

**Work Plan
for the Consideration of Incorporating
International Financial Reporting Standards
into the Financial Reporting System
for U.S. Issuers**

OFFICE OF THE CHIEF ACCOUNTANT
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

This is a report by the Staff of the U.S. Securities and Exchange Commission.
The Commission has expressed no view regarding the analysis, findings, or
conclusions contained herein.

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Background

In the 2010 Statement,¹ the U.S. Securities and Exchange Commission (“SEC” or “Commission”) directs the staff of the Office of the Chief Accountant of the SEC, with appropriate consultation with other Divisions and Offices of the Commission (collectively, the “Staff”), to develop and execute a work plan (“Work Plan”). The purpose of the Work Plan is to consider specific areas and factors relevant to a Commission determination of whether, when, and how our current financial reporting system for U.S. issuers should be transitioned to a system incorporating International Financial Reporting Standards (“IFRS”).² Specifically, the Work Plan addresses areas of concern that were highlighted by commenters on the Commission’s proposed *Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers*,³ including:

1. Sufficient development and application of IFRS for the U.S. domestic reporting system;
2. The independence of standard setting for the benefit of investors;
3. Investor understanding and education regarding IFRS;
4. Examination of the U.S. regulatory environment that would be affected by a change in accounting standards;
5. The impact on issuers, both large and small, including changes to accounting systems, changes to contractual arrangements, corporate governance considerations, and litigation contingencies; and
6. Human capital readiness.

The first two areas above consider characteristics of IFRS and its standard setting that would be the most relevant to a future determination by the Commission regarding whether to incorporate IFRS into the financial reporting system for U.S. issuers. The remaining four areas above relate to transitional considerations that will enable the Staff to better evaluate the scope of, timing of, and approach to changes that would be necessary to effectively incorporate IFRS into the financial reporting system for U.S. issuers, should the Commission determine in the future to do so.

In formulating this initial Work Plan, the Staff considered commenters’ views that U.S. issuers would need approximately four to five years to successfully implement a change

¹ See *Commission Statement in Support of Convergence and Global Accounting Standards*, Release No. 33-9109 (February 24, 2010) (“2010 Statement”).

² Hereafter, the term “IFRS” refers to “IFRS as issued by the International Accounting Standards Board (‘IASB’)” unless otherwise noted.

³ Release No. 33-8982 (November 14, 2008) [73 FR 70816 (November 21, 2008)] (“Proposed Roadmap”).

in their financial reporting systems to incorporate IFRS.⁴ Therefore, assuming that the Commission determines in 2011 to incorporate IFRS into the U.S. financial reporting system, the first time U.S. issuers would report under such a system would be approximately 2015 or 2016. The Staff will further evaluate this timeline as a part of the Work Plan.

While an ultimate determination of any specific methods (e.g., convergence, standard-by-standard adoption, wholesale adoption) or dates for the possible incorporation of IFRS into the financial reporting system for U.S. issuers is beyond the scope of the Work Plan, the information obtained through the Work Plan will facilitate future Commission consideration of those matters. Further, while the Work Plan focuses on the implications of incorporation of IFRS into the financial reporting system for U.S. issuers on U.S. constituents, the Staff also will consider the effects of its recommendations to the Commission on other jurisdictions that have incorporated or have committed to incorporate IFRS into their financial reporting systems.

Each area is important to the Staff's consideration of the most effective approach to advance the Commission's objective of achieving a single set of high-quality globally accepted accounting standards. The Staff, however, did not develop the Work Plan with the intention that any one step is individually determinative of the optimal path forward. Further, for many of the steps, the Staff is seeking to assess the degree to which a particular attribute or condition exists for consideration of how the topic interacts with policy considerations. The Staff does not view the objective of its efforts as being to determine whether an attribute "passes" or "fails" a pre-determined standard.

The Staff has developed this Work Plan based on its understanding of the current environment. The Staff intends to continually re-assess this Work Plan and adjust it as new information is obtained or developments occur. Further, of necessity, the Staff will modify this Work Plan in response to constraints encountered, such as limited availability of information, with the intention of accomplishing each section's stated objective to the maximum extent possible.

In executing this Work Plan, the Staff will gather information using a variety of methods, including, but not limited to, performing its own research; seeking comment from, holding discussions with, and analyzing information from constituents, including investors, issuers, auditors, attorneys, other regulators, standard setters, and academics; considering academic research; and researching the experiences of other jurisdictions that have incorporated or have committed to incorporate IFRS into their financial reporting systems and foreign private issuers who currently report under IFRS. The Staff will

⁴ See, e.g., The Boeing Company ("Boeing"), Northrop Grumman Corporation ("Northrop Grumman"), PepsiCo, Inc. ("Pepsi"), and tw telecom inc ("tw telecom"). Comment letters in response to the Proposed Roadmap are available on the Commission's Web site (at <http://www.sec.gov/comments/s7-27-08/s72708.shtml>). Comments are also available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Unless otherwise noted, comment letters referenced in this Work Plan were submitted in response to the Proposed Roadmap and are cited by author.

provide public progress reports beginning no later than October 2010 and frequently thereafter until the work is complete.

I. Sufficient Development and Application of IFRS for the U.S. Domestic Reporting System

A. Introduction

The 2010 Statement notes that “[a] necessary element for a set of global accounting standards to meet [the agency’s mission] is that they must be high-quality....” The Commission previously has described high-quality standards as consisting of a “comprehensive set of neutral principles that require consistent, comparable, relevant and reliable information that is useful for investors, lenders and creditors, and others who make capital allocation decisions.”⁵ The Commission also has expressed its belief that high-quality accounting standards “must be supported by an infrastructure that ensures that the standards are rigorously interpreted and applied.”⁶

In the Proposed Roadmap, the Commission stated that, in further considering IFRS, it would “consider whether those accounting standards are of high-quality and sufficiently comprehensive.” Accordingly, the Staff believes that an evaluation of whether IFRS is sufficiently developed and applied to be the single set of globally accepted accounting standards for U.S. issuers requires consideration of the following areas:

- The comprehensiveness of IFRS;
- The auditability and enforceability of IFRS; and
- The comparability of IFRS financial statements within and across jurisdictions.

As the Commission noted in the Proposed Roadmap, there are areas where completion of the IASB’s standard-setting initiatives, including those included in its convergence agenda with the Financial Accounting Standards Board (“FASB”), as discussed in the 2010 Statement, should improve and further develop IFRS. The Commission further notes in the 2010 Statement, “[t]he successful completion of these efforts would be a significant accomplishment toward improving financial reporting for investors worldwide.” As such, the Staff’s efforts in the above areas will include consideration of the IASB’s efforts to improve IFRS.

B. Comprehensiveness of IFRS

The Commission stated in the Proposed Roadmap that “IFRS is not as developed as [U.S. generally accepted accounting principles (‘U.S. GAAP’)] in certain areas.” This is due, in part, to IFRS’s relative youth, as articulated by one commenter:

[W]e are concerned about quality and maturity of IFRS in comparison to...[U.S.

⁵ *International Accounting Standards*, Release No. 33-7801 (February 16, 2000) [65 FR 8896 (February 23, 2000)] (“2000 Concept Release”).

⁶ 2000 Concept Release.

GAAP]. U.S. GAAP has a long history and has been tested and refined through multiple and complex economic events and developments. Many of the standards in U.S. GAAP have emerged as a direct result of circumstances and events that demonstrated the need for better and more transparent financial reporting (for example, the rise of derivative instruments and recent financial scandals such as the collapse of Enron)....⁷

The Commission and commenters have noted limited IFRS guidance in two respects. First, IFRS lacks broad guidance for: (1) certain topical areas, such as accounting for certain common control transactions, recapitalization transactions, reorganizations, acquisitions of minority shares not resulting in a change of control and similar transactions, and the push down of a new accounting basis in an entity's separate financial statements; (2) certain industries, such as those related to utilities, insurance, extractive activities, and investment companies; and (3) disclosures in order to provide better transparency regarding the application of accounting principles.⁸

Second, where IFRS provides broad guidance, the IASB, as a matter of operating practice, has elected to make guidance less detailed and prescriptive than U.S. GAAP.⁹ Commenters' views were mixed as to whether the lesser degree of detailed guidance under IFRS, as compared to U.S. GAAP, is indicative of a higher quality set of accounting standards. Commenters who preferred IFRS's approach asserted that it is less complex than U.S. GAAP and allows companies to capture the substance of transactions.¹⁰ On the other hand, commenters who preferred U.S. GAAP's approach expressed that IFRS relies too much on management discretion, thereby increasing the potential for opportunistic accounting; creating challenges for auditors, as discussed in section I.C below; and reducing comparability, as discussed in section I.D below.¹¹

Other commenters have argued, however, that this debate may not be relevant in the U.S.

⁷ CMS Energy Corporation and Consumers Energy Company. See also, e.g., FedEx Corporation, Hess Corporation, Honeywell International ("Honeywell"), Northrop Grumman, and Andrea Psoras ("Psoras").

⁸ See, e.g., Proposed Roadmap. See also, e.g., Financial Accounting Foundation ("FAF"), Investors Technical Advisory Committee ("ITAC"), Liberty Global, and Standard & Poor's Ratings Services. The Staff acknowledges that in certain of these specified areas, these concerns are equally applicable to U.S. GAAP.

⁹ See, e.g., Proposed Roadmap. See also, e.g., Accretive Solutions, First Commonwealth Financial Corporation ("First Commonwealth"), and ITAC.

For example, as the FASB staff discussed in "Board Meeting Handout: Joint Revenue Recognition Project" (April 9, 2008) (available at: http://www.fasb.org/04-09-08_rev.pdf), revenue recognition guidance under U.S. GAAP (prior to the FASB Codification) consisted of over 200 pieces of literature from various sources, whereas revenue recognition guidance under IFRS "lacks explicit measurement guidance. Although such measurement guidance exists in abundance in U.S. GAAP, IFRS suffers from the opposite extreme."

¹⁰ See, e.g., Alcoa Inc. ("Alcoa"), The Bank of New York Mellon, Federation of European Accountants ("FEE"), Institute of Chartered Accountants in England and Wales ("ICAEW"), and Gregory Misiorek.

¹¹ See, e.g., First Commonwealth, Fund of Stockowners Rights ("Fund Stockowners Rights"), State of New York Banking Department ("NYBD"), Psoras, Sanctuary Financial Group, Inc., and tw telecom.

environment. For example, the FAF asserted in its comment letter that:

[W]hile it is perceived that IFRS provides financial statement preparers more discretion in application than U.S. GAAP, such additional discretion may not result in major differences in the application of IFRS by U.S. companies because the U.S. institutional framework plays a major role in shaping how companies would apply the discretion.

