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SEC Issues Proposed IFRS Roadmap

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The proposed roadmap outlines seven milestones that, if achieved, could lead to an SEC decision on mandatory use of IFRSs.

On November 14, 2008, the SEC issued its long-awaited [proposed IFRS "roadmap"](#) outlining milestones that, if achieved, could lead to mandatory transition to IFRSs starting in fiscal years ending on or after December 15, 2014. The roadmap also contains proposed rule changes that would give certain U.S. issuers the early option to use IFRSs in financial statements for fiscal years ending on or after December 15, 2009. The SEC believes that "the use of a single, widely accepted set of high-quality accounting standards would benefit both the global capital markets and U.S. investors by providing a common basis for investors, issuers and others to evaluate investment opportunities and prospects in different jurisdictions." The roadmap also notes that IFRSs have the potential "to best provide the common platform on which companies can report and investors can compare financial information."

The SEC seeks comments on numerous questions raised in the proposed roadmap concerning (1) the use of IFRSs by U.S. issuers, (2) the SEC's overall approach and considerations, (3) proposed technical amendments to the SEC's rules and regulations, (4) standard setting under IFRSs, and (5) other areas. The comment period for the proposed roadmap is 90 days, which will begin after its publication in the *Federal Register* (expected in the next week or two). Therefore, the comments will be due sometime in mid to late February.

Editor's Note: Over the weekend of November 15, 2008, the leaders of the G-20 met in Washington, D.C., to discuss the global financial crisis and develop an action plan to prevent its recurrence. A "medium-term action" proposed under the plan was that "[t]he key global accounting standards bodies should work intensively toward the objective of creating a single high-quality global standard."

Mandatory Adoption of IFRSs by U.S. Issuers

The proposed roadmap outlines seven milestones. Milestones 1–4 discuss issues that need to be addressed before mandatory adoption of IFRSs:

1. Improvements in accounting standards.
2. Accountability and funding of the International Accounting Standards Committee Foundation.
3. Improvement in the ability to use interactive data for IFRS reporting.
4. Education and training on IFRSs in the United States.

Milestones 5–7 discuss the transition plan for the mandatory use of IFRSs:

5. Limited early use by eligible entities — This milestone would give certain U.S. issuers the option of using IFRSs for fiscal years ending on or after December 15, 2009. Details on eligibility and filing requirements are described below.

6. Anticipated timing of future rule making by the SEC — On the basis of the progress made on milestones 1–4 and experience gained from milestone 5, the SEC will determine in 2011 whether to require mandatory adoption of IFRSs for all U.S. issuers. Potentially, the option to use IFRSs could also be expanded to other issuers before 2014.
7. Implementation of mandatory use — The roadmap raises many questions, including whether the transition to IFRSs should be phased in. According to the roadmap, large accelerated filers would be required to file IFRS financial statements for fiscal years ending on or after December 15, 2014, then accelerated filers in 2015, and nonaccelerated filers in 2016.

Permitting certain U.S. issuers the ability to report under IFRSs would supply the SEC with valuable information that could help inform the decision on whether to mandate IFRSs.

The Proposed Rule on Early Use of IFRSs

The SEC's objectives are twofold in giving certain U.S. issuers the early option to use IFRSs. First, permitting certain U.S. issuers the ability to report under IFRSs would provide the SEC with valuable information that could help inform their decision on whether to mandate IFRSs. Further, it would promote comparability with the significant global industry competitors of the U.S. issuers that early adopt IFRSs.

Under the proposed roadmap, U.S. issuers that meet both of the following criteria would be eligible to use IFRSs earlier in financial statements for fiscal years ending on or after December 15, 2009:

- The U.S. issuer is globally among the 20 largest listed companies worldwide in its industry, as measured by market capitalization.
- IFRSs, as issued by the IASB, are used as the basis for financial reporting more often than any other basis of accounting by the 20 largest listed companies worldwide in the U.S. issuer's industry, as measured by market capitalization.

An issuer that meets these criteria and chooses to use IFRSs (an "IFRS issuer") must prepare its financial statements in accordance with IFRSs as issued by the IASB. Issuers electing to file IFRS financial statements with the SEC would be required first to do so in an annual report and would not be able to file IFRS financial statements with the SEC for the first time in a quarterly report, registration statement, or proxy or information statement. Such issuers also must disclose certain information relating to their decision to change to IFRS in their first Form 10-K that contains IFRS financial statements.

In its SEC filings, an IFRS issuer's financial statements must include three years of audited annual periods in the first year of IFRS reporting, as opposed to two years of annual periods, as allowed under IFRSs. For example, a calendar-year-end company that is eligible to early adopt IFRSs, and elects to do so for its 2009 fiscal year, would present audited IFRS financial statements for the years ended December 31, 2007, 2008, and 2009, in its Form 10-K filed in 2010.

Editor's Note: Investment companies; employee stock purchase, savings, and similar plans; and smaller reporting companies, as defined by the SEC, are excluded from the definition of an "IFRS issuer" in the proposed roadmap and therefore would not be eligible to early adopt IFRSs.

