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In This Issue:

- Future SEC Rule-Making
- When Will We Be Ready?
- Considerations of Different Types of Reporting Entities
- U.S. Cultural Issues in an IFRS World

How Long Can We Ride Two Horses at Once?

FASB Forum on High-Quality Global Accounting Standards: Issues and Implications for U.S. Financial Reporting

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I think we should be focused on implementation of switching to IFRS.
—SEC Chief Accountant Conrad Hewitt

How long can we ride two horses at once? This was a recurring theme at the June 16, 2008, forum hosted by the FASB to discuss whether and how to move the U.S. financial reporting system to IFRSs. The forum consisted of a panel discussion between FASB board members and invited guests, including financial statement users, representatives from small and large private and public companies, auditors, and regulators.

FASB Chairman Bob Herz used the “two-horse” analogy to signify the FASB’s dual challenge of maintaining and improving U.S. GAAP while continuing to work on convergence projects with the IASB. Currently, the FASB is updating the Memorandum of Understanding (MOU) with the IASB. The revised MOU will outline future convergence projects and confirm the Board’s commitment to strengthen IFRSs for eventual U.S. adoption.

Forum participants also used the two-horse analogy to describe challenges faced by their organizations. (Some of these challenges are discussed below.) Although participants generally supported moving to a single set of high-quality global accounting standards, it was clear from their remarks that several issues need to be addressed in the short term.

Future SEC Rule-Making

Conrad Hewitt, chief accountant of the SEC, and John White, director of the SEC’s Division of Corporation Finance, discussed possible future rule-making for U.S. issuers but did not give many details about it. Although uncertain at this time, rule-making later this summer may include an updated SEC transition roadmap and a rule giving U.S. issuers the option to use IFRSs. However, the SEC representatives neither discussed effective dates nor indicated whether such a rule would give the option to all U.S. issuers or only to certain U.S. issuers on the basis of a screening process.

Hoping to better manage their transition to IFRSs, participants continually urged the SEC to cite a definite mandatory transition date for U.S. issuers. It is unclear whether the SEC’s rule-making this summer will provide a mandatory transition date. However, the SEC representatives commented that decisions about certain regulatory and educational benchmarks must be reached before adoption of IFRSs is required.

The SEC representatives also discussed convergence, which was a cornerstone of the SEC's decision in 2007 to eliminate the U.S. GAAP reconciliation requirement for foreign private issuers. Mr. Hewitt cited "seven or eight standards that need to be accomplished on both sides" and indicated that it is confusing not to have true convergence between newly issued standards. Mr. Hewitt suggested that any new FASB standards should conform with the IASB standards to avoid confusion among investors.

When Will We Be Ready?

Participants were asked to provide a feasible timeline for IFRS adoption by all U.S. entities. While several options were discussed, there was a consensus that adoption of IFRSs by public companies would be feasible in five years but that nonpublic entities may need additional time. However, views differed on how the SEC should approach the transition of U.S. issuers to IFRSs as a single set of global accounting standards. Some believe that the SEC should initially give U.S. issuers the option to use IFRSs or U.S. GAAP in preparing their financial statements, with a longer-term goal of requiring all U.S. issuers to make the transition to IFRSs. Others believe that the SEC should not give U.S. issuers such an interim option but should set a mandatory date for all U.S. issuers to make the transition to IFRSs. Regardless of the approach advocated, the message from many participants was clear: IFRS awareness is increasing, but only a mandatory adoption date will create the necessary demand for action and provide the momentum required to focus on transition efforts.

Participants also discussed the obstacles of IFRS adoption within the various constituent groups and the steps in preparing for transition. Larger accounting firms and organizations indicated that they are moving ahead with some IFRS training and transition assessments; however, lack of demand and resources in smaller organizations often precludes such a proactive approach. In addition, participants indicated that IFRSs are still not in the mainstream of university accounting curricula and are not expected to be an integral part of the CPA exam until 2011.

From a regulatory perspective, Thomas Ray, chief auditor and director of professional standards for the PCAOB, discussed potential changes to U.S. auditing standards, noting that the "U.S. [auditing] standards can be applied to other accounting standards" even though the U.S. standards sometimes specifically refer to U.S. GAAP. Mr. Ray further noted that going forward, revisions will be made to existing standards and the PCAOB will take a "framework-neutral" approach with new standards. However, for certain banking and IRS regulations, the transition is not so easy. Frank Ng, deputy commissioner for the IRS's Large and Mid-Size Business (International) division, noted that the effect of a transition to IFRSs on tax accounting "is just tremendous." For example, a common concern with the conversion of U.S. GAAP to IFRSs is that while IFRSs prohibit the last-in, first-out (LIFO) method of accounting for inventories, U.S. companies that wish to report inventories on LIFO for tax purposes are required to use LIFO for financial reporting purposes. Overall, however, while significant work remains to be done on the regulatory front, none of the participants indicated that allowing U.S. entities to adopt IFRSs would present insurmountable changes to existing regulation.

Considerations of Different Types of Reporting Entities

While the use of IFRSs for public companies was generally supported, concerns were raised regarding the use of IFRSs for nonpublic and not-for-profit entities. Judy O'Dell, president of the Private Company Financial Reporting Committee (PCFRC), discussed several options for private-company financial reporting. These options ranged from staying with the current U.S. GAAP model to using a version of IFRSs that is specific to private companies. Polls conducted by the PCFRC of its members revealed that IFRSs, with some reporting differences for private companies, were the most logical choice for

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future financial reporting. In addition, there were concerns that IFRSs do not address the unique characteristics of not-for-profit entities, including accounting for donations, donor intent/restrictions, and lack of an equity structure.

Participants representing the interests of such entities believe that the related financial reporting should focus on the needs of specific users, which may require different accounting standards or financial reporting requirements. Further, they believe that these entities would need more time to make the transition to IFRSs (or a version of IFRSs).

U.S. Cultural Issues in an IFRS World

Companies will need to look at accounting and financial reporting in a new way, which could have a significant impact on a company's culture. IFRSs are a more principles-based set of standards than U.S. GAAP and therefore contain much less application guidance. While most panel participants believe that U.S. GAAP are often too detailed and complex, some participants questioned whether U.S. users of IFRSs can suppress their appetite for detailed guidance and strict conformity to avoid developing a U.S. version of IFRSs.

IFRIC Coordinator Patricia O'Malley cautioned the United States that using a "differences" approach to IFRS adoption could lead to U.S.-specific application of IFRSs. She further stated that a more strategic approach that addresses such questions as "What are the choices?" and "What is best for my situation?" would help minimize this risk.

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