The Staff will analyze for the Commission's benefit the extent to which IFRS is comprehensive so as to support a Commission decision regarding whether to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Inventory areas in which IFRS does not provide guidance or where it provides less guidance than U.S. GAAP.
- Analyze how issuers, auditors, and investors currently manage these situations in practice.
- Identify areas in which issuers, auditors, and investors would most benefit from additional IFRS guidance.

C. Auditability and Enforceability

IFRS's less detailed and prescriptive guidance may or may not create challenges in its auditability and enforceability. If it were to do so, IFRS may "[make] litigation or enforcement outcomes more difficult to predict."¹² This outcome may be true not only within jurisdictions, but also across jurisdictions, as the existence of differing regulatory regimes and legal environments across jurisdictions may exacerbate the inconsistent interpretation and enforcement of IFRS. For example, the CFA Institute stated the following in its comment letter:

Investors need greater assurance regarding the divergence of application within the principles-based standards of IFRS prior to adoption. Conversion to more principles-based standards that are applied inconsistently in different regulatory environments, auditing regimes and cultures may not be beneficial to investors.

Commenters raised several concerns regarding the auditability and enforceability of IFRS, including the risk of opportunistic accounting; the potential for accounting conclusions of preparers to be unfairly criticized by auditors, regulators, and investors; and diminished comparability.

First, regarding the risk of opportunistic accounting, some commenters expressed that IFRS allows for increased flexibility, as compared to U.S. GAAP, and may result in standards being less auditable and enforceable, which would not be in the public

¹² Proposed Roadmap.

interest.¹³ For example, one commenter stated:

The international standards (IFRS) are widely viewed as less specific and providing less prescriptive guidance than U.S. GAAP (i.e., IFRS are more principles based), as well as more subjective primarily due to more use of fair value measurements. The downgrading of verifiability as a key concept guiding accounting standard setting and the resulting focus on fair value measurement significantly impairs the ability of an auditor to limit opportunistic actions of management and improve financial reporting.¹⁴

Second, regarding the potential for accounting conclusions of preparers to be unfairly criticized by auditors, regulators, and investors, some commenters have expressed concerns that IFRS's less detailed and prescriptive guidance could expose companies to increased claims by shareholders and others seeking to challenge its application, given the perceived litigious environment in the United States.¹⁵ The Staff has acknowledged similar concerns in the context of an objectives-oriented system, noting:

We believe that the existence of a strong and consistently applied enforcement mechanism is a necessary component to the success of an objectives-oriented system. Preparers and auditors have expressed concern that those charged with enforcement in a principles-based environment will question reasonable judgments made in good faith (footnote omitted). In fact, some have asked whether the Commission staff would be willing to accept reasonable views and interpretations by preparers and auditors in the application of accounting principles (citation omitted).¹⁶

However, the Staff also stated:

We believe...that the concern over litigation uncertainty is sometimes overstated...If preparers and auditors maintain contemporaneous documentation that demonstrates that they properly determined the substance of a covered transaction or event, applied the proper body of literature to it, had a sound basis for their conclusions-particularly those involving the exercise of judgment-and ensured through disclosure that their method was transparent, their exposure to litigation may be reduced.¹⁷

Some commenters stated that the U.S. legal system, which relies, to a larger extent, on guidance, rules, and bright lines, ultimately will drive IFRS to evolve, similar to U.S.

¹³ See, e.g., Fund Stockowners Rights, National Association of State Boards of Accountancy ("NASBA"), and Psoras.

¹⁴ American Accounting Association, Financial Accounting Standards Committee ("AAA-FASC").

¹⁵ See, e.g., FPL Group, Inc. ("FPL") and tw telecom.

¹⁶ "Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System" (July 25, 2003) ("Principles-Based Accounting System Study").

¹⁷ Principles-Based Accounting System Study.

GAAP, into a rules-based set of standards.¹⁸ Accordingly, commenters advocated addressing the causes of rules-based standards, such as through changes to the U.S. legal and regulatory environment, and development of an accounting and auditing judgment framework to reassure issuers that they will not be penalized for the use of reasonable judgment in the application of IFRS.¹⁹

The Staff also observed that the exercise of professional judgment in an objectives-oriented regime would require certain cultural changes, including: (1) a reduction in the tendency to ask questions like “where does the literature say I cannot do this,” (2) a reduction in an audit checklist mentality, (3) an improvement in accounting professionals’ understanding of the economic substance of a transaction, and (4) an improvement in the transparency of disclosures.²⁰

Finally, IFRS’s less detailed and prescriptive guidance, coupled with any diversity of perspectives amongst issuers, auditors, and regulators on a global basis may affect the comparability of financial statements prepared under IFRS. For example, in the auditing context, commenters raised concerns regarding the possibility that each audit firm will develop its own interpretations of IFRS,²¹ resulting in reduced comparability across companies using different auditors. Some commenters went further by echoing concerns raised in the 2007 Concept Release²² that IFRS also may contribute to reduced comparability within audit firms, due to the lack of internationally integrated accounting firms with a single global accounting perspective.²³

Similarly, commenters expressed concern that differing regulation and enforcement structures and practice on a global basis may undermine the comparability of financial statements prepared under IFRS.²⁴ The Commission has noted that securities regulators have developed and continue to improve infrastructure to foster the consistent and

¹⁸ See, e.g., Air Products and Chemicals, Inc. (“Air Products”), Community Health Systems, Inc. (“Community Health”), JPMorgan Chase (“JP Morgan”), The London Centre for International Corporate Governance Law (“London Ctr Int’l Corp Gov Law”), and Edward Randle.

¹⁹ See, e.g., American Institute of Certified Public Accountants (“AICPA”), California Society of Certified Public Accountants (“CA CPAs”), Center for Audit Quality (“CAQ”), Deloitte & Touche LLP (“Deloitte”), McGladrey & Pullen LLP (“McGladrey”), Morgan Stanley, NYBD, and The Ohio Society of CPAs (“Ohio CPAs”).

²⁰ See Principles-Based Accounting System Study.

²¹ See, e.g., Community Health, Eli Lilly and Company (“Eli Lilly”), and Marriott International, Inc. (“Marriott”).

²² In *Concept Release on Allowing U.S. Issuers to Prepare Financial Statements in Accordance with International Financial Reporting Standards*, Release No. 33-8831 (August 7, 2007) [72 FR 45600 (August 14, 2007)] (“2007 Concept Release”), the Commission stated, “for the U.S. firms that are members of global audit networks, systems of quality control need to foster the high quality and consistent application of IFRS across national borders.”

²³ See, e.g., London Ctr Int’l Corp Gov Law.

²⁴ See, e.g., California Public Employees’ Retirement System (“CalPERS”), Cleary Gottlieb Steen & Hamilton LLP, Group of North American Insurance Enterprises, and International Corporate Governance Network (“ICGN”).

faithful application and enforcement of IFRS around the world.²⁵ For example, in January 2007, an International Organization of Securities Commissions (“IOSCO”) database for cataloguing and sharing securities regulators’ experiences on IFRS application around the world became operational.²⁶ Further, the Commission and the Committee of European Securities Regulators (“CESR”) published a work plan in August 2006, covering information sharing in regular meetings and the confidential exchange of issuer-specific information.²⁷ In addition to the coordination with organizations of securities regulators and under the CESR work plan, the Commission also has developed bilateral dialogues with particular securities regulators to discuss accounting and enforcement matters.

These recent developments were noted by the CFA Institute in its comment letter:

[T]his coordinated effort and related processes [by members of IOSCO] are still being developed and the overall effectiveness of their regulatory oversight has not been fully demonstrated (i.e., that the interpretation and enforcement of IFRS is consistent). The SEC should focus on how IFRS is being applied and ensure that studies about this are undertaken and widely circulated to all interested parties.

The Staff believes that the auditability and enforceability of financial statements prepared under IFRS is a key component in considering whether to incorporate IFRS into the financial reporting system for U.S. issuers. Accordingly, the Staff intends to gather data to inform the Commission in this regard. Specifically, the Staff will:

- Analyze factors that may influence the auditability of financial statements prepared under, and the enforceability of, IFRS.
- Evaluate factors that may influence the consistent audit of financial statements prepared under, and the enforcement of, IFRS.
- Identify potential changes to improve the auditability and enforceability of financial statements prepared under IFRS and to facilitate their consistent audit and enforcement.

D. Comparability Within and Across Jurisdictions

One of the primary benefits of a single set of global accounting standards is increased comparability of financial statements. However, as the Proposed Roadmap stated:

The advantages to U.S. investors of increased comparability across investment alternatives, as contemplated under this Roadmap, are dependent upon financial

²⁵ See 2007 Concept Release.

²⁶ See *Id.*

²⁷ See *Id.*

reporting under IFRS that is, in fact, consistent across companies, industries and countries.

A number of factors may undermine the comparability of IFRS financial statements. As discussed above, the lesser degree of comprehensiveness and the challenges of consistent audit and enforcement of IFRS financial statements may affect their comparability. In addition, jurisdictional variations in the application of IFRS, the optionality within IFRS, and inconsistencies arising from differences in the translation of IFRS also may reduce the benefits of IFRS as a single set of global accounting standards.²⁸

Some sources indicate that more than 100 countries “require or allow the use” of IFRS.²⁹ At the same time, there is the real possibility of jurisdictional variations, which could undermine comparability. Jurisdictional variations may arise from both authoritative and informal application guidance, changes made to the standards for purposes of use within a jurisdiction, and variations in the times it may take separate jurisdictions to complete their respective processes to enact into law or otherwise adopt new or amended standards. Historical approaches and cultural differences also may give rise to jurisdictional variations.

Commenters frequently cited concerns regarding the existence of and future potential for jurisdictional variations of IFRS.³⁰ Similarly, the Commission noted that “the extent to which IFRS is adopted and applied globally, and whether IFRS is adopted and applied in foreign jurisdictions as issued by the IASB or as jurisdictional variations of IFRS” “may influence the degree to which comparability may be achieved through widespread adoption of IFRS.”³¹

Regarding optionality, the SEC’s Advisory Committee on Improvements to Financial Reporting (“CIFiR”) and others have asserted that IFRS’s permitted alternative accounting treatments in a number of areas “contribute to avoidable complexity by making financial reports less comparable.”³²

²⁸ See Proposed Roadmap.

²⁹ See, e.g., Deloitte Touche Tohmatsu, “Use of IFRSs by Jurisdiction.” (available at: <http://www.iasplus.com/country/useias.htm>)

³⁰ See, e.g., Corporate Roundtable on International Financial Reporting (“CRIFR”), The Davey Tree Expert Company (“Davey Tree”), Institute of Chartered Accountants of Scotland (“ICAS”), KPMG LLP (“KPMG”), The Lubrizol Corporation, McDonald’s Corporation (“McDonald’s”), Mead Westvaco Corporation (“Mead Westvaco”), NASBA, The Travelers Companies, Inc. (“Travelers”), and Tuesday Morning Corporation (“Tuesday Morning”).

³¹ Proposed Roadmap.

