SEC Issues Staff Paper Outlining "Condorsement" Approach to Incorporating IFRS into U.S. GAAP

The Securities and Exchange Commission's ("SEC") Office of the Chief Accountant has issued a staff paper entitled *Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers* ("Staff Paper"), which outlines one possible method for incorporating the International Financial Reporting Standards ("IFRS") into U.S. generally accepted accounting principles ("U.S. GAAP").[1] The approach discussed in the Staff Paper is predicated on the following principles:

(1) U.S. GAAP would be retained, but the Financial Accounting Standards Board ("FASB") would incorporate IFRS into U.S. GAAP over a defined period of time (*e.g.*, five to seven years), with a focus on minimizing transition costs, particularly for smaller issuers. During this transitional period, existing differences between IFRS and U.S. GAAP would be eliminated through ongoing FASB standard-setting efforts; and

(2) the FASB would incorporate newly issued or amended IFRSs into U.S. GAAP pursuant to an established endorsement protocol. The endorsement protocol would provide the FASB and SEC with the ability to modify or supplement IFRS when in the public interest and when necessary to protect investors.

The first principle above is consistent with a "convergence" approach, while the second principle is consistent with an "endorsement" approach to incorporation.[2] Because the framework discussed in the Staff Paper essentially blends both approaches, it has colloquially been referred to as "condorsement."[3]

I. Background

Since 2002, the FASB and IASB have recognized the need to develop high-quality, compatible accounting standards that may be used for both domestic and cross-border financial reporting.[4] Incorporation of IFRS into U.S. GAAP through the condorsement framework would achieve the goal of having a single set of high-quality, globally accepted accounting standards, and it would enable U.S. issuers who comply with U.S. GAAP to also represent that they are compliant with IFRS.

---

1 *Available at* http://www.sec.gov/spotlight/globalaccountingstandards/globalaccountingstandards.pdf.

2 The "convergence" approach and "endorsement" approach are discussed in more detail in the SEC's *Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers, Progress Report* (October 29, 2010), *available at* http://www.sec.gov/spotlight/globalaccountingstandards/workplanprogress102910.pdf. Please note that although the joint projects between the FASB and the International Accounting Standards Board ("IASB") are often referred to as "convergence," the term has a different meaning in this memorandum. That is, the FASB-IASB process involves movement by *both* standard setters toward a new, mutually acceptable standard, while the "convergence" approach discussed in this memorandum merely involves movement by the United States toward existing IFRS.

3 The term was first coined by SEC Deputy Chief Accountant, Paul A. Beswick, in his *Remarks before the 2010 AICPA National Conference on Current SEC and PCAOB Developments* (Dec. 6, 2010), *available at* http://www.sec.gov/news/speech/2010/spch120610pab.htm.

4 *See, e.g.*, The Norwalk Agreement, *available at* http://www.fasb.org/news/memorandum.pdf.

II. The Role of the FASB and the SEC

The condorsement framework would modify the role of the FASB. Although the FASB would continue to participate in the development and improvement of accounting standards that foster high-quality financial reporting, the manner of its participation would differ considerably from its current standard-setting role. Most significantly, the FASB would participate in the process of developing IFRS, rather than serving as the principal body responsible for developing new accounting standards or modifying existing standards under U.S. GAAP. The FASB would play an instrumental role in global standard setting by (i) providing input and support to the IASB in developing and promoting IFRS, (ii) advancing consideration of U.S. perspectives in those standards and (iii) incorporating those standards, by way of an endorsement process, into U.S. GAAP. In addition, the FASB would become an educational resource for U.S. constituents to facilitate the understanding and proper application of IFRS and promote ongoing improvement in the quality of financial reporting in the U.S.

The FASB would continue to promulgate U.S. GAAP, primarily through its endorsement of standards promulgated by the IASB. Because the FASB would participate in the IASB's standard setting process, however, the FASB would often be in a position to directly incorporate the newly issued IFRSs. Although the FASB would retain the authority to modify or add to the requirements of the IFRSs to ensure that they are in the public interest and protect investors, the condorsement framework contemplates that such modifications would be rare and generally avoidable.[5]

Under the condorsement framework, the SEC would maintain oversight of the FASB and continue to be charged with protecting U.S. investors, maintaining fair, orderly and efficient markets, and facilitating capital formation. In addition, however, it would be actively engaged in the IFRS standard-setting process and with the broader activities of the IASB and its governance bodies. Because the IASB interacts with a multinational constituent base of regulators, however, it is unclear how large a role and how much influence the SEC would have with respect to the IASB's standard-setting process.

III. Risks and Benefits

The condorsement framework has several potential benefits and risks relative to other possible incorporation approaches. These include:

- The condorsement framework allows for a more flexible transition strategy that can be better tailored and more responsive to the needs of U.S. constituents than other potential mechanisms for incorporation. To realize these benefits, however, the transition plan must be well-developed, comprehensive and flexible enough to adapt to changing circumstances in a structured manner during transition.

- The condorsement framework contemplates a gradual implementation of IFRS and could thus avoid the costs associated with a "big-bang" approach in which U.S. issuers would have to incorporate the entire body of IFRS all at once. However, some U.S. issuers—especially large issuers with foreign subsidiaries that have already incorporated or which are prepared to

[5] The Staff Paper notes that the most likely example of a modification to IFRS is the possible continuation of some existing U.S. GAAP requirements that have no specific IFRS counterparts, at least until the IASB develops corresponding requirements. In addition, there may be a need for U.S. interpretations of IFRS on issues that are significant in the U.S. but not the rest of the world.

incorporate IFRS—might prefer date-certain, full adoption of IFRS and view a gradual transition as unnecessary.

- Insofar as the condorsement framework would not require direct incorporation of IFRS but would instead allow for endorsement and modification, it may provide greater protection for investors. It would be important, however, to ensure that a high threshold be met before modifications could be made to the IFRSs. Otherwise, a derivation of IFRS could develop in the U.S. that might differ significantly from the body of IFRS issued by the IASB. This could compromise the comparability of financial statements across countries and defeat the very purpose of incorporation.

- By retaining U.S. GAAP as the statutory basis of financial reporting, the condorsement framework would minimize constituent concerns about complying with legal, regulatory and contractual requirements based on U.S. GAAP. In addition, the complexities associated with changing all of the references to U.S. GAAP in laws, regulations and contracts would be alleviated. It is important to note, however, that a multitude of changes to the underlying U.S. financial reporting requirements—regardless of the ultimate title of the accounting framework—will likely require extensive efforts during transition to understand the full impact on affected U.S. laws, regulatory schemes and contracts.

IV. Conclusion

The SEC has not yet decided whether to incorporate the IFRS into U.S. GAAP, but such a decision is expected later in 2011. The SEC seeks feedback on the condorsement framework outlined in the Staff Paper and any of the other possible methods of incorporation by July 31, 2011.[6]

In addition, the SEC will sponsor a roundtable on July 7, 2011 to discuss the benefits and challenges for U.S. issuers associated with possible incorporation of IFRS into U.S. GAAP.[7] The Staff Paper and condorsement framework will likely be among the items discussed.

* * *

If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; or Abigail Darwin at 212.701.3240 or adarwin@cahill.com.

---

6 The SEC has previously described and sought public comments on other approaches for incorporation, including full adoption of the IFRS on a specified date, full adoption of the IFRS following a staged transition over several years, and optional use of IFRS by U.S. issuers.

7 *See SEC Announces Roundtable on International Financial Reporting Standards* (April 20, 2011), *available at* http://www.sec.gov/news/press/2011/2011-95.htm.