According to the roadmap, issuers that are eligible to use IFRSs would need to obtain a “letter of no objection” from the SEC’s Division of Corporation Finance.

Determining Eligibility

Under the proposed rule, a U.S. issuer would first need to ascertain its industry group by using either the North American Industry Classification System (NAICS) code at the three-digit level, the Standard Industrial Classification (SIC) codes at the two-digit level, or the International Standard Industrial Classification (ISIC) codes at the “Division” level. Alternatively, the issuer could use a privately provided, published, and widely accepted industry classification scheme at a similar level of detail, such as the Industry Classification Benchmark (ICB) at the “Sector” level or the Global Industry Classification Standard (GICS) at the “Industry” level. For classifications of individual companies, the issuer must use a single published and widely accepted industry source.

Once the industry group is determined, the U.S. issuer would ascertain which accounting standards each of the 20 largest listed companies (determined on the basis of market capitalization) in its industry uses to report its financial results. Market capitalization would be based on the worldwide market value of the listed company’s outstanding voting and nonvoting common equity securities and would need to be determined from a widely accepted source within 180 days of the date on which the SEC staff receives a request for a letter of no objection (discussed below). The U.S. issuer then would determine whether IFRSs are used as the basis of financial reporting more often than any other basis of financial reporting of the 20 largest listed companies. If so, and if the U.S. issuer were among the 20 largest listed companies worldwide in the industry, the U.S. issuer would be eligible to use IFRSs.

Editor’s Note: The SEC estimates that under the two-digit SIC code method, at least 110 U.S. issuers in 34 industries would be currently eligible to use IFRSs in accordance with the proposed criteria as of December 31, 2007. The overall number of eligible companies could be even higher, however, because companies could use different industry classification systems to determine eligibility. In addition, currently noneligible industries may become eligible as foreign companies within those industries transition to IFRSs. For example, assuming Brazil, Canada, Chile, and South Korea use IFRSs (which is expected in the next couple of years), the number of eligible U.S. issuers using the SEC’s method would increase to 160, representing approximately 23 percent of the market capitalization in the United States.

Letter of No Objection to Use IFRSs

According to the roadmap, issuers that are eligible to use IFRSs would need to obtain a “letter of no objection” from the SEC’s Division of Corporation Finance. U.S. issuers would submit to the SEC their analysis for eligibility. The SEC staff would then review the analysis and, if it does not object to the issuer’s conclusion, would issue a letter of no objection that would permit the issuer to use IFRSs in SEC filings. Receiving a no-objection letter would provide an issuer with the ability to begin filing financial statements using IFRSs anytime during a three-year period from the date of the letter. However, an issuer that receives such a letter would not be obligated to use IFRSs. An issuer’s submission, along with the SEC staff’s letter of no objection, would be made public on the SEC’s Web site. The submission would not be made public if the SEC staff does not issue a letter of no objection.

Editor’s Note: A U.S. issuer would not have to recalculate its eligibility using more current data once it began filing reports using IFRSs. A recalculation and a new letter of no objection would be necessary only if the issuer did not begin filing reports using IFRSs within three years of receipt of the letter.

U.S. GAAP Information

If an issuer elects to use the option to file using IFRSs, it must still provide some financial information relating to U.S. GAAP. The proposed rule will request input on the following two alternatives for presenting this information:

- Alternative A — An IFRS issuer would provide the reconciling information from U.S. GAAP to IFRSs called for under IFRS 1, *First-time Adoption of International Financial Reporting Standards*. This information includes the restatement of and reconciliation from prior years' financial statements and the related disclosures.
- Alternative B — In addition to providing the one-time reconciliation under Alternative A, an IFRS Issuer would be required to provide, on an ongoing basis, an unaudited reconciliation from IFRSs to U.S. GAAP for the annual IFRS financial statements included in the Form 10-K. The reconciliations would cover all of the financial statements required to be presented under IFRSs: balance sheets, statements of income (loss), statements of cash flow, and statements of changes in equity. No specific form and content requirements for this information have been proposed. While not required to be included in the financial statements, this information would be considered "filed" with the SEC. Quarterly reports would not need to include this reconciling information.

The SEC is proposing amendments to permit the limited early use of IFRSs for certain U.S. issuers.

Editor's Note: Under Alternative A, a U.S. issuer filing an annual report for the first time using IFRSs for the year ending December 31, 2009, would include a reconciliation of equity from U.S. GAAP to IFRS as of January 1, 2007, and December 31, 2008, and a reconciliation of total comprehensive income for the year ending December 31, 2008. Under Alternative B, the same U.S. issuer would be required to include the one-time reconciliation under Alternative A, as well as a reconciliation from IFRSs to U.S. GAAP as of December 31, 2008, and December 31, 2009, for balance sheet information and for the three years ending December 31, 2009, for statements of income (loss) and other annual period financial statements. Subsequently, in each annual report on Form 10-K, the issuer would provide a reconciliation covering the same three-year period as the audited financial statements included in the Form 10-K.