³² “Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission” (August 1, 2008) (“CIFiR Final Report”), page 50. (available at: <http://www.sec.gov/about/offices/oca/acifr/acifr-finalreport.pdf>)

In the Proposed Roadmap, the Commission expressed that:

IFRS...in certain areas permits a greater amount of options than in U.S. GAAP....[This] greater optionality in IFRS could reduce comparability of reported financial information, as different issuers may account or provide disclosure for similar transactions or events in different ways[,] but this flexibility also allows a financial statement that may more closely reflect the economics of transactions.

To counter any diminished comparability, commenters expressed the need for greater transparency around divergence in application.³³ However, as one commenter noted, extensive footnote disclosures explaining how management has applied its discretion “will place the burden upon the user of the financial statements to understand and interpret the differences between companies....”³⁴

In light of these concerns, the Staff will analyze for the Commission’s benefit the extent to which financial statements prepared under IFRS are comparable within and across jurisdictions so as to support a Commission decision regarding whether to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Analyze factors that may influence the degree of comparability of financial statements prepared under IFRS on a global basis.
- Assess the extent to which financial statements prepared under IFRS may not be comparable in practice and how investors manage these situations.
- Identify ways to improve the comparability of financial statements prepared under IFRS on a cross-border basis to provide the most benefit for investors.

³³ See, e.g., CFA Institute (“CFA”) and ITAC.

³⁴ tw telecom.

II. Independent Standard Setting for the Benefit of Investors

A. Introduction

The 2010 Statement notes that “[a]nother important element for a set of high-quality global accounting standards is whether the accounting standard setter’s funding and governance structure support the independent development of accounting standards for the ultimate benefit of investors.” To provide the Commission with the information necessary to determine whether the IASB is sufficiently independent for IFRS to be the single set of high-quality globally accepted accounting standards for U.S. issuers, the Staff will analyze four areas in particular:

- Oversight of the IFRS Foundation (formerly called the “International Accounting Standards Committee (‘IASC’) Foundation”);³⁵
- Composition of the IFRS Foundation and the IASB;
- Funding of the IFRS Foundation; and
- IASB standard-setting process.

B. Oversight of the IFRS Foundation

The IASB was established to develop global standards for financial reporting.³⁶ The IASB is overseen by the IFRS Foundation, which is responsible for the activities of the IASB and other work that centers on IFRS, such as initiatives related to translation of IFRS from the English language, education about IFRS, and the development of interactive data taxonomies for IFRS.³⁷

National accounting standard setters traditionally have been accountable to a national securities regulator or other government authority. In the United States, the FASB is overseen by the Commission. Until 2009, the IFRS Foundation did not have a similar link with any national securities regulators and public capital market authorities.³⁸

The Commission has long supported enhanced governance of the IFRS Foundation (and its predecessor, the IASC), which includes independent oversight representing the public

³⁵ In January 2010, the IFRS Foundation Trustees (“Trustees”) agreed to a number of changes to their Constitution, including changes to the names of several bodies within the organization, effective March 1, 2010. This Work Plan uses the revised names, except when citing a document issued under the predecessor name. See IASC Foundation, Trustees Announce Further Governance Enhancements (February 15, 2010). (available at: <http://www.iasb.org/News/Press+Releases/further+governance+enhancements.htm>)

³⁶ For more information on the structure and operation of the IASB, see www.iasb.org.

³⁷ See Proposed Roadmap.

³⁸ See Id.

interest.³⁹

Recognizing that a relationship with public capital market authorities would enhance the public accountability of the IFRS Foundation, the Trustees amended the IFRS Foundation's Constitution to establish a connection between the IFRS Foundation and a Monitoring Board⁴⁰ composed of public capital market authorities charged with the adoption or recognition of accounting standards used in their respective jurisdictions.

Commenters noted that recent events have demonstrated the significant pressure that can be exerted on a standard setter and acknowledged that the establishment of the Monitoring Board was an important step in improving the public accountability of the IFRS Foundation.⁴¹ However, some commenters suggested improvements to the Monitoring Board⁴² and urged that the Monitoring Board should include representatives from the investment community, analysts, auditors, and preparers, as well as national and regional regulators.⁴³ A number of commenters noted that additional time is needed to determine the effect that the Monitoring Board will have on the public accountability of the IFRS Foundation and the IASB.⁴⁴

³⁹ See *Id.*; *Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP*, Release No. 33-8879 (December 21, 2007) [73 FR 986 (January 4, 2008)] ("2007 FPI Adopting Release"); 2007 Concept Release; and 2000 Concept Release.

⁴⁰ For more information on the mission, duties, structure, and operation of the Monitoring Board, see "Charter of the IASCF Monitoring Board" (available at: http://www.iasb.org/NR/rdonlyres/28B9BB17-79C8-4623-B043-B15F8D7A774D/0/Monitoring_Board_Charter.pdf) and Memorandum of Understanding To Strengthen the Institutional Framework of the International Accounting Standards Committee Foundation (April 2009) (available at: <http://www.iasb.org/NR/rdonlyres/67B0EE51-56B8-4183-9958-CDAC52BC505C/0/MGMou060409.pdf>).

⁴¹ See, e.g., Alcoa, Ernst & Young LLP ("EY"), FEE, U.K. Financial Reporting Council ("FRC"), Potash Corporation of Saskatchewan Inc. ("Potash"), and Securities Industry and Financial Markets Association ("SIFMA").

⁴² See, e.g., Council of Institutional Investors ("CII") (suggested, for example, that the Monitoring Board duties include: (1) explicit responsibility for protecting and defending the independence of the IASB and (2) focus primarily on educating and communicating with the representatives of public authorities about the benefits of independent private-sector standard setting), Institut der Wirtschaftsprüfer in Deutschland (Institute of Public Auditors in Germany) ("IDW") (suggested the Monitoring Board participate in the appointment process and approve the appointment of Trustees, but not assume responsibility for Trustee appointment directly, so as to avoid overstepping the fine line between oversight and control of the IFRS Foundation).

⁴³ See, e.g., CalPERS, CII, FRC (expressed the view that in due course the IFRS Foundation Monitoring Board should be extended to encompass official global organizations with a wider range of responsibilities, notably those with financial stability, banking, and insurance mandates, provided that the primary aim of accounting standards to improve information to providers of capital is respected), ICGN, and Nicholas Véron (observed that the current Monitoring Board is badly designed as it excludes important stakeholders. This commenter suggested that the Commission should promote the transformation of the Monitoring Board into a broader body that represents all the stakeholders, especially investor groups).

⁴⁴ See, e.g., AICPA, Alcoa, Deloitte, Deutsche Bank AG ("Deutsche Bank"), FAF, FEE, FRC, IBM Corporation, ICAEW, IDW, Potash, tw telecom, and XenoPort, Inc. ("XenoPort").

The Staff believes that effective oversight is critical to any decision to incorporate IFRS into the financial reporting system for U.S. issuers. The Staff will analyze for the Commission's benefit the extent to which the Monitoring Board is functioning as designed so as to support a Commission decision regarding whether to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will analyze the operations of the Monitoring Board and assess any areas for improvement.

C. Composition of the IFRS Foundation and the IASB

The IFRS Foundation is governed by 22 trustees with geographically diverse backgrounds.⁴⁵ Trustees are appointed for a term of three years that is renewable once.

The IASB is currently composed of 15 full-time members who serve five-year terms subject to one re-appointment.⁴⁶ Full-time members are required to sever all employment relationships and positions that may give rise to economic incentives that might compromise a member's independent judgment in setting accounting standards. The IASB members come from ten countries⁴⁷ and have a variety of backgrounds (e.g., auditors, investors, and preparers). In selecting IASB members, the Trustees must seek an appropriate mix, such that the IASB is not dominated by any particular constituency.

In response to feedback received through its current Constitution review, the IFRS Foundation has approved amendments to its Constitution, which:

- Emphasize the organization's commitment to developing standards for investors.
- Provide for enhanced guidelines regarding the Trustees' geographical diversity.⁴⁸
- Provide additional guidelines regarding geographical diversity of the IASB members to help ensure that membership of the IASB represents a broad international basis.⁴⁹
- Increase the maximum number of members of the IASB to 16 by July 2012, with up to three positions being permitted for part-time members (There are no part-time

⁴⁵ Six of the Trustees must be selected from the Asia/Oceania region, six from Europe, six from North America, one from Africa, one from South America, and two from any region, subject to maintaining overall geographical balance.

⁴⁶ As a result of changes to the IFRS Foundation's Constitution in January 2010, second terms will be limited to three years for IASB members not serving as the chair or vice chair. See Trustees Announce Further Governance Enhancements (February 15, 2010). (available at: <http://www.iasb.org/News/Press+Releases/further+governance+enhancements.htm>)

⁴⁷ As of February 2010.

⁴⁸ See footnote 45, above.

⁴⁹ Membership of the IASB will be four members drawn from each of the Asia/Oceania region, Europe, and North America; one member from South America; one member from Africa; and two members from any area, subject to overall geographical balance.

members currently).⁵⁰

Some commenters argued that all IASB members should be full time – for example, in order to avoid potential conflicts of interest with their outside employers.⁵¹ Further, these commenters expressed the view that the IASB should include greater representation from investors, as the primary consumers of financial reports.

The Staff believes the composition of the IFRS Foundation and the IASB affects the independence of the IASB's standard-setting process. The Staff will analyze for the Commission's benefit the extent to which the composition of the IFRS Foundation and the IASB promotes the independent development of accounting standards for the ultimate benefit of investors so as to support a Commission decision regarding whether to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will analyze the changes to the composition of the IFRS Foundation and the IASB and their effect on the IASB's ability to independently develop accounting standards for the ultimate benefit of investors.

D. Funding of the IFRS Foundation

Until 2008, the IFRS Foundation financed IASB operations largely through voluntary contributions from a wide range of market participants from across the world's capital markets, including from a number of firms in the accounting profession, companies, international organizations, central banks, and governments. Funding commitments were made for the period 2001–2005 and then were extended for an additional two years through 2007. In June 2006, the Trustees agreed on four characteristics⁵² that should govern the establishment of a funding approach designed to enable the IFRS Foundation to remain a private-sector organization with the necessary resources to conduct its work in a timely fashion. The IFRS Foundation has no authority to impose funding regimes on countries, but the Trustees have worked closely with regulatory and other public authorities and key stakeholder groups on the creation of national regimes. Since 2008, efforts to change the financing basis of the IFRS Foundation have continued. Most funds are now obtained on a national basis from national standard setters and national capital market authorities.⁵³ The number of narrowly-based voluntary regimes is decreasing. Contributions from the major accounting firms also are decreasing.

⁵⁰ The Trustees concluded that the expansion of the IASB to 16 members would enable the IASB to discharge its increasing liaison functions in an improved manner, while not negatively affecting the efficiency of the IASB's deliberative processes.

