benefit plans:

- Actuarial gains and losses are either recognized directly in equity, or in the income statement using the 'corridor' approach or through the application of an accelerated recognition approach, whereas Canadian GAAP does not permit the recognition of actuarial gains and losses directly in equity;
- Under the 'corridor' approach, the minimum amortization of actuarial gains and losses is over the average remaining service period of employees participating in the plan

regardless of whether the majority of participants were active or inactive. Canadian GAAP requires the amortization of actuarial gains and losses over the average remaining life expectancy of the former employees when all, or almost all, of the employees in the plan are no longer active;

- Past service costs are recognized on a straight-line basis over the average period until the benefits become vested, whereas under Canadian GAAP, past service costs are typically recognized over the average remaining service period of active employees expected to receive benefits under the plan;
- Gains or losses on the curtailment or settlement of a defined benefit plan are recognized when the curtailment or settlement occurs, whereas Canadian GAAP requires a curtailment loss to be recognized when it is probable that a curtailment will occur; and
- The plan assets and obligation must be measured with sufficient regularity that the amounts recognized in the financial statements do not differ materially from the amounts that would be determined at the balance sheet date. Canadian GAAP permits the use of a date not more than three months prior to the date of the financial statements.

The IASB recently issued a discussion paper on employee benefits with the intention of issuing an exposure draft by the end of the third quarter of 2009. The discussion paper proposes eliminating the deferred recognition and smoothing features of IAS 19, which would essentially eliminate the ability to defer the recognition of actuarial gains and losses and past service costs.

The accounting for defined contribution plans under IAS 19 is substantially converged with Canadian GAAP.

# Conversion is not just a technical accounting exercise

IFRS will present unique challenges for senior management, the financial reporting function, the treasury function and many other areas across the organization. IFRS may impact existing management reporting including budgets, forecasts, performance measures, reward schemes and bonus structures, key performance indicators and covenants. Furthermore, new procedures should be considered to ensure IFRS implications are considered as part of the approval process for all new strategic investments. Depending on the size and complexity of the organization, most retail and consumer companies will likely find that their human resources, IT, investor relations and business development departments will need to be involved in planning the transition to IFRS. Each individual company will have unique circumstances that require sound judgment and expert advice. Advanced planning and an in-depth diagnostic of how IFRS will affect your company's financial reporting will reduce the risk associated with compliance and lower the overall cost of transition.

IFRS across the organization		
<p><b>Implementation Resources</b></p> <ul style="list-style-type: none"> <li>• Need for resources over 12-18 months</li> <li>• Competing projects</li> <li>• Not just a finance issue</li> </ul> <p><b>Training and Education</b></p> <ul style="list-style-type: none"> <li>• All finance staff will need some training</li> <li>• Broader awareness of the issues</li> <li>• Other business professionals within organization</li> <li>• Executives need to be able to understand and explain the “new” numbers</li> </ul>	<p><b>Business Acquisitions</b></p> <ul style="list-style-type: none"> <li>• Need for IFRS figures for due diligence</li> <li>• Models required for annual goodwill impairment tests</li> </ul> <p><b>Financing/Refinancing</b></p> <ul style="list-style-type: none"> <li>• Impact of IFRS on earnings or asset-based debt covenants</li> </ul> <p><b>Remuneration</b></p> <ul style="list-style-type: none"> <li>• Impact of earnings volatility on profit-based bonus plans</li> </ul>	<p><b>Systems and Processes</b></p> <ul style="list-style-type: none"> <li>• Need for different/new data</li> <li>• New systems</li> </ul> <p><b>SOX/ICOFR Certification</b></p> <ul style="list-style-type: none"> <li>• Process/control documentation updates</li> </ul> <p><b>Investor Relations</b></p> <ul style="list-style-type: none"> <li>• Preparing analysis for the impact of IFRS</li> </ul> <p><b>Management Reporting</b></p> <ul style="list-style-type: none"> <li>• Budgets, forecasts, management accounts and KPIs need to be on an IFRS basis</li> </ul>

## Communication

The financial statements of a Canadian retail and consumer company will look different under IFRS than they currently do under Canadian GAAP. Senior executives need to be prepared to discuss the reasons for, and the nature of, the differences to board members, shareholders, the investment community and financial analysts. A detailed communication plan is necessary to educate stakeholders and actively manage perceptions.

There are a number of areas within IFRS that are subject to interpretation. While a primary aim of the IASB is to have a global set of standards applied consistently, the reality is that there are differences in the specific application of a particular accounting rule from one company to another. Communication of key policy choices, interpretations and accounting decisions in some detail may also be necessary to differentiate and explain a retail and consumer company's financial results under IFRS as compared to its peers.

