

SEC Staff Publishes Final Report on Work Plan Regarding Incorporating IFRS into U.S. GAAP

The Securities and Exchange Commission's ("SEC") Office of the Chief Accountant recently published a final staff report ("Final Report") on its work plan related to incorporating the International Financial Reporting Standards ("IFRS") into U.S. generally accepted accounting principles ("U.S. GAAP").¹ The Final Report, together with such other matters as the SEC may consider, is intended to inform any SEC determination on whether to incorporate IFRS into the U.S. financial reporting system. Notably, the Final Report does not contain a recommendation from the SEC staff on whether, how or when IFRS should be incorporated into U.S. GAAP. It remains unclear whether such a recommendation will come and when the SEC will render a decision.

I. Background

Since 2002, the Financial Accounting Standards Board ("FASB") and the International Accounting Standards Board ("IASB") have recognized the need to develop high-quality, compatible accounting standards that may be used for both domestic and cross-border financial reporting.² In February 2010, the SEC published the *Commission Statement in Support of Convergence and Global Accounting Standards*,³ in which it mentioned that it had directed the staff of the Office of the Chief Accountant of the SEC, with appropriate consultation with other Divisions and Offices of the SEC (collectively, the "Staff"), to develop and execute a work plan ("Work Plan") aimed at assisting the SEC in evaluating the implications of incorporating IFRS into the U.S. financial reporting system.⁴ More specifically, the purpose of the Work Plan was to consider specific areas and factors relevant to an SEC determination as to whether, when and how the current U.S. financial reporting system should be transitioned to a system incorporating IFRS.

In executing the Work Plan, the Staff gathered information using a variety of methods, including, but not limited to: performing research, seeking comments from marketplace participants, holding roundtables, considering academic research and researching the experiences both of other jurisdictions that have incorporated or have committed to incorporating IFRS into their financial reporting systems and of foreign private issuers that currently report under IFRS. The Staff also considered a wide array of options regarding whether and, if so, how to incorporate IFRS. Early in the research process, however, the Staff became aware that the vast majority of participants in the U.S. capital markets opposed adopting IFRS as authoritative guidance. The Staff also realized that doing so would not be consistent with the methods of incorporation employed by other major capital markets around the world (*e.g.*, the European Union uses an endorsement mechanism instead). The Staff did find, however, that substantial support existed for exploring other methods of incorporating IFRS. Therefore, the Staff focused its efforts on other potential incorporation methods of IFRS, including an endorsement mechanism or continued convergence of accounting standards issued by the FASB and the IASB.⁵

¹ See *Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers: Final Staff Report* (July 13, 2012), available at <http://www.sec.gov/spotlight/globalaccountingstandards/ifrs-work-plan-final-report.pdf>.

² See, *e.g.*, *Memorandum of Understanding: "The Norwalk Agreement"* (September 18, 2002) ("Norwalk Agreement"), available at <http://www.fasb.org/news/memorandum.pdf>. The Norwalk Agreement represents the first formal agreement between the IASB and FASB to work together on developing high-quality accounting standards and outlines the objectives for their work together towards the international convergence of accounting standards.

³ Available at <http://www.sec.gov/rules/other/2010/33-9109.pdf>.

⁴ The Work Plan document is contained as an appendix to the *Commission Statement in Support of Convergence and Global Accounting Standards*.

⁵ In May 2011, the Staff issued a paper on one possible method of incorporating IFRS into the U.S. financial reporting

II. The Final Report

Since publication of the Work Plan in February 2010, the Staff has periodically issued papers and reports updating the public on its progress in executing the Work Plan.⁶ The Final Report summarizes the observations and analyses of the Staff regarding several key areas identified for study in the Work Plan. Some of the more significant themes that emerged from the Staff's analysis are summarized as follows:

- *Development of IFRS.* The IFRSs are generally perceived to be of high quality by the global financial reporting community. While both IFRS and U.S. GAAP contain areas for which guidance is in need of continued development, however, the perception among U.S. constituents is that the “gap” in IFRS is greater.
- *Interpretive Process.* The IFRS Interpretations Committee should do more to address and provide guidance related to IFRS application issues on a timely basis. Although recent changes have been implemented that may assist in addressing this concern, it is unknown yet whether they will be effective.
- *IASB's Use of National Standard Setters.* In order to develop accounting standards that can be successfully incorporated in multiple jurisdictions, the IASB should consider greater reliance on national standard setters (e.g., obtaining assistance with individual projects for which they have expertise, outreach activities, identifying areas in which there is a need to narrow diversity in practice or issue interpretive guidance and post-implementation reviews).
- *Global Application and Enforcement.* A Staff review of financial statements prepared in accordance with IFRS found that while the financial statements reviewed generally appeared to comply with IFRS, diversity in the application of IFRS exists globally. Regulators in different countries must work cooperatively to foster global consistency in the application and enforcement of IFRS.
- *Governance of the IASB.* Although the overall design of the governance structure of the IFRS Foundation appears to strike a reasonable balance of providing oversight of the IASB while simultaneously recognizing and supporting the IASB's independence, it may be necessary to put mechanisms in place to specifically consider and protect the U.S. capital markets (e.g., maintaining an active FASB to endorse IFRSs).

system, which it referred to as “condorsement,” that would entail the FASB participating in the process of developing IFRS and then incorporating IFRS into U.S. GAAP over an extended period of time. For further discussion, see *Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers: Exploring a Possible Method of Incorporation: A Securities and Exchange Commission Staff Paper* (May 26, 2011), available at <http://www.sec.gov/spotlight/globalaccountingstandards/globalaccountingstandards.pdf>. See also our firm memorandum, *SEC Issues Staff Paper Outlining “Condorsement” Approach to Incorporating IFRS into U.S. GAAP* (June 23, 2011), available at http://www.cahill.com/news/memoranda/101286/res/id=sa_File1/CGR%20Memo%20-%20SEC%20Issues%20Staff%20Paper%20Outlining%20%27Condorsement%27%20Approach%20to%20Incorporating%20IFRS%20into%20US%20GAAP.pdf.

⁶ Copies of the documents that the Staff has previously issued in connection with the Work Plan are attached as appendices to the Final Report.

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- *Status of Funding.* The IFRS Foundation is a private, not-for-profit organization and ultimately has no ability to require or compel funding. Currently, the IFRS Foundation Trustees have been unsuccessful in obtaining the funding for the portion of the IASB budget allocated to the U.S. Contributions to the IFRS Foundation are generated through several methods, but with respect to the U.S., they come directly from voluntary contributions by the private sector. In 2012, approximately 25% of contributions to the IFRS Foundation came from large accounting firms. Continued reliance by the IFRS Foundation on funding from large accounting firms will continue to cause concerns related to the adequacy and independence of the IASB’s funding model.
- *Investor Understanding.* Investor education on accounting issues and changes in the accounting standards is not uniform. Regardless of the ultimate determination by the SEC as to whether to incorporate IFRS, the Staff will consider how investor engagement and education related to the development and use of accounting standards could be improved.

As mentioned above, the Final Report does not contain a Staff recommendation to the SEC on whether, how or when IFRS should be incorporated into U.S. GAAP. Indeed, the Staff notes that publication of the Final Report “does not imply—and should not be construed to imply—that the [SEC] has made any policy decision as to whether [IFRS] should be incorporated into the financial reporting system for U.S. issuers, or how any such incorporation, if it were to occur, should be implemented.”⁷ The Staff further states that the Work Plan did not set out to answer the fundamental question of whether transitioning to IFRS is in the best interests of the U.S. securities markets and investors, and additional analysis and consideration of this threshold policy question is necessary before any decision concerning whether to incorporate IFRS can occur. Because the Final Report does not include any timetable for this “additional analysis and consideration,” it remains unclear when the Staff will issue a recommendation to the SEC and when the SEC will make any decisions regarding whether, how or when to incorporate IFRS into U.S. GAAP. Although the Staff indicated that it welcomes feedback, it has not requested formal comments on the Final Report.

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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.

⁷ See Introductory Note to the Final Report.