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Dbriefs Webcast on the SEC's Work Plan Update

On Monday, June 13, 2011, at 2:00 PM (EDT), Deloitte will host a webcast on the SEC's latest update to its work plan on the consideration of IFRSs. This 90-minute presentation will cover:

- What the SEC announcement really means.
- How the announcement is expected to affect the FASB's and IASB's convergence efforts.
- A possible time line for IFRS adoption in the U.S.
- What U.S. companies could consider doing now to prepare.

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IFRSs Anyone?

SEC Staff Paper Explores Method of Incorporating International Standards Into U.S. Reporting System

by Joe DiLeo, Magnus Orrell, and Beth Young, Deloitte & Touche LLP

The SEC's consideration of whether, when, and how the current U.S. financial reporting system should be transitioned to a system incorporating IFRSs continues to receive much attention. On May 26, 2011, the SEC issued a staff paper, "Exploring a Possible Method of Incorporation," that presents a possible framework for incorporating IFRSs into the U.S. financial reporting system. Comments on the framework outlined in the staff paper and on any other potential approaches to incorporating IFRSs are due by July 31, 2011.

Editor's Note: On July 7, 2011, the SEC will sponsor roundtable discussions on "the benefits or challenges in potentially incorporating International Financial Reporting Standards (IFRS) into the financial reporting system for U.S. issuers." We would expect the staff paper to be a topic of discussion at the roundtable.

Background

In February 2010, the SEC issued a statement on its commitment to the development of a single set of high-quality globally accepted accounting standards and directed the SEC staff to execute a work plan addressing specific areas and factors relevant to the SEC's consideration of the potential incorporation of IFRSs into the U.S. financial reporting system. In the February statement, the SEC indicated that it would provide frequent public progress reports beginning no later than October 2010 and continuing thereafter through completion of the work plan. Accordingly, in October 2010 the SEC staff issued its first public progress report on the staff's efforts and observations related to the work plan.

The progress report outlines how other jurisdictions incorporate IFRSs into their financial reporting systems. It notes that such jurisdictions have incorporated IFRSs by either full use of IFRSs as issued by the IASB or use of IFRSs after a specific national incorporation process. Countries using a national incorporation process have either (1) converged their local standards with IFRSs or (2) incorporated IFRSs into local standards through endorsement.

It was expected that as part of the work plan, the SEC staff would evaluate various approaches to incorporating IFRSs and would seek feedback from the public as warranted. Thus, the staff paper elaborates and seeks feedback on one potential method and requests feedback on other possible approaches that have been previously explored, e.g., full adoption of IFRSs on a specified date without any U.S. endorsement mechanism, full adoption of IFRSs after a staged transition over several years, and an option for U.S. issuers to apply IFRSs.

Editor's Note: The staff paper clarifies that "[t]he Commission has not yet made a decision as to whether and, if so, how, to incorporate IFRS into the financial reporting system for U.S. issuers." In addition, although acknowledging that the time line for incorporation is a critical issue, the staff paper does not extensively discuss this issue and instead indicates that such consideration is outside its scope.

See Deloitte's February 26, 2010, and November 1, 2010, *Heads Up* newsletters for additional information on the SEC's work plan and progress report.

Framework

In the staff paper, the SEC staff elaborates on an approach that combines elements of convergence and endorsement (dubbed "condorsement" by a member of the SEC staff at the 2010 AICPA National Conference on Current SEC and PCAOB Developments).

The SEC staff reiterates that the framework outlined in the staff paper is one alternative currently being evaluated and is neither the only approach nor necessarily the preferred approach.

Under an endorsement approach, jurisdictions incorporate individual IFRSs into their local financial reporting systems in accordance with specified endorsement processes and usually by using specified endorsement criteria. The European Union and Australia follow such an approach. The staff paper notes that the United States would follow similar processes and that the FASB and SEC would have specific responsibilities. In particular, the FASB would incorporate newly issued IFRSs into U.S. GAAP, and the SEC and the FASB would retain the ability to modify or supplement IFRSs when doing so would be in the public interest or necessary for the protection of investors.

During a transition phase, the framework would follow a convergence approach under which the FASB would bring U.S. GAAP closer to IFRSs by addressing and evaluating differences between the sets of standards and incorporating IFRSs into U.S. GAAP, with a focus on minimizing transition costs.[1] While the term "U.S. GAAP" would be retained, the ultimate goal of the framework is that at the end of the transition period, a "U.S. issuer compliant with U.S. GAAP should also be able to represent that it is compliant with IFRS as issued by the IASB."

Editor's Note: The framework outlined in the staff paper is largely consistent with remarks made at the 2010 AICPA National Conference on Current SEC and PCAOB Developments (see Deloitte's December 16, 2010, *Heads Up* on the conference for more information).

The framework essentially follows an endorsement approach, except for the transition period during which convergence efforts would occur. Although the staff paper does not define the transition period, it cites examples of five to seven years or five years or more into the future. Other countries that use an endorsement approach typically have incorporated IFRSs at a single point in time through a so-called "first-time adoption" of IFRSs rather than over a transitional period as contemplated under the framework.