⁵¹ See, e.g., CII and ICGN.

⁵² The Trustees determined that characteristics of the new plan for 2008 would be broad-based, compelling, open-ended, and country-specific. See IASC Foundation, Annual Report 2006. (available at: <http://www.iasb.org/NR/rdonlyres/D95B6BF3-A12A-4C6C-BDA1-BDC98B4F2A45/0/IASCFoundationAnnualReportFinal.pdf>)

⁵³ See the list of long-term funding commitments on the IASB's Web site. (available at: <http://www.iasb.org/The+organisation/Governance+and+accountability/Financing/Long-term+funding+commitments.htm>)

The Commission previously has expressed concern that the IASB may be subject to a perceived or, potentially, an actual connection between the availability of funding and the outcome of its standard-setting process.⁵⁴ Similarly, the FCAG Final Report stated that in order for the IASB to protect its independence from undue influence, “the IASB must have a permanent funding structure under which sufficient funds are provided to it on an equitable and mandatory basis.” In the Proposed Roadmap, the Commission expressed the view that its “future determination regarding the required use of IFRS for all U.S. issuers should only occur after the IFRS Foundation reaches its goal of securing a stable funding mechanism that supports the independent functioning of the IASB.”

Similarly, many comment letters raised concerns about the independence and stability of the IASB’s funding.⁵⁵ A number of commenters were concerned that the current voluntary nature of the contributions, as well as the source, might impact the apparent, or actual independence of the IASB.⁵⁶ Commenters expressed the view that establishing a stable, transparent funding framework for the IFRS Foundation would significantly reduce the concern that financial pressure could compromise the independence of the IASB’s decision-making.⁵⁷

The Staff recognizes that the United States has a significant interest in the stable funding of the IFRS Foundation⁵⁸ and is committed to exploring strategies to address this issue. Accordingly, the Staff will analyze for the Commission’s benefit: (1) the extent to which the IFRS Foundation’s sources of funding promote the independence of the IASB, and (2) possible funding mechanisms to provide the U.S.-based contribution to the IFRS Foundation. Specifically, the Staff will:

- Evaluate whether the Trustees’ four characteristics governing the establishment of a funding approach are appropriate.

⁵⁴ See Proposed Roadmap and 2007 FPI Adopting Release. See also “Report of the Financial Crisis Advisory Group” (July 28, 2009) (“FCAG Final Report”). (available at: http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocument_Page&cid=1176156365880). The Financial Crisis Advisory Group (“FCAG”) was formed to advise the FASB and the IASB (collectively, the “Boards”) about the standard-setting implications of the financial crisis and potential changes in the global regulatory environment. The members of the FCAG are senior leaders with broad international experience in the financial markets, observed by key global banking, insurance and securities regulators.

⁵⁵ See, e.g., Association of Chartered Certified Accountants (“ACCA”), Alcoa, BEP, CAQ, Grant Thornton LLP (“GT”), McGladrey, PPL Corporation (“PPL”), PricewaterhouseCoopers LLP (“PwC”), UBS AG (“UBS”), United Technologies Corporation (“UTC”), and WellPoint, Inc.

⁵⁶ See, e.g., American Accounting Association, Financial Reporting Standing Committee; CalPERS; CRIFR; and Institute of Management Accountants (“IMA”).

⁵⁷ See, e.g., CalPERS and IMA.

⁵⁸ In 2009, 33 companies based in the United States were expected to provide voluntary contributions, ranging widely in amount. See IASC Foundation, Information for Observers: IASCF Meeting with Monitoring Board (April 1, 2009). (available at: <http://www.iasb.org/NR/rdonlyres/B0B1770C-F414-4DCA-968D-505D521D1839/0/APMB2CFundingreport.pdf>)

- Monitor the IFRS Foundation’s funding arrangements to determine whether voluntary funding from individual organizations continues to be reduced and a stable, independent funding platform is secured.
- Explore alternatives for funding mechanisms in the United States.

E. IASB Standard-Setting Process

The IASB conducts projects necessary to develop high-quality standards. The *Due Process Handbook for the IASB* details procedures to be followed when setting standards, with an emphasis on how each stage of the process must address transparency and accessibility, extensive consultation and responsiveness, and accountability.⁵⁹

The IASB solicits views and seeks input from the public throughout the standard-setting process, starting with selecting items for its agenda and including developing and publishing a discussion paper and/or exposure draft and issuing a final standard. Input is received from discussions at its project working group and roundtable meetings as well as written submissions from constituents.⁶⁰

In the 2003 Policy Statement, the Commission stressed the importance of three components in the standard-setting process, as follows:

- Consideration of international convergence on high-quality accounting standards for the public interest and for the protection of investors;⁶¹
- Timeliness in completing projects, while satisfying appropriate public notice and comment requirements; and
- Objectivity in decision-making and careful consideration of the views of constituents and the expected benefits and perceived costs of each standard.

The following discussion will consider each of these components in the context of the IASB’s standard-setting process.

1. Pre-eminence of Investors

In its final report, CIFIIR asserted that:

Investor perspectives are critical to effective standards-setting, as investors are the

⁵⁹ See IASC Foundation, *Due Process Handbook for the IASB* (October 2008) (“Handbook”). (available at: <http://www.iasb.org/NR/rdonlyres/1E8D75B7-927F-495B-BE4A-04C9BE967097/0/DueProcess09.pdf>)

⁶⁰ See *Id.*

⁶¹ The effect of international convergence on the quality of IFRS will be evaluated in section I. Accordingly, in this section, this component of the standard-setting process will focus on accounting standards for the public interest and the protection of investors.

primary consumers of financial reports. Only when investor perspectives are properly considered by all parties does financial reporting meet the needs of those it is primarily intended to serve. Therefore, investor perspectives should be given pre-eminence by all parties involved in standards-setting.⁶²

Several commenters, including investor groups, expressed the view that greater investor representation on the IASB (and FASB) and related oversight groups would assist in meeting the primary objective of general purpose financial reporting (i.e., providing useful information to investors in making business and economic decisions).⁶³ One commenter expressed the view that the lack of investor representation may expose those charged with governance to pressure from special interest groups to act in a manner that may not be compatible with the best interests of investors.⁶⁴

The Staff notes the IFRS Foundation's recent efforts involving investor groups. Recently, two new members from the U.S. investor community have been appointed to the IASB.⁶⁵ In addition, the IASB has an advisory council – the IFRS Advisory Council (formerly called the “Standards Advisory Council”)⁶⁶ – that is composed of approximately 40 individuals⁶⁷ drawn from geographically-diverse countries, some of which use IFRS and others that do not. The IFRS Advisory Council has an investor subgroup representing major investment organizations in the U.S. and internationally to allow for better engagement of the IASB and its staff with investor representatives.

The Staff intends to explore the extent to which the IASB promotes the pre-eminence of investor views. For example, the Staff will review the IASB's practices, as compared to the requirements detailed in the Constitution, Handbook, and other relevant IFRS Foundation and IASB documents and constituent expectations, to assess the IASB's focus on the pre-eminence of investor views.

2. Timeliness

The IASB normally allows a period of 120 days for comment on a discussion paper and exposure draft. For major projects (which are those projects involving pervasive or difficult conceptual or practical issues), the IASB normally will allow a period of more than 120 days for comments.

⁶² See CIFIIR Final Report, page 57.

⁶³ See, e.g., ICGN.

⁶⁴ See CFA.

⁶⁵ See “Two leading US analysts appointed to the IASB,” IASB press release (May 21, 2009). (available at: <http://www.iasb.org/NR/rdonlyres/2BA72D82-ACFD-4899-89D9-4DB8151B44F2/0/PRTwoleadingUSanalystsappointedtotheIASB210509.pdf>)

⁶⁶ The IFRS Advisory Council supports the IASB and provides a forum where the IASB consults individuals and representatives of organizations affected by its work that are committed to the development of high-quality IFRS.

⁶⁷ A list of members is available at: <http://www.iasb.org/NR/rdonlyres/A0D53C88-8988-4B3F-8B0A-07B01DCBF975/0/MembershipSAC.pdf>.

A commenter noted that the IASB's standard-setting process could be improved through prompt consideration to keep standards current and reflect emerging accounting issues and changing business practices. The commenter also noted that in rare circumstances, the IASB may need to shorten its due process period in order to achieve a timely solution.⁶⁸

The Handbook allows for the IASB to have a shorter period of consultation, if required, of 30 days. Effective March 1, 2010, the Trustees revised their Constitution to include a provision to allow them, in exceptional circumstances, to authorize a shorter due process period. Authority would be given only with the approval of 75 percent of the Trustees after the IASB had made a formal request. The due process periods could be reduced but never dispensed with completely.

Recently, the FCAG addressed situations in which it may be appropriate for the Boards to expedite due process. The FCAG Final Report urged the Boards to adequately define the circumstances under which it is appropriate to act on the basis of expedited due process and develop procedures to ensure that, in such circumstances, the maximum consultation practicable is obtained.

The Staff believes that the standard-setting process requires a careful balance between timely resolution of emerging issues and sufficient due process. The Staff will analyze for the Commission's benefit the extent to which the IASB balances timely resolution of emerging issues and due process so as to support a Commission decision regarding whether to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will review the IASB's practices, as compared to the requirements detailed in relevant IFRS Foundation and IASB documents and constituent expectations, to assess the IASB's ability to resolve emerging issues in a timely and effective manner without compromising due process.

3. Objectivity

The Monitoring Board, of which the SEC Chairman is a member, recently stated that “[c]onfidence in the quality and integrity of the standards depends upon independence and transparency in the standard setter’s due process.”⁶⁹ The Monitoring Board statement expressed the view that robust participation by all interested parties is an essential element of due process.

Commenters expressed concerns regarding whether the independence of the IASB recently has been compromised.⁷⁰ A commenter further questioned whether the IFRS

⁶⁸ See FRC.

⁶⁹ Statement of the Monitoring Board for the International Accounting Standards Committee Foundation on Principles for Accounting Standards and Standard Setting (September 22, 2009). (available at: http://www.iosco.org/monitoring_board/pdf/Monitoring_Board_of_IASCF_Statement_22092009.pdf)

⁷⁰ See, e.g., BEP, CFA, and ITAC.

Foundation and the IASB have the ability and infrastructure to confront political pressure from governments around the world.⁷¹

Similarly, the FCAG observed that:

[T]o develop standards that are high quality and unbiased, accounting standard setters must enjoy a high degree of independence from undue commercial and political pressures, but they must also have a high degree of accountability through appropriate due process, including wide engagement with stakeholders and oversight conducted in the public interest.⁷²

The IASB relies on a number of practices and other factors to ensure that it considers a diversity of views, including:

- The IASB’s meetings are open to public observers and broadcast over the internet.
- Meeting materials, comment letters received, and staff summaries of comment letters on discussion papers and exposure drafts are publicly available on the IASB Web site.⁷³
- The IASB is assisted on IFRS interpretive matters by its IFRS Interpretations Committee (formerly called the “International Financial Reporting Interpretations Committee,” or “IFRIC”).⁷⁴
- The IASB consults with the IFRS Advisory Council on single projects with a particular emphasis on practical application and implementation issues.⁷⁵
- The IASB cooperates with national accounting standard setters and other official bodies concerned with standard setting in order to promote the convergence in accounting standards around the world.⁷⁶

⁷¹ See MetLife, Inc. (“MetLife”).

⁷² See FCAG Final Report.

⁷³ See the IASB’s Web site at <http://www.iasb.org> for more information on IASB process.

⁷⁴ The IFRS Interpretations Committee interprets IFRS and reviews accounting issues that are likely to receive divergent or unacceptable treatment in the absence of authoritative guidance, with a view to reaching consensus on the appropriate accounting treatment. The IFRS Interpretations Committee is comprised of fourteen voting members, appointed by the IFRS Foundation Trustees for renewable terms of three years, and two observers (IOSCO and the European Commission). Interpretations by the IFRS Interpretations Committee are ratified by the IASB prior to becoming effective.

⁷⁵ In 2008, the Trustees agreed to change the membership structure of the SAC, so that members would serve primarily as representatives of organizations. The Trustees believe that this adaptation of the IFRS Advisory Council will enable the IASB to receive views reflecting a wider range of interested parties and would give greater authority to views received. The Commission also participates as an observer of the IFRS Advisory Council.

⁷⁶ For additional information, see IASB, Statement of Best Practice: Working Relationships between the IASB and other Accounting Standard-Setters (February 2006). (available at:

- The due process of the IASB is subject to the active oversight of the Trustee Due Process Oversight Committee.

The Staff will analyze for the Commission's benefit the extent to which the IASB's standard-setting process is independent and objective. Specifically, in conjunction with the other steps in this section related to the oversight, composition, and funding of the IFRS Foundation and the IASB, the Staff will review the IASB's practices, as compared to the requirements detailed in relevant IFRS Foundation and IASB documents and constituent expectations, to assess the adequacy of the IASB's independence and objectivity during recent standard-setting efforts.

III. Investor Understanding and Education Regarding IFRS

A. Introduction

Incorporation of IFRS into the financial reporting system for U.S. issuers requires consideration of the impact on investors. This consideration includes focus on the extent to which the accounting standards and the standard-setting process promote the reporting of transparent and useful financial information to support investors in their investment decision-making process. In addition, this consideration requires an assessment of investor understanding and education regarding IFRS, as the main benefits to investors of a single set of high-quality globally accepted accounting standards would be realized only if investors understand and have confidence in the basis for the reported results.

Investor considerations regarding IFRS and investor confidence in IFRS and its standard setting are discussed in more detail in sections I and II, respectively. This section focuses on investor understanding and education regarding IFRS. In particular, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers, transitional considerations related to investor understanding and education regarding IFRS require evaluation to assess the scope of, timing of, and approach to changes that would be necessary for effective incorporation.

B. Investor Understanding and Education

IFRS currently differs from U.S. GAAP in a number of areas; consequently, incorporation of IFRS into the financial reporting system for U.S. issuers may require significant investor education regarding IFRS. However, as noted by one commenter, many U.S. investors already possess some understanding of IFRS due to global industry focus, cross-border investment decisions, and investments in foreign private issuers.⁷⁷ Moreover, through the convergence process undertaken by the Boards, we expect the differences between the two sets of standards should become fewer and narrower. As part of this Work Plan, the Staff will consider U.S. investors' current familiarity with IFRS and how they currently become educated about changes to accounting standards, in order to better assess the extent of investor educational effort necessary to effectively incorporate IFRS into the financial reporting system for U.S. issuers.

Because standard setters are continually improving accounting standards, mechanisms already exist for investors to become educated about the effects of changes to the accounting standards. By considering the general education process currently used by investors in understanding changes to U.S. GAAP, the Staff will evaluate how this process could apply to investor education with respect to IFRS in preparation for its potential incorporation into the financial reporting system for U.S. issuers. In addition, the staff will consider whether additional educational efforts are needed.

Existing mechanisms to educate investors traditionally are considered in the context of

⁷⁷ See EY.

education after a standard has been developed. Also important, however, is investor education during the standard-setting process, which may occur in two ways. First, active investor outreach by the standard setters may increase both the extent and quality of understanding of new standards. In the past, both Boards have used a number of tools to facilitate investor, issuer, and auditor education about new standards, including education sessions, roundtables, and Web casts. Second, the Boards' convergence projects will be completed in accordance with their due process procedures, providing investors with time to become familiar with the new converged standards as they are developed. The Staff believes the effectiveness of these two areas in educating investors during the standard-setting process needs to be evaluated.

The Staff will analyze for the Commission's benefit how to promote investor understanding of IFRS, as well as the existing mechanisms to educate investors about changes in the accounting standards, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Conduct research aimed at understanding U.S. investors' current knowledge of IFRS and preparedness for incorporation of IFRS into the financial reporting system for U.S. issuers.
- Gather input from various investor groups to understand how investors educate themselves on changes in accounting standards and the timeliness of such education.
- Consider the extent of, logistics for, and estimated time necessary to undertake changes to improve investor understanding of IFRS and the related education process to ensure investors have a sufficient understanding of IFRS prior to potential incorporation.

IV. Regulatory Environment

A. Introduction

In addition to filing financial statements with the Commission, U.S. issuers commonly provide financial information to a wide variety of other parties for different purposes. While the federal securities laws provide the Commission with the authority to prescribe accounting principles and standards to be followed by public companies and other regulated entities that file financial statements with the Commission, the provision and content of information to other regulators generally is not determined by the Commission.⁷⁸ However, these other regulators frequently rely on U.S. GAAP as a basis for their regulatory reporting regimes.

Therefore, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers, transitional considerations related to the role of financial reporting in various regulatory regimes and how such incorporation would affect issuers, investors, and others in those contexts, require evaluation to assess the magnitude and logistics of changes that would be necessary for effective incorporation.

Accordingly, this section explores considerations related to the following:

- Manner in which the SEC fulfills its mission;
- Industry regulators;
- Federal and state tax impacts;
- Statutory dividend and stock repurchase restrictions;
- Audit regulation and standard setting;
- Broker-dealer and investment company reporting; and
- Public versus private companies.

B. Manner in which the SEC Fulfills its Mission

Incorporation of IFRS into the financial reporting system for U.S. issuers may affect the manner in which the Commission fulfills its mission in two ways. First, the Commission must consider how to incorporate IFRS into its rules and regulations and Staff application guidance, to the extent they refer to accounting standards and requirements. Second, as stated in the Commission's 2003 Policy Statement:

The federal securities laws set forth the Commission's broad authority and

⁷⁸ See Proposed Roadmap.

responsibility to prescribe the methods to be followed in the preparation of accounts and the form and content of financial statements to be filed under those laws (citations omitted), as well as its responsibility to ensure that investors are furnished with other information necessary for investment decisions. To assist it in meeting this responsibility, the Commission historically has looked to private-sector standard-setting bodies designated by the accounting profession to develop accounting principles and standards.

Commenters questioned how a move to IFRS would affect the Commission's relationship with the standard setter. For example, some questioned whether, under securities law, as amended by the Sarbanes-Oxley Act, the SEC has the ability to designate the IASB as the U.S. standard setter.⁷⁹ If the IASB were designated as the U.S. standard setter, commenters observed that the Proposed Roadmap is unclear as to how the Commission would exercise oversight of the IASB. Accordingly, commenters urged the Commission to determine how it would react in a crisis situation and how the Commission would protect U.S. investors if the IASB did not address U.S.-specific issues in a timely manner.⁸⁰ For example, some commenters indicated the Commission should retain the authority to interpret IFRS.⁸¹

At the same time, other commenters have cautioned against a "U.S. version of IFRS,"⁸² as follows:

We do not believe the Commission should supplement any missing accounting or disclosure requirements or the financial statements would not be considered to be prepared in accordance with IFRS as issued by the IASB. We believe any additional disclosures the Commission would consider requiring should be included outside of the audited financial statements.⁸³

In response to these concerns, the 2010 Statement states:

[The Commission] believe[s] the FASB will continue to play a critical and substantive role in achieving the goal of global accounting standards. The FASB is the accounting standard setter for the U.S. capital markets, and it should continue to work with the IASB to improve accounting standards. Moreover, that role would remain critical after adoption of global standards.

The Staff will analyze for the Commission's benefit the impact on Commission rules and procedures and potential approaches for the ongoing role of the FASB in accounting standard setting and interpretation, should the Commission determine in the future to

⁷⁹ See, e.g., American Bar Association Business Law Section ("ABA Committee").

⁸⁰ See, e.g., Darden Restaurant, Inc. ("Darden") and Intel Corporation ("Intel").

⁸¹ See, e.g., ABA Committee and Travelers.

⁸² See section I.D for further discussion regarding jurisdictional variations of IFRS.

⁸³ PPL. See also, e.g., Cisco Systems, Inc. ("Cisco") and Liberty Global.

incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Analyze references to accounting standards and requirements in existing Commission rules and interpretations and Staff application guidance to identify the extent of, logistics for, and estimated time necessary to implement any changes prior to such incorporation.
- Consider how, if at all, such incorporation would affect the nature, manner, or frequency in which the Commission and its Staff provide interpretative accounting guidance and enforce accounting standards, and the extent of, logistics for, and estimated time necessary to implement any changes.
- Analyze approaches to the FASB’s ongoing role in accounting standards used in the United States, and the extent of, logistics for, and estimated time necessary to undertake these approaches.

C. Industry Regulators

In the Proposed Roadmap, the Commission observed:

Various federal and state regulators, including regulators of financial institutions, insurance companies and public utilities, are provided with periodic financial information on an on-going basis. For example, U.S. GAAP financial statements frequently are used as the basis for determining capital requirements for financial institutions.

Due to the prevalence of financial information provided to different U.S. regulators, incorporation of IFRS into the financial reporting system for U.S. issuers may significantly affect different regulators and issuers subject to those regulators’ compliance requirements. As such, it is important to identify the full range of regulatory regimes that rely on information developed for financial reporting purposes.

A number of commenters suggested that the Commission determine the extent to which industry regulators would continue to accept financial statements prepared for SEC reporting purposes as a starting point for regulatory filings.⁸⁴ Otherwise, commenters cautioned that a move to IFRS for financial reporting purposes risks creating costly dual-reporting requirements for issuers.⁸⁵ Further, if regulators continue to accept reporting prepared for SEC purposes, any changes in the reporting as a result of incorporating IFRS

⁸⁴ See, e.g., Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, and Office of Thrift Supervision (collectively, “BankReg”), Committee of Annuity Insurers, Dominion Resources Services (“Dominion”), First Data Corporation (“First Data”), and National Association of Regulatory Utility Commissioners (“NARUC”).