Our experience with companies in Europe has shown that early communication, including the sharing of pro forma financial statements with preliminary figures and/or opening balance sheets under IFRS – in advance of the transition date – has allowed investors and analysts to understand and become comfortable with financial results and their presentation. In contrast, late or absent dialogue with key stakeholders concerning the financial implications of the adoption of IFRS could result in a direct impact on share price.

## Impact on systems and processes

IFRS compliance may require the realignment of reporting systems for new and additional data.

Our experience has shown that many companies implementing IFRS underestimate the time and resources needed to meet this challenge. This is especially true with existing management systems or legacy systems from past acquisitions that have never been updated and are not geared to provide sufficient or appropriate data for preparing new and increased disclosures. To make the best decisions on IT investment and achieve user engagement, it is important that company IT executives have sufficient time to perform systems realignment and are not forced to complete this work in a “fire drill” environment.

Other process changes under the move to IFRS can be equally as important and may include the following:

- Revising existing reporting templates and other checklists to incorporate data required for disclosures under IFRS;
- Rationalizing or expanding the chart of accounts to post additional measurement changes and/or collect additional disclosures under IFRS;
- Reviewing period-end close procedures to achieve efficient close times;
- Reviewing outsourced operations' controls and capability in producing IFRS-compliant information; and
- Obtaining IFRS information from significantly influenced investees and/or variable interest entities.

### Education, awareness and culture

The migration to IFRS may also require a training program that combines knowledge transfer with the ability to address skills, attitudes and motivation. The entire organization, not just finance and accounting, will need to be trained in this area (e.g. functions such as internal audit and investor relations). Training should focus on what information individual business units will need to provide in order to comply with IFRS and how IFRS will affect their decision-making and value creating strategies.

Early awareness training on the important impact areas and changes under IFRS will enable key stakeholders, including key executives and board members, to be fully briefed on the new requirements and help drive a positive spirit of change management throughout the organization.

### Regulatory requirements

The adoption of IFRS will require Canadian entities to consider various regulatory requirements.

#### **Use of IFRS by Canadian SEC registrants**

A significant benefit to a Canadian SEC registrant of adopting IFRS-IASB is that the entity will no longer have to reconcile its primary financial statements to US GAAP in SEC filings. The SEC also has extended an accommodation to first-time IFRS reporters, enabling them to present only a single year of comparative financial statements, rather than the two years it usually requires.

The SEC's IFRS accommodations are effective now but are not available to Canadian SEC registrants before 2011 unless approval of an early adoption of IFRS is obtained from the Canadian securities regulators for Canadian filing purposes as previously discussed on page 2.

On adopting IFRS, a Canadian SEC registrant will no longer have to reconcile to US GAAP.

The Canadian Securities Administrators ("CSA") is also proposing to retain the existing option in NI52-107 for Canadian SEC registrants to continue using US GAAP.

#### **Internal controls over financial reporting**

Public companies will also need to consider Multilateral Instrument 52-109 (certification of disclosure in issuers' annual and interim filings) and Sarbanes-Oxley requirements (management assessment of internal controls) as they transition to IFRS. Specifically, entities will need to update their documentation on the internal controls over financial reporting and related evaluation procedures for processes and changes impacted by the migration to IFRS. Furthermore, entities will need to consider controls over the conversion process itself.

### Merger and acquisition implications

The move to IFRS may add increased complexity to merger and acquisition (M&A) transactions in countries that have not yet adopted IFRS.

The main challenges will be the need to translate the target's historical and projected performance into IFRS to assess the accounting implications of the transaction and to understand the impact on the acquirer's earnings per share.

Complexities in IFRS accounting will lead to tougher due diligence requirements when evaluating targets in the retail and consumer sector, even if the target is already reporting under IFRS.

The potential cost of bringing the target's reporting systems up to the acquirer's standards, and the time required to do

this, could significantly affect a company's ability to realize integration synergies, especially as we get closer to the transition date.

To the extent that a Canadian entity completes any acquisition of a target company not currently reporting under IFRS before 2011, it will need to include the target company in its IFRS conversion and readiness plan.

Our experience assisting companies with M&A transactions has shown that they have struggled to obtain the additional data and disclosure requirements of target companies under IFRS.

## Planning an effective conversion

It is easy to underestimate the volume and complexity of the work involved with the implementation of IFRS.

Our experience in Europe and Australia has shown that some companies transitioning to or applying IFRS for the first time will try to make manual adjustments from local GAAP to IFRS using spreadsheets or similar tools. These quick-fix conversions are often not the most cost-effective choice in the long run, especially as these fixes can be prone to error, confusion and typically lack the appropriate internal controls surrounding their preparation.

To ensure sustainable and uniform application of IFRS throughout your organization, you will need to document your accounting policy selections and make sure they are consistently followed.