In addition, the SEC staff reiterates that the framework outlined in the staff paper is one alternative currently being evaluated and is neither the only approach nor necessarily the preferred approach.

[1] Unlike the FASB's and IASB's existing convergence program, which seeks to bring both IFRSs and U.S. GAAP toward a new, mutually accepted high-quality standard, the convergence element of the framework involves moving U.S. GAAP gradually closer to IFRSs during the transition period.

Role of the FASB

The SEC staff believes that it is important for the FASB to continue to be heavily involved in the standard-setting process and in protecting the interests of U.S. constituents. "For the endorsement aspect of the framework, the FASB would continue to participate in the development and improvement of accounting standards that foster high-quality financial reporting that provides decision-useful information to investors and other users of financial reports." However, the FASB's role would be focused on participating in the IASB's standard-setting process rather than developing new U.S. accounting standards or modifying existing U.S. GAAP.

The SEC staff highlighted various ways the FASB could participate in the IASB's standard-setting process, including carrying out research related to it and providing input on strategic planning. It is expected that this participation would be consistent with that of other national standard setters after adoption of IFRSs. Because the FASB has participated significantly in the IASB's standard-setting process, it is also expected that the FASB would be able to incorporate most IFRSs directly into U.S. GAAP.

As part of this process, however, "the FASB would retain the authority to modify or add to the requirements of the IFRSs incorporated into U.S. GAAP," although the SEC staff expects that modifications would be rare. The FASB would also retain the authority to determine whether U.S. constituents would benefit from supplemental or interpretive guidance. The staff paper indicates that before issuing such additional guidance, the FASB should provide the IASB with recommended solutions to bridge any gaps in guidance. Thus, the FASB could:

- Require additional disclosures.
- Determine which of two or more accounting alternatives under IFRSs would achieve greater consistency.
- Set requirements that are not addressed by IFRSs.

Although certain requirements in U.S. GAAP may continue to exist if there is no corresponding guidance under IFRSs, once such requirements are developed by the IASB, the U.S. GAAP guidance would be rescinded.

The FASB's role would be focused on participating in the IASB's standard-setting process rather than developing new U.S. accounting standards or modifying existing U.S. GAAP.

Editor's Note: The staff paper notes that the goal is for IFRSs and U.S. GAAP to be consistent and to avoid having a U.S. "flavor" of IFRSs. Accordingly, the circumstances under which the FASB would consider modifying IFRSs should be similar to those under which the SEC would consider modifying U.S. GAAP (e.g., through Staff Accounting Bulletins). That is, the SEC staff expects such situations to be "rare and generally avoidable."

Role of the SEC

Under the proposed framework, the SEC would maintain its oversight role of the FASB. Because the IASB has a broader constituent base, the SEC's oversight of the IASB would be less direct. The SEC staff emphasized that any method of incorporation of IFRSs into the U.S. financial reporting system would not affect or diminish the SEC's responsibilities under the federal securities laws; namely, to "protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation through its regulation." Further, the SEC would retain its right to issue reporting and accounting guidance (e.g., through a format similar to a Staff Accounting Bulletin); however, the preferred method for providing guidance would be through the IASB's standard-setting process with the FASB's endorsement.

Role of U.S. Constituents

Although the FASB would represent the interests of U.S. constituents broadly, it would not act as a single U.S. voice in the standard-setting process. Rather, the staff paper notes that "it would be imperative" for constituents to be engaged in the IASB's standard-setting process by commenting on proposed guidance and providing other direct feedback to the IASB.

Transition

The transition element of the framework is based on a convergence approach. "Convergence under the framework would involve the full, but potentially staged or phased, replacement of existing U.S. GAAP through the incorporation of IFRS into U.S. GAAP pursuant to an orderly transition plan." The transition plan would be developed by the FASB on the basis of an evaluation of how and when IFRSs should be incorporated into U.S. GAAP. One of the goals of the transition plan would be to minimize the impact on U.S. constituents while still providing useful information to investors. The staff paper delineates three categories of standards that are subject to the transition plan: (1) projects that are currently part of the FASB and IASB Memorandum of Understanding (MoU), (2) IFRSs currently on the IASB's standard-setting agenda, and (3) all other IFRSs (i.e., those not currently subject to standard setting).

Editor's Note: The SEC staff's proposed framework stresses prospective application of IFRSs whenever possible to "lessen the costs and burden of transition." The staff also indicates that a goal under the proposal is "for a U.S. issuer complying with U.S. GAAP also to be in a position to assert that it is compliant with IFRS as issued by the IASB" at the end of the transition period (e.g., five to seven years). However because IFRS 1, *First-Time Adoption of International Financial Reporting Standards*, requires an entity to retrospectively apply the impact of all IFRSs effective at the end of its first IFRS reporting period with certain specified exceptions, it is unclear whether or when an entity that follows the framework would be able to make an explicit and unreserved statement that it complies with all IFRSs (including IFRS 1).

