

IFRS Developments SEC staff issues two papers on IFRS

What you need to know

- ▶ The SEC Staff Papers provide additional information for the Commission to review before it decides whether to incorporate IFRS into the US financial reporting system.
- ▶ The Staff Papers do not take a position on whether IFRS should be incorporated into the US financial reporting system.
- ▶ The SEC staff did not analyse topics currently subject to joint standard setting by the IASB and the FASB.
- ▶ While the staff found that financial statements prepared under IFRS appear to comply with IFRS, staff noted that disclosures about accounting policies could be clearer and more transparent and that comparability is challenging due to diversity in the application of IFRS.
- ▶ Nonetheless, the staff also noted some topical areas where a majority of companies applied certain requirements of IFRS in a consistent manner, thereby contributing to greater comparability on a global basis.

Highlights

As part of its Work Plan ¹ to consider whether, and if so, when and how IFRS should be incorporated into the US financial reporting system, the SEC staff released two papers: *An Analysis of IFRS in Practice* and *A Comparison of US GAAP and IFRS*. ²

The Staff Papers help address whether IFRS is sufficiently developed and consistently applied for use in the US financial reporting system. As one of six areas under the Work Plan, the SEC staff planned to evaluate the comprehensiveness and enforceability of IFRS, as well as the auditability and comparability of financial statements prepared using IFRS, both in concept and in practice. These Staff Papers are only two components of this evaluation and of the extensive output of the overall Work Plan to help the Commission make a decision on incorporating IFRS into the US financial reporting system.

IFRS in practice

In this paper, the staff analysed “the manner in which IFRS is applied in practice, with a focus on the recognition and measurement of transactions in a company’s financial statements.” The observations made by the SEC staff were limited to the information disclosed in the company’s financial statements and the staff did not have the opportunity to obtain clarifying information from company officials. The SEC staff reviewed the financial statements of all of the *Fortune Global 500* ³ companies that report in accordance with IFRS and publish their financial statements in English. Of the 183 companies reviewed, 47 were SEC registrants and 29 were former SEC registrants. The review consisted of reading company financial statements and developing observations regarding data points, including transparency and clarity of disclosures, compliance with applicable accounting standards and comparability of financial statements.

The SEC staff also summarised areas of frequent comment from the Division of Corporation Finance’s reviews performed in its disclosure review programme. The SEC staff reviewed approximately 140 of the 170 foreign private issuer SEC registrants during the time of the Staff Paper analysis.

¹ The SEC staff’s Work Plan is available at <http://www.sec.gov/rules/other/2010/33-9109.pdf>.

² The SEC Staff Paper, *An Analysis of IFRS in Practice*, is available at <http://www.sec.gov/spotlight/globalaccountingstandards/ifrs-work-plan-paper-111611-practice.pdf>. The SEC Staff Paper, *A Comparison of US GAAP and IFRS*, is available at <http://www.sec.gov/spotlight/globalaccountingstandards/ifrs-work-plan-paper-111611-gaap.pdf>.

³ The *Fortune Global 500* is a listing of the world’s largest companies by revenue.

Summary observations

The SEC staff found that the financial statements reviewed generally appear to comply with IFRS, but noted the following:

- ▶ The disclosure of accounting policies often did not appear to provide sufficient detail or clarity. Some companies omitted accounting policy disclosures in areas that appeared relevant and significant to the financial statements (e.g., estimate uncertainty). Others used language that was inconsistent with IFRS terminology.
- ▶ Diversity in IFRS application results in comparability challenges across countries and industries stemming from: (1) either explicit options in IFRS or the absence of IFRS guidance; and (2) apparent non-compliance with IFRS. However, these differences were mitigated by the use of home country practices in IFRS financial statements. For example, IFRS does not specify financial statement formats; instead, it provides guidelines for form and content. Many companies presented financial statements based on their country's regulations or long standing practices, which creates diversity on a global basis.

However, the staff also identified instances where IFRS requirements were applied consistently by companies in the sample:

- ▶ Within the operating section of the statement of cash flows, a vast majority of companies used the indirect method to present operating cash flows, "thereby contributing to greater comparability on a global basis."
- ▶ Companies consistently used the cost model for the subsequent measurement of property, plant and equipment.
- ▶ Even though it is optional to use an allowance account to record the impairment of loans, almost all companies in the banking industry used the allowance method instead of recording impairment as a direct charge off.

- ▶ Although IFRS does not specify precise financial statement formats, the staff noted that presentations for all the companies analysed did not appear to conflict with IFRS and there was a "fair degree of comparability associated with asset and liability classification on the face of the statement of financial position."

The Staff Paper noted fewer observations about companies that are currently or previously had been SEC registrants. These companies are or have been the subject of the Division of Corporation Finance disclosure review programme.

A comparison of US GAAP and IFRS

The SEC staff's Work Plan contemplated inventorying areas in which IFRS does not provide guidance or it provides less guidance than US GAAP. This SEC Staff Paper analyses the US GAAP Accounting Standards Codification (ASC) by topic (e.g., interim reporting, inventory, intangibles) and compares it with IFRS. The staff looked at IFRS and US GAAP effective as of 2010.

The staff did not assess any US GAAP accounting standards and their IFRS equivalents that are currently subject to joint standard setting (e.g., revenue recognition, financial instruments, leases and consolidations) by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) (collectively, the Boards). The Staff Paper acknowledges substantial convergence on certain Joint Projects such as revenue recognition and leases, but notes it is unclear whether the Boards will achieve convergence on projects such as financial instruments and insurance contracts before the Commission makes a decision about IFRS. The Staff Paper notes that the Work Plan expected the Joint Projects and related conclusions to be factors in the SEC's decision regarding incorporation of IFRS in the US.

How we see it

Neither of the papers indicates when the staff might make a recommendation to the Commission about incorporating IFRS in the US or what form any recommendation may take. We expect to hear more about this in the coming months.

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