Each individual company will have unique circumstances that require sound judgment and expert advice. Advanced planning and an in-depth diagnostic of how IFRS will affect your company's financial reporting will reduce the risk associated with compliance and lower the overall cost of transition.



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# How we can help

PricewaterhouseCoopers has unparalleled experience in helping many of the world's largest companies adopt IFRS. We have assisted with IFRS conversion projects in Canada and elsewhere for a wide range of companies across all industries. Our dedicated resources and experience in working with many of the more than 12,000 companies that have already made the transition to IFRS have taught us valuable lessons that will help Canadian retail and consumer companies with their own conversion process.

Our experience has shown that a critical success factor for IFRS conversion is a well-planned implementation, which is started several years in advance of the required convergence date.

Our industry-focused teams specialize in IFRS/GAAP conversions for a wide range of organizations – from large, complex institutions, requiring detailed analysis, to organizations with more straightforward requirements. These teams are supported by our Capital Markets Group, a global team of over 500 IFRS conversion experts, who specialize in multi-GAAP environments and the related conversion implications.

## Our Retail and Consumer Group

To combine our collective experiences and promote consistency across our clients, we have an established Retail and Consumer Group in Canada. The group has access to retail and consumer specialists from some of the key territories in which IFRS is currently being adopted or already applies, including Europe and Australia. The group has knowledge and experience in providing solutions for the accounting issues faced by the Canadian retail and consumer sector and plays a key role in resolving new issues that emerge.

**PwC professionals can help you plan and complete your transition to IFRS by providing:**

- **An initial diagnostic of Canadian GAAP/IFRS accounting differences;**
- **Advice on selection of appropriate accounting policies;**
- **Advice on development of an IFRS implementation plan;**
- **Training for all levels of your staff, including your board of directors;**
- **IFRS trained and experienced people to supplement your IFRS team;**
- **Project management support to your IFRS team;**
- **Communication strategies and change management support;**
- **Assessment of your requirements for data, processes, systems and controls;**
- **Advice on process and system solutions to embed IFRS;**
- **Competitor benchmarking;**
- **M&A target accounting conversion assistance;**
- **Valuation advice under IFRS fair value and impairment models; and**
- **Tax planning considerations on conversion to IFRS.**

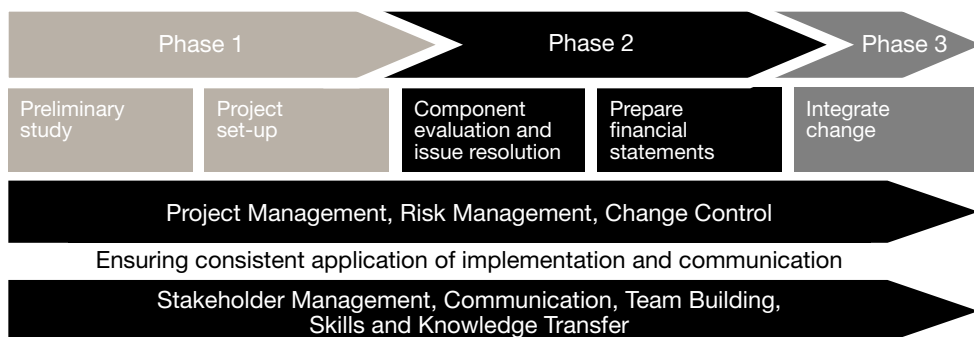
## PwC's Transition/IFRS Methodology

While compliance with the new rules is the driver for IFRS projects, our experience indicates that a methodical approach to the conversion process can yield wider benefits. Our Transition/IFRS methodology is a robust, tried and tested framework that has an inherent flexibility, enabling us to adapt it to work most effectively within your organization and one that we would tailor to your needs and phases, as outlined below. This methodology has consistently delivered successful results.

Typically, each IFRS transition project consists of three phases. In Phase 1, the diagnostic stage, we carry out an initial impact analysis and plan the later phases. Phase 2 consists of the detailed steps necessary to prepare the first complete IFRS financial statements. In Phase 3, we take the information, issues and solutions gathered and integrate them into your underlying financial systems and processes.

Transition/IFRS acts as a springboard from which you can launch and control your conversion project, accessing the support and guidance you need as the implementation progresses.

We are ready to help you manage the conversion process with fewer headaches. To learn more about how we can help, visit our website at [www.pwcifrs.ca](http://www.pwcifrs.ca) or contact one of the IFRS professionals.



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For more information on IFRS and to view IFRS publications, visit our website at [www.pwcifrs.ca](http://www.pwcifrs.ca).

This publication does not provide a complete list of Canadian GAAP differences that Canadian retail and consumer companies need to consider upon transition to IFRS.

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