One of the goals of the transition plan would be to minimize the impact on U.S. constituents while still providing useful information to investors.

In addition, the staff paper notes that certain U.S. issuers may prefer an option for early adoption but indicates that such an option is beyond the staff paper's scope and that "the Staff is continuing to consider the possible mechanics and implications" to U.S. issuers and how early adoption could be applied within the framework.

IFRSs Subject to MoU Projects

The FASB and IASB are still aiming to complete their MoU projects (such as financial instruments, revenue recognition, leases, and presentation of other comprehensive income) by the end of 2011. See Deloitte's May 2011 *Accounting Roundup — Special Edition* for details on the timing and status of the projects. If this target is met and reasonably converged guidance is issued, the standards would be incorporated into both IFRSs and U.S. GAAP in 2011, which is most likely before any potential U.S. transition to IFRSs. Therefore, the staff paper notes that other than potential competition between priorities related to issuers' implementing completed MoU standards (which could be substantial) and their other convergence transition efforts under the framework, it is not expected that these projects would have a significant impact on the overall transition plan. The FASB will need to take into account the timing of implementation for those projects when developing its overall plan for convergence to IFRSs to ensure that enough time is given for transition to the new standards.

IFRSs on the IASB's Current Standard-Setting Agenda

For projects on the IASB's current standard-setting agenda, the FASB will need to evaluate the timing and significance of expected standard setting to determine how to incorporate those IFRSs that are "expected to be newly issued or modified significantly in the near term." While such standards are in development, the FASB would participate in the process outlined in the framework. The FASB would need to consider all relevant ASC guidance in determining how to incorporate this category of projects into U.S. GAAP. Considerations would include (1) requirements for specific transactions, (2) content of other IFRSs, (3) illustrative examples, and (4) industry guidance. In addition, the FASB would need to consider interaction with other IFRSs and elements of the ASC for consistency.

Editor's Note: To illustrate the potential transition strategy for items on the IASB's current standard-setting agenda, the SEC staff paper suggests that if the IASB were expected to undertake a project to revise or replace IAS 38, *Intangible Assets*, during the transition period, the FASB would retain ASC 350, *Intangibles — Goodwill and Other*, in U.S. GAAP until the effective date of a revised standard for intangible assets under IFRSs. Accordingly, U.S. issuers would apply the new IFRSs on intangible assets at the same time as other entities already applying IFRSs.

Certain costs associated with a "big-bang" approach could be avoided with the framework since it is more of a staggered, gradual transition. Some U.S. issuers (e.g., large multinational corporations with foreign subsidiaries), however, may prefer a single-date approach rather than prolonging transition over several years. There is also the risk that a staggered transition could cause uncertainty related to the U.S. commitment to fully incorporating IFRSs.

All Other Existing IFRSs and Areas Not Addressed by IFRSs

Within this category, the FASB would be likely to first consider incorporation of all other existing IFRSs since they would not be subject to a standard-setting time line. The process of evaluating and incorporating such IFRSs would be similar to that for IFRSs on the IASB's current standard-setting agenda. The framework would allow for prospective application of the standards whenever possible. The method prescribed in each case would be determined after giving consideration to comparability, reliability, cost/benefit, and other relevant factors, while promoting the integrity of the requirements of the underlying IFRSs."

Editor's Note: For instance, the FASB could determine that the componentization requirement of IAS 16, *Property, Plant and Equipment*, should be incorporated prospectively for U.S. issuers to minimize the implementation effort associated with retrospective application.

Benefits and Risks

The SEC staff acknowledges in its proposal that any approach taken to incorporate IFRSs into the U.S. financial reporting system would have advantages and disadvantages. Specifically, the SEC staff identified the following:

- The proposed framework would allow for a flexible and tailored transition strategy. If well developed, this strategy would reduce the overall burden of transition and allow the FASB and SEC to be responsive to the needs of U.S. constituents. If not well developed, the strategy could result in an unnecessarily burdensome transition and create confusion in the convergence process. Further, because this would be a U.S.-specific plan, there is risk associated with being the only jurisdiction to use this process.
- Certain costs associated with a "big-bang" approach could be avoided with the framework since it is more of a staggered, gradual transition. Some U.S. issuers (e.g., large multinational corporations with foreign subsidiaries), however, may prefer a single-date approach rather than prolonging transition over several years. There is also the risk that a staggered transition could cause uncertainty related to the U.S. commitment to fully incorporating IFRSs.
- The potential exists for greater investor protection with FASB endorsement of IFRSs. Under the proposed framework, the FASB "could represent the financial reporting interests of U.S. capital markets to the IASB." If modifications by the FASB to incorporated standards are not rare, however, there is the risk that the U.S. version of IFRSs could differ "more than insignificantly from the body of IFRS issued by the IASB." This could result in less comparable results among jurisdictions.
- The proposal would retain U.S. GAAP as the statutory basis for financial reporting in the United States. This would alleviate any complexities associated with modifying contracts, agreements, and other regulatory documents that often refer to U.S. GAAP.

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