

SEC Staff Paper explores a possible approach to incorporating IFRS

What you need to know

- ▶ The Staff Paper describes in more detail an approach for incorporating IFRS into the US financial reporting system that was first described by an SEC official as “condorsement”
- ▶ Under the approach, US GAAP would be retained and the FASB would incorporate IFRS into US GAAP during a transition period
- ▶ The FASB would incorporate newly issued or amended IFRSs following an endorsement protocol
- ▶ The SEC is seeking comments on this and other approaches for incorporating IFRS by 31 July 2011. A roundtable is scheduled for 7 July 2011

Overview

The staff of the Securities and Exchange Commission (SEC) has published a Staff Paper¹ outlining a possible approach for incorporating IFRS into the US financial reporting system. This approach was first described by Deputy Chief Accountant, Paul Beswick, in December 2010 colloquially referred to as “condorsement”.

The approach would establish an endorsement protocol for the Financial Accounting Standards Board (FASB) to incorporate new or amended IFRSs into US GAAP. During a defined transition period (e.g., five to seven years), the FASB would eliminate differences between IFRS and US GAAP through standard setting.

The staff notes that this approach is one of several ways that IFRS could be incorporated into the US financial reporting system and that the SEC has not yet decided whether to move ahead with incorporation. SEC Chairman, Mary Schapiro, has indicated the SEC expects to make this decision in 2011.

The SEC expects to make a decision in 2011 on whether, and if so, when and how to incorporate IFRS into the US financial reporting system.

¹ The SEC staff paper, *Exploring a Possible Method of Incorporation*, was released on 26 May 2011 and is available at <http://sec.gov/spotlight/globalaccountingstandards/ifrs-work-plan-paper-052611.pdf>.

Background

The SEC staff has been studying issues outlined in its 2010 Work Plan² to help the Commission decide whether, and if so, when and how to incorporate IFRS into the US financial reporting system.

As noted in the staff's October 2010 Progress Report³ on its Work Plan and again in the Staff Paper, other jurisdictions have generally incorporated or intend to incorporate IFRS into their reporting requirements for listed companies by either: (1) full use (without intervening review) of IFRS as issued by the IASB; or (2) use of IFRS after a national or multinational incorporation process, which could lead to the full use of IFRS as issued by the IASB or to a local variation of IFRS. Note that local variations of IFRS would not constitute compliance with IFRS as issued by the IASB.

Jurisdictions using a national incorporation process generally have either converged their local standards with IFRS without fully incorporating IFRS (the convergence approach) or they have endorsed IFRS by incorporating individual IFRSs into their local standards (the endorsement approach). In his speech in December, Mr Beswick proposed combining these two approaches.

Framework

The staff notes that the following approaches for incorporating IFRS have been discussed:

- ▶ Full adoption of IFRS on a specified date without any endorsement mechanism
- ▶ Full adoption following a transition period
- ▶ An option for US issuers to apply IFRS

And

- ▶ Continued convergence of US GAAP with IFRS

The SEC staff believes the approach described in its paper could achieve the goal of a single set of high-quality accounting standards and could minimise the cost and effort needed to incorporate IFRS into the financial reporting system for US issuers. Under this possible framework, the FASB would be retained as the US standard-setter and IFRS would be incorporated into US GAAP during a transition period of, for example, five to seven years. At the end of this period, the objective would be that a US issuer compliant with US GAAP should also be able to represent that it is compliant with IFRS as issued by the IASB. Following the transition period, the SEC staff envisages the roles of the FASB and the SEC and their constituents as follows:

Role of the FASB in the US

The SEC staff believes the US should play an active role in international standard-setting, proactively identifying financial reporting issues and ensuring that US interests are addressed. The staff believes the FASB would be best suited to fill this role. The staff envisages the FASB participating in the development of IFRS, rather than focusing on developing or modifying US GAAP.

The Staff Paper describes the FASB's role in international standard setting as:

- ▶ Providing input and support to the International Accounting Standards Board (IASB) in standards development
- ▶ Advancing the consideration of US perspectives
- ▶ Incorporating IFRS into US GAAP through an endorsement process
- ▶ Educating US constituents about IFRS

² The SEC staff's Work Plan is available at <http://www.sec.gov/rules/other