⁸⁵ See, e.g., Boeing and Honeywell.

could have regulatory impacts. The Staff recognizes that acceptance of IFRS-based financial statements by industry regulators may have consequences on issuers and others that require analysis.

The Staff will analyze for the Commission's benefit the effects on issuer compliance with industry regulatory requirements, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Analyze the effects on issuer compliance with industry regulatory requirements.
- Consider the impact of a change in SEC reporting on industry regulators.
- Analyze constituent concerns associated with any potential changes, or lack thereof, to regulatory regimes.

D. Federal and State Tax Impacts

Incorporation of IFRS into the financial reporting system for U.S. issuers also could affect federal and state tax regulations (e.g., Internal Revenue Code).⁸⁶ As explained in the Proposed Roadmap:

As the Internal Revenue Code has developed over an extended period of time with existing U.S. GAAP as the predominant set of accounting standards used in the United States, certain interactions exist between certain provision of U.S. GAAP and income tax requirements. For example, the Internal Revenue Code has conformity provisions related to the method of accounting for inventory for tax reporting purposes and the method used for reporting to shareholders (and other owners or beneficiaries) or for credit purposes.⁸⁷ IFRS does not allow for the use of last-in, first-out, or LIFO, method of accounting for inventory. As a result, a company that reports in accordance with IFRS would be required to use a method of accounting for inventory that is acceptable under IFRS, for example the first-in, first-out, or FIFO, method. U.S. issuers changing to FIFO for financial reporting purposes may experience a change in taxable income based on the difference between inventory valued on a LIFO basis and on a FIFO basis.

If federal and state tax regulators maintained their current tax codes, companies may experience a significant increase in the number of book-tax differences they would be required to track upon incorporation of IFRS into the financial reporting system for U.S. issuers. Several commenters expressed that because of the high cost that otherwise would be incurred in maintaining two sets of records, the U.S. Internal Revenue Code, as well as state and local tax codes and related regulations, would need to be modified.⁸⁸

⁸⁶ 26 U.S.C. § 1 *et seq.* [1986.]

⁸⁷ See Section 472 of the Internal Revenue Code (26 U.S.C. 472).

⁸⁸ See, e.g., Allergan, Inc. and tw telecom.

Alternatively, if federal and state tax regulators continued to align their tax codes with reporting for SEC purposes, companies may experience significant changes to their expected tax liabilities. Commenters expressed that the SEC should work with the Internal Revenue Service and other tax authorities to mitigate the LIFO transitional issue,⁸⁹ as well as address the transfer pricing arrangements and franchise tax considerations that may be affected in the transition.⁹⁰

The Staff will analyze for the Commission's benefit the effects on federal and state tax regulations, as well as issuers subject to such regulations, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Analyze the effects on federal and state tax regulations, as well as issuers subject to such regulations.
- Consider the impact of a change in SEC reporting on federal and state tax regulators.
- Analyze constituent concerns associated with any potential changes, or lack thereof, to federal and state tax regulation.

E. Statutory Dividend and Stock Repurchase Restrictions

Certain legal standards may be tied to amounts determined for financial reporting purposes. For example, companies may declare dividends to or repurchase stock from shareholders. While the amount, timing, and manner of payment of dividend distributions and stock repurchases are typically determined by the companies' boards of directors, the amount available may be restricted by state statute. For example, some jurisdictions provide that dividends may only be paid from retained earnings or may be paid from current earnings despite an accumulated deficit.

To the extent that jurisdictions base legal standards on amounts determined for financial reporting purposes, incorporation of IFRS into the financial reporting system for U.S. issuers could affect a company's ability to undertake certain actions and an investor's expectations in that regard. In addition, to the extent that legal standards do not change based on changes in SEC reporting, companies would need to maintain two sets of records. Accordingly, the Staff will analyze for the Commission's benefit the effects on such legal standards, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Analyze the effect of such incorporation on legal standards, such as a company's ability to pay dividends or repurchase stock, on issuers and investors.

⁸⁹ See, e.g., KPMG, The LIFO Coalition ("LIFO"), and National Association of Wholesaler-Distributors.

⁹⁰ See KPMG.

- Consider the impact of a change in SEC reporting on state statutes in this regard.
- Analyze constituent concerns associated with any potential changes, or lack thereof, to such state statutes.

F. Audit Regulation and Standard Setting

Another regulatory body that may be affected by incorporation of IFRS into the financial reporting system for U.S. issuers is the Public Company Accounting Oversight Board (“PCAOB”), which is responsible for overseeing public company audit firms and establishing audit, quality control, ethics, and independence standards used by those firms.⁹¹ The Proposed Roadmap and commenters raised two primary considerations related to the PCAOB. First, commenters questioned whether a move to global accounting standards should be coupled with a move to global auditing standards in the United States, for example, through convergence of PCAOB standards with or adoption of auditing standards issued by the International Accounting and Assurances Standards Board.⁹² Second, commenters noted that PCAOB auditing standards may require better alignment with IFRS. For example, one commenter expressed a general concern that there would be a mismatch between the less prescriptive standards in IFRS and U.S. auditing standards.⁹³ In addition, the Proposed Roadmap identified a general need for conforming amendments to PCAOB standards where they refer to current U.S. GAAP literature.

Commenters also provided specific examples of PCAOB auditing standards that may require better alignment with IFRS. For example, commenters suggested that the PCAOB issue additional guidance for auditors engaged in auditing market risk information included in the audited financial statements pursuant to IFRS 7 (currently U.S. issuers provide similar information outside the financial statements pursuant to Item 305 of Regulation S-K).⁹⁴

Further, the Proposed Roadmap discussed the audit of legal contingencies as follows:

One of the conditions under IFRS for recognizing a provision for a legal contingency is that it is more likely than not that an obligation exists (footnote omitted). This recognition threshold is lower than the current recognition threshold in U.S. GAAP, resulting in the potential for an earlier income statement recognition of costs associated with litigation (footnote omitted). Concerns have been raised about an auditor’s ability to corroborate the information furnished by management related to litigation, claims, and assessments by obtaining an audit inquiry letter from a client’s

⁹¹ See Section 101 of the Sarbanes-Oxley Act (15 U.S.C. 7211).

⁹² See, e.g., CalPERS and FEE.

⁹³ See AAA-FASC.

⁹⁴ See, e.g., KPMG.

attorney.⁹⁵

Notwithstanding the above examples of areas where PCAOB auditing standards may require better alignment with IFRS, most auditors that responded to the Proposed Roadmap did not have concerns regarding their ability to opine on financial statements prepared under IFRS.⁹⁶

The Staff will analyze for the Commission's benefit the effects on audit standard setting and auditor requirements, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Consider the impact of such incorporation on PCAOB standards.
- Consider the extent of, logistics for, and estimated time necessary to undertake any changes to the auditing standards.

G. Broker-Dealer and Investment Company Reporting

The Proposed Roadmap excluded investment companies registered under the Investment Company Act of 1940 and certain other regulated entities that are required to file or furnish certain types of financial reports (e.g., broker-dealers).

Some commenters expressed that no issuers should be exempt from the scope of the Proposed Roadmap⁹⁷ and that the final Roadmap should include a plan so that all filings with the SEC are based on IFRS and allow adequate time for the IASB and SEC to consider the appropriate financial reporting model for these entities.⁹⁸

Alternatively, some commenters supported the exclusion of investment companies from

⁹⁵ As further discussed in the Proposed Roadmap:

Some believe that changes to the American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information may be necessary. See AU § 337C. The Statement of Policy, commonly referred to as the "Treaty," recognizes the professional responsibilities of attorneys and auditors and seeks to preserve confidentiality while providing the necessary level of assurance for the audit. The Treaty recognizes that the confidentiality of communications between an attorney and a client may be impaired by the disclosure of the substance of such communications to third parties, including auditors. By describing thresholds for disclosure and limitations on responses, the Treaty sets the scope of the attorney's responses to audit requests for information on legal matters. Some believe that the thresholds and limitations described in the Treaty are inconsistent with certain provisions within IFRS.

See also, e.g., ABA Committee (echoed the Commission's statements in the Proposed Roadmap regarding the audit of legal contingencies).

⁹⁶ See, e.g., CAQ (stated that the U.S. auditing profession stands ready to support the use of IFRS by all U.S. issuers, including early adopters under an option), J.H. Cohn LLP (confirmed its readiness to prepare for audits of IFRS financial statements once the SEC reaches a decision), and PwC.

⁹⁷ See, e.g., BDO Seidman, LLP ("BDO"), CAQ, and Verizon Communications, Inc.

⁹⁸ See, e.g., EY.

the rule proposal.⁹⁹ Another commenter expressed the view that the Commission has not sufficiently articulated its rationale for excluding investment companies and other regulated entities from the scope of the Proposed Roadmap and would agree with excluding these issuers “only if there are unique considerations surrounding these entities that could delay the Commission’s decision making process.”¹⁰⁰

Finally, commenters also expressed concerns regarding costs imposed by the reduced comparability introduced by the continued use of another basis of accounting (e.g., for private companies (see below), and/or Investment Company Act registrants).¹⁰¹ As another example, excluding broker-dealer reporting could result in a broker-dealer subsidiary being required to report to the Commission under one set of standards with the public holding company that consolidates that subsidiary required to report under another. Also, to the extent reporting results changed if IFRS were to be incorporated for these entities, such a change could impact compliance with financial responsibility rules, such as net capital requirements.

In light of the different views noted above, the Staff will analyze for the Commission’s benefit possible approaches for financial reporting requirements for broker-dealers and investment companies, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Assess the effects of such incorporation on broker-dealers, investment companies, and investors, including whether IFRS includes sufficient standards, and the extent of, logistics for, and estimated time necessary to undertake any changes, should broker-dealers and investment companies be included in the scope any potential Commission decision.
- Evaluate the effect on investors of excluding broker-dealers and investment companies from the scope of any potential Commission decision.

H. Public versus Private Companies

The Proposed Roadmap focused only on companies that file with the Commission. However, existing U.S. GAAP also is used by private companies.

Commenters expressed concern over the impact a move to IFRS would have on U.S. private companies.¹⁰² One concern raised in the Proposed Roadmap and echoed by commenters was that, to the extent two sets of standards existed, a requirement to file different financial statements with the Commission would increase costs of capital for

⁹⁹ See, e.g., AICPA and Investment Company Institute (who expressed that convergence in accounting standards as applied to investment companies and resolution of conflicts between IFRS and Article 6 of Regulation S-X should be prerequisites to a move to IFRS).

¹⁰⁰ GT.

¹⁰¹ See, e.g., Private Equity Council.