Proposed Amendments to SEC Rules and Forms

The SEC's disclosure requirements and forms have not been specifically adapted for IFRSs. Therefore, the SEC is proposing amendments to permit the early use of IFRSs for certain U.S. issuers. Also, the proposed amendments provide further information on how an IFRS issuer should respond to disclosure requirements. The discussion below describes some of the amendments that are being proposed.

Proposed Amendments to Rule 4-01 of Regulation S-X

Rule 4-01 of Article 4 of Regulation S-X describes the form, order, and terminology to be used for financial statements included in filings under the Securities Act of 1933 and the Securities Exchange Act of 1934. The SEC proposes to add a new category of issuer, an "IFRS issuer," that meets the eligibility criteria and prepares financial statements in accordance with IFRSs. Financial statements prepared in accordance with IFRSs would be subject to the new proposed Article 13 (discussed below).

Issuers in specific industries may be subject to various industry guides developed by the SEC's Division of Corporation Finance.

Article 13 of Regulation S-X

The SEC is proposing to add Article 13 to Regulation S-X. The Article sets out requirements on the application of Regulation S-X and related rules and forms for any issuer that prepares financial statements in accordance with IFRSs.

Proposed Rule 13-01(a) addresses the scope of Article 13 and applies to financial statements that are prepared in accordance with IFRSs by an IFRS issuer, a foreign private issuer, or an issuer with regard to nonissuer financial statements under Rules 3-05, 3-09, or 3-14 of Regulation S-X. However, foreign private issuers are still subject to the separate disclosure and reporting requirements under Form 20-F.

Proposed Rule 13-01(b) addresses three basic requirements for IFRS financial statements. First, the financial statements must contain a captioned note in which the IFRS issuer unreservedly and explicitly states compliance with IFRSs as issued by the IASB. Second, the applicable accountant's report must include an opinion on whether the financial statements comply with IFRSs as issued by the IASB. Third, financial statements that are not prepared in accordance with IFRSs, as issued by the IASB, will be presumed to be misleading or inaccurate unless the SEC has indicated otherwise.

Proposed Rule 13-02 describes how the other articles in Regulation S-X would apply to IFRS financial statements. Various provisions of Regulation S-X specify financial presentation, disclosure content, recognition, and measurement of amounts for an issuer's financial statements. Under the proposed rule, an IFRS issuer would ordinarily not be required to comply with such provisions. However, in some instances, an IFRS issuer may be permitted to follow some of them as an acceptable accounting policy under IFRSs or be required to do so to comply with the requirement for fair presentation. The roadmap describes which provisions are required to be applied, may be applied, or cannot be applied.

Proposed Rule 13-03 addresses the application of general references both to GAAP and to specific U.S. GAAP pronouncements. Under the proposed rule, references to "generally accepted accounting principles" in certain parts would mean IFRSs, as issued by the IASB, for those issuers to which Article 13 applies. Also, IFRS issuers would be required to provide disclosures under the relevant IFRSs that satisfy the objective of the relevant disclosure requirements. Finally, Article 13 clarifies that IFRS issuers may provide amounts based on IFRSs for general caption data, segment data, or schedule information.

Item 301(a) of Regulation S-K

Under Item 301(a) of Regulation S-K, issuers must provide five years of selected financial data in their financial filings. As part of the proposed amendments, an IFRS issuer is allowed to present selected historical financial data using IFRSs for the three most recent fiscal years in its first filing applying IFRSs, then provide an additional year in each of the two subsequent filings, eventually building up to five years.

Disclosure Pursuant to Industry Guides

Issuers in specific industries may be subject to various industry guides developed by the SEC's Division of Corporation Finance. The SEC is not proposing any amendments to these guides. Rather, an IFRS issuer that is subject to an industry guide would continue to provide disclosures that satisfy the objective of the guide's disclosure requirements. Certain of the guides require the disclosure of trend information such as loan quality for banks (Industry Guide 3) or property casualty reserve development (Industry Guide 6). An IFRS issuer would be required to provide three years of information under IFRSs,

with information provided by U.S. GAAP to cover any earlier years that are required by an industry guide. Under Industry Guide 5, the SEC would permit prior performance information of programs sponsored by the general partner and its affiliates using U.S. GAAP.

Disclosure From Oil and Gas Companies Under FAS 69

The SEC would require IFRS issuers to provide the information required under FASB Statement No. 69, *Disclosures About Oil and Gas Producing Activities*. The SEC believes that the information is not U.S. GAAP information but rather is supplementary and useful to investors.

The SEC's Next Steps Regarding IFRSs

The SEC will assess the comments it receives and decide whether to issue a final roadmap and rule that allows early use of IFRSs. This may occur sometime in the first half of 2009. If approved, the final roadmap is expected to be published in the SEC's Codification of Financial Reporting Policies.

We encourage you to submit comments on the proposed roadmap. Your comments will form the basis for future steps that will affect all issuers in the United States.

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