¹⁰² See, e.g., The New York State Society of Certified Public Accountants (“NY CPAs”) and Ohio CPAs.

private companies considering an initial public offering.¹⁰³ It could also impact the evaluation of business combinations between public and private companies. Some commenters acknowledged that private company reporting is largely outside of the mandate of the Commission, but stated that the Commission should assess the consequences its decision on IFRS would have to this large and important part of the U.S. economy. Specifically, certain of these commenters believed that if a “dual-GAAP” system emerged for private versus public companies, this could adversely affect the efficiency of the U.S. capital markets.¹⁰⁴ Even if U.S. private companies were to report under IFRS, a “dual-GAAP” system may evolve, if private companies followed IFRS for small- and medium-sized entities (“SMEs”), which:

[I]s a self-contained standard of about 230 pages tailored for the needs and capabilities of smaller [private] businesses. Many of the principles in full IFRSs for recognising and measuring assets, liabilities, income and expenses have been simplified, topics not relevant to SMEs have been omitted, and the number of required disclosures has been significantly reduced. To further reduce the reporting burden for SMEs revisions to the IFRS will be limited to once every three years.¹⁰⁵

The Staff will analyze for the Commission’s benefit the effects on U.S. private companies, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Analyze the effects of such incorporation for U.S. issuers on private companies, auditors, and investors.
- Assess the extent of, logistics for, and estimated time necessary to undertake changes to accommodate any resulting implications on private companies.

¹⁰³ See, e.g., ABA Committee, Center for Capital Markets Competitiveness (“CCMC”), Davey Tree, First Data, and ITAC.

¹⁰⁴ See, e.g., CA CPAs and CIGNA Corporation.

¹⁰⁵ “IASB publishes IFRS for SMEs,” IASB press release (July 9, 2009). (available at: <http://www.iasb.org/News/Press+Releases/IASB+publishes+IFRS+for+SMEs.htm>)

V. Impact on Issuers

A. Introduction

Incorporation of IFRS into the financial reporting system for U.S. issuers would significantly affect preparers of financial statements – the several thousand issuers that file reports with the Commission. Numerous commenters expressed the view that the costs, effort, and time involved with a move to IFRS would be considerable,¹⁰⁶ with many asserting that the benefits of such a move may not outweigh those costs.¹⁰⁷ A number of commenters further asserted that the transition time articulated in the Proposed Roadmap was not sufficient¹⁰⁸ and may cause confusion, thereby damaging investor confidence.¹⁰⁹

Accordingly, this aspect of the Work Plan explores the magnitude and logistics of changes that issuers would need to undertake to effectively incorporate IFRS into the financial reporting system for U.S. issuers, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers in the following areas:¹¹⁰

- Accounting systems, controls, and procedures;
- Contractual arrangements; and
- Corporate governance.

The Work Plan will also consider the effect of such incorporation on the following:

- Accounting for litigation contingencies; and
- Smaller issuers versus larger issuers.

¹⁰⁶ See, e.g., Phil Ameen (“Ameen”), Chevron Corporation, Eli Lilly, Shawn S. Fahrner, Hot Topic Inc. (“Hot Topic”), Intel, Graduating Seniors - Jacksonville University (Georgia), Kohl’s Department Stores, Inc. (“Kohl’s”), Molson Coors Brewing Company, NARUC, PPL, Psoras, Mark A. Supin, SIFMA, U.S. Congressman Lee Terry, Tuesday Morning; and U.S. Congressman Zach Wamp.

¹⁰⁷ See, e.g., Davey Tree, Exxon Mobil Corporation (“Exxon Mobil”), Marriott, McDonald’s, Pfizer Inc. (“Pfizer”), Plantronics, Inc. (“Plantronics”), Regions Financial Corp., and tw telecom.

¹⁰⁸ See, e.g., ABA Committee, American Insurance Association (“AIA”), AICPA, BankReg, Best Buy Co., Inc., CAQ, Cisco, Cymer Inc., Deloitte, EY, Fannie Mae, Graybar Electric Company, Inc., ICAEW, IMA, KPMG, National Association of Real Estate Investment Trusts, NARUC, Progress Energy, Inc., PwC, Reznick Group, P.C., TransCanada Corporation, and Xenoport.

¹⁰⁹ See, e.g., Association of the Bar of the City of New York, Community Health, CSX Corporation, and Plantronics.

¹¹⁰ The human resource impact on issuers is discussed separately in section VI.

B. Accounting Systems, Controls, and Procedures

U.S. issuers may be required to significantly modify their accounting systems, controls, and procedures, if the Commission incorporates IFRS into the financial reporting system. As stated in the Proposed Roadmap:

Use of any new accounting standards requires changes to financial reporting systems and procedures to identify, collect, analyze and report financial information and the corresponding controls. Changing numerous accounting standards at the same time, regardless of the starting point, would require numerous changes in a company's policies and procedures and system of internal controls.

For example, commenters expressed the need for:

- A complete survey of accounting policies as a first step because IFRS explicitly requires that all similar transactions in the enterprise (including affiliates) be accounted for similarly;¹¹¹
- More detailed company policies, as IFRS is viewed as less developed than U.S. GAAP;¹¹² and
- Changes to systems, including ledgers and related internal controls, and related testing of such changes,¹¹³ particularly to ensure effectiveness for reporting purposes under section 404 of the Sarbanes-Oxley Act.

Commenters noted that the burden of changes to accounting systems, controls, and procedures would be exacerbated in a number of ways. First, issuers may be required to maintain dual-accounting systems for a period of time (e.g., (1) for periods reported under existing U.S. GAAP after the opening balance sheet date under IFRS 1, *First-time Adoption of International Financial Reporting Standards*, but before the initial filing under a system incorporating IFRS, (2) if the SEC were to require supplemental U.S. GAAP information for a period of time to aid in transition, (3) if such incorporation were effective in the financial statements of consolidated entities prior to those of the consolidated entities' stand-alone subsidiaries, and (4) if other regulators continued to require reporting based on U.S. GAAP). One commenter stated:

Maintaining dual reporting presents U.S. issuers with a significant burden since all of the processes, controls, and checks must occur twice for each transaction. Indeed, it is likely that the Sarbanes Oxley control testing requirements could nearly double during the period of parallel reporting.¹¹⁴

¹¹¹ See, e.g., Ameen.

¹¹² See, e.g., Air Products, Community Health, Darden, and Mead Westvaco.

¹¹³ See, e.g., Ameen.

¹¹⁴ UTC.

Second, changes to accounting systems, controls, and procedures require sufficient lead time. However, if IFRS continues to change at a rapid pace during this lead time, U.S. issuers will experience additional challenges in planning for incorporation of IFRS into the financial reporting system. As such, some commenters expressed the need for a “stable platform” for a period of time during which accounting standards do not change.¹¹⁵ However, a “stable platform” may constrain the standard setters’ ability to address emerging issues.

Third, some commenters asserted that certain industries would be disproportionately impacted by incorporation of IFRS into the financial reporting system for U.S. issuers because of differences between existing U.S. GAAP and IFRS that are specific to their circumstances. One commenter stated that financial institutions will need sufficient time to prepare for conversion to IFRS, given the extent of systems changes and communications that will need to occur.¹¹⁶ Other commenters expressed concerns about specific differences between U.S. GAAP and IFRS for which they believed the accounting under IFRS would be onerous.¹¹⁷

The Staff will analyze for the Commission’s benefit the effects on U.S. issuers’ accounting systems, controls, and procedures, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Determine the extent of, logistics for, and estimated time necessary to undertake changes to issuer accounting systems, controls, and procedures to facilitate such incorporation.
- Consider the implications of a “stable platform,” including the length of time and means of addressing emerging issues.

C. Contractual Arrangements

The Proposed Roadmap also noted that companies’ contracts often, either explicitly or implicitly, require the use of U.S. GAAP or are based off of current U.S. GAAP reporting. For example, companies may have issued debt instruments which include financial covenants based on U.S. GAAP or require periodic reporting of financial statements prepared under U.S. GAAP. Similarly, lease contracts and employee compensation plans may be based on metrics computed using U.S. GAAP financial

¹¹⁵ See, e.g., Eli Lilly, Exxon Mobil, EY, and SIFMA.

¹¹⁶ See ICAEW.

¹¹⁷ See, e.g., Mead Westvaco, Plum Creek Timber Company, Inc., Potlatch Corporation, and Rayonier Inc. (who expressed concerns regarding the costs of complying with the requirement in International Accounting Standard 41, *Agriculture*, to fair value timberlands). See also, e.g., Hot Topic, J.C. Penney Company, Inc., Kohl’s, and Tuesday Morning (who expressed concerns about the IFRS disallowance of the retail inventory method).

information.

Commenters indicated that a move to IFRS for U.S. issuers may require contract renegotiation or the preparation of two sets of financial statements, depending on how IFRS is incorporated in the U.S. capital markets.¹¹⁸ In addition, performance under the existing agreements could be affected if the reported information changes. Accordingly, the Staff will analyze for the Commission's benefit the effects on contractual arrangements, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Assess the types and pervasiveness of contractual arrangements that would be affected by such incorporation and the manner in which they would be affected.
- Determine the costs, ability, plans, and estimated time required to address concerns regarding affected contractual arrangements.

D. Corporate Governance

Incorporation of IFRS into the financial reporting system for U.S. issuers may affect an issuer's compliance with corporate governance requirements. For example, in 2003, as required by the Sarbanes-Oxley Act, the SEC adopted rules that require a registrant to disclose whether it has at least one "audit committee financial expert" (as defined) serving on its audit committee and, if so, the name of the expert and whether the expert is independent of management.¹¹⁹ Those rules also indicate the education and experience through which those attributes must have been acquired.

Listing rules for U.S. securities exchanges also have requirements regarding audit committee competence. One commenter explained:

[R]ules of the NYSE, NASDAQ, and AMEX require members of the audit committee of each listed company to be financially literate and each listed company audit committee must have at least one member who has accounting or related financial management expertise. Many board members who currently meet the "financial expertise" qualifications are not likely to have had experience with IFRS or its adoption as they have been trained in U.S. GAAP. If a company adopts IFRS, its board is likely to need additional training in IFRS in order to meet the level of financial expertise necessary for them to carry out these functions and satisfy these requirements.¹²⁰

Accordingly, incorporation of IFRS into the financial reporting system may result in challenges for U.S. issuers in identifying audit committee financial experts and in listing

¹¹⁸ See, e.g., AIA, CCMC, Hot Topic, JP Morgan, Psoras, and Tuesday Morning.

¹¹⁹ See *Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002*, Release No. 33-8177 (January 23, 2003) [68 FR 5110 (January 31, 2003)].

¹²⁰ Metlife.

on securities exchanges, as well as, more broadly, compliance with other aspects of corporate governance. Further, similar to the potential effects on compliance with other regulatory requirements, changes in financial reporting could impact a company's compliance with certain quantitative listing standards. The Staff will analyze for the Commission's benefit the impact on compliance with corporate governance standards, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Determine the potential effects on corporate governance and related concerns of such incorporation.
- Determine possible approaches to address corporate governance concerns and the extent of, logistics for, and estimated time necessary to undertake these approaches.

E. Accounting for Litigation Contingencies

Commenters expressed concerns regarding the treatment of litigation-related loss contingencies under IFRS. For example, the ABA Committee asserted that accounting for such contingencies under IFRS raises serious concerns by its use of a lower recognition threshold than U.S. GAAP and its requirements to make additional disclosures. Their concerns included "avoidance of prejudice to companies and their shareholders in our highly litigious society" and erosions of the protections of attorney-client privilege and work product. Other commenters expressed similar concerns, with one noting:

[T]he loss contingency disclosures required under IFRS are similar to those proposed by the FASB in 2008. As these disclosures were rejected for use in the U.S. primarily due to objections from the legal community, it is likely that similar issues will arise if IFRS becomes mandatory.¹²¹

Incorporation of IFRS into the financial reporting system for U.S. issuers requires careful consideration of the impact of litigation contingency accounting and disclosure requirements under IFRS on issuers and investors. Accordingly, the Staff will analyze for the Commission's benefit the effects on accounting and disclosure requirements for litigation contingencies under IFRS in the U.S. legal environment, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Discuss with issuers, the legal profession, and investors concerns regarding accounting and disclosure requirements for litigation contingencies under IFRS.

¹²¹ Dominion. See also, e.g., FPL and Pfizer. The Staff notes that the FASB is in the process of re-deliberating loss contingency disclosure requirements. See also section IV.E regarding concerns related to the auditing of loss contingencies accounted for under IFRS.

- Determine possible approaches to address concerns regarding accounting and disclosure requirements for litigation contingencies under IFRS and the extent of, logistics for, and estimated time necessary to undertake these approaches.

F. Smaller Issuers versus Larger Issuers

Several commenters asserted that a move to IFRS would be particularly burdensome for smaller U.S. issuers. For example, one commenter included studies from two independent consultants indicating that, while recognizing potential cost savings for some large, multinational firms, a move to IFRS is likely to impose substantial transition costs, including disproportionate costs on smaller issuers.¹²² Conversely, one commenter stated that “the impact is expected to be very small and the majority of the impact will occur in non-routine or one-off transactions which are typically subject to significant scrutiny in any case.”¹²³

In light of the above comments, the Staff will analyze for the Commission’s benefit the extent to which incorporation of IFRS into the financial reporting system for U.S. issuers would affect smaller issuers differently than larger issuers and the extent of, logistics for, and estimated time necessary to undertake any changes, should the Commission determine in the future to do so. Specifically, the Staff will:

- Determine the manner in which the impact of such incorporation varies based on issuer size.
- Determine possible approaches to mitigate concerns regarding any disproportionate effects on smaller issuers of such incorporation and the extent of, logistics for, and estimated time necessary to undertake these approaches.

¹²² FAF. See also, e.g., Biotechnology Industry Organization, Business Roundtable, CCMC, CRIFR, and IMA.

¹²³ Xenoport.

VI. Human Capital Readiness

A. Introduction

Should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers, transitional considerations related to the readiness of all parties involved in the financial reporting process, including investors (see section III for further discussion), issuers, attorneys, auditors, regulators, and educators require evaluation to assess the magnitude and logistics of changes that would be necessary to effectively incorporate IFRS into the financial reporting system for U.S. issuers. Accordingly, this section explores considerations related to:

- Education and training; and
- Auditor capacity.

B. Education and Training

In the Proposed Roadmap, the Commission noted that the education and ongoing training of most accountants in the United States are limited to or predominantly focused on the current provisions of U.S. GAAP. As a result, the Commission acknowledged that many parties likely would need comprehensive IFRS training, including:

- Investors, as discussed in section III;
- The personnel of issuers, including their accounting, internal audit, and investor relations departments, and their governing bodies, such as their audit committees and board of directors;
- Specialists, such as actuaries and valuation experts, as they often are engaged by management to assist in measuring certain assets and liabilities for financial reporting purposes;
- Attorneys, who will need to understand financial statements in order to, for example, advise on disclosures required under the securities laws and provide legal representations to external auditors;
- External auditors;
- Regulators, such as the Staff, PCAOB staff, and the staff of other regulatory bodies;¹²⁴

¹²⁴ See, e.g., BankReg (noted that they “collectively employ thousands of examination and policy support personnel that will need to be adequately trained in the use of IFRS if it is adopted before convergence is achieved”).

- State licensing bodies, professional associations, and industry groups, who would need to integrate IFRS into their training materials, publications, testing, and certification programs (including the Uniform CPA Examination); and
- Colleges and universities that would need to include IFRS in their curricula.

In the Proposed Roadmap, the Commission observed that strategies taken by those participants in markets where issuers already report in accordance with IFRS might serve as examples of approaches to increasing education and awareness of IFRS.

The Commission also expressed that the private sector may respond to any increased demand for IFRS education by making educational materials available.¹²⁵ Since the Commission's issuance of the Concept Release in August 2007, several of the largest accounting firms in the United States have made more material available to the public about IFRS generally, as well as about the application of specific IFRS standards.¹²⁶

Commenters expressed mixed views in terms of the importance of this issue, as well as timing for improvements in this area. Some commenters expressed concerns about the challenges faced in training and educating both existing and future practitioners.¹²⁷ For example, the nature of accounting education would require change, as professionals and students would not only need training in IFRS, but in utilizing judgment in the application of less prescriptive standards and in understanding the economic substance of transactions.¹²⁸ Accordingly, commenters expressed the view that a move to IFRS for U.S. issuers would be costly for educators,¹²⁹ particularly if a dual-reporting system (e.g., due to different systems for public versus private companies) evolved in the United States.¹³⁰ Commenters also asserted that educators would not be ready in the near term¹³¹ and that work needs to begin immediately.¹³² As such, some commenters recommended that the Commission address how sufficient resources and incentives for training would be achieved.¹³³

Others, however, were of the view that educators, issuers, and other impacted parties

¹²⁵ See Proposed Roadmap.

¹²⁶ These materials include publications (e.g., PwC's *IFRS and US GAAP: similarities and differences*; EY's *US GAAP vs. IFRS The basics: Oil and gas*) and other IFRS-related education initiatives (e.g., the KPMG IFRS Institute; Deloitte's IFRS University Consortium; EY's Academic Resource Center; PwC's IFRS Video Learning Center).

¹²⁷ See, e.g., CalPERS, CFA, Fund Stockowner Rights, ITAC, NASBA, NYCPAs, and Ohio CPAs.

¹²⁸ See, e.g., London Ctr Int'l Corp Gov Law and Shyam Sunder.

¹²⁹ See, e.g., AmerisourceBergen Corporation, Teresa P. Gordon, and Thomas N. Tyson.

¹³⁰ See, e.g., Travelers.

¹³¹ See, e.g., American Accounting Association, Financial Accounting and Reporting Section, and Financial Reporting Policy Committee (pointed to surveys of educators indicating concerns over readiness).

¹³² See, e.g., ING Insurance Americas.

¹³³ See, e.g., CalPERS and ICGN.

would be prepared in time, particularly once a date for moving to IFRS were established.¹³⁴ One commenter expressed that IFRS education and expertise will grow in the United States anyway – even if the United States does not move to IFRS – because of the ongoing increased foreign investment in the United States.¹³⁵

The Staff recognizes that education and training efforts to facilitate incorporation of IFRS into the financial reporting system for U.S. issuers could be significant. Accordingly, the Staff will analyze for the Commission’s benefit the sufficiency of the IFRS education and training infrastructure and the extent of, logistics for, and estimated time necessary to undertake changes, should the Commission determine in the future to do so. Specifically, the Staff will:

- Evaluate the current level of IFRS expertise and extent of IFRS education and training needs among constituents.
- Consider the extent of, logistics for, and estimated time to implement plans for future training among constituents.

C. Auditor Capacity

Incorporation of IFRS into the financial reporting system for U.S. issuers could strain audit firm resources if sufficient training and time are not provided. The Proposed Roadmap noted that “[a]udit firms would need to consider elements of their systems of quality control, such as their practices related to hiring, assigning personnel to engagements, professional development and advancement activities.” An increase in the demand for IFRS expertise may affect the availability of audit services, with consequences on audit quality, cost, and audit firm concentration.

While some commenters expressed that moving to IFRS is likely to have little or no effect on the availability of audit services and audit quality,¹³⁶ others expressed concerns about a likely reduction in these areas, along with an increase in both internal and external audit costs, due to IFRS being less comprehensive and requiring more application of judgment.¹³⁷ For additional discussion regarding the impact of IFRS’s comprehensiveness on its auditability, see section I.C.

Others commented that the consequences of a move to IFRS for U.S. issuers on audit firms may differ based on audit firm size. With respect to the large audit firms, commenters believed that a move to IFRS for U.S. issuers is likely to have little or no effect on the availability of audit services and audit quality.¹³⁸ Two large audit-firm

¹³⁴ See, e.g., ACCA, Alcoa, CAQ, Dell Inc., EY, and PwC.

¹³⁵ See Pepsi.

¹³⁶ See, e.g., Deutsche Bank, UBS, and UTC.

¹³⁷ See, e.g., Davey Tree.

¹³⁸ See, e.g., BDO, Deloitte, EY, and PwC.

commenters noted that they currently audit foreign private issuers as well as subsidiaries of foreign multi-nationals that report under IFRS.¹³⁹ Further, they anticipated leveraging personnel from other member firms in countries that have already moved to IFRS.

On the other hand, opinions were mixed on the impact of moving to IFRS on “smaller” audit firms. The Proposed Roadmap stated that the potential use of IFRS by U.S. issuers:

[M]ay be particularly challenging for less globally-oriented audit firms, which typically may have fewer resources available through affiliated or network firms located in jurisdictions in which issuers already report in accordance with IFRS. This could be a further factor affecting concentration in the auditing profession.

One commenter expressed concern that current IFRS expertise is concentrated within the “Big Four” public accounting firms, which could allow for opportunistic business behaviors when dealing with other competitors and regulators.¹⁴⁰ However, others commented that an SEC mandate to move to IFRS would not affect the competitive position of smaller firms.¹⁴¹

In light of these differing views, the Staff will analyze for the Commission’s benefit potential auditor capacity constraints with respect to IFRS and their consequences, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Analyze concerns regarding auditor capacity constraints, including the effect on audit quality, cost, and audit firm concentration and competitiveness.
- Determine possible approaches to mitigate these concerns and the extent of, logistics for, and estimated time necessary to undertake these approaches.

¹³⁹ See Deloitte and PwC.

¹⁴⁰ See ITAC.

¹⁴¹ See, e.g., ACCA, Deloitte, EY, ICAEW (indicated that a move to IFRS did not have an identifiable impact on audit concentration in Europe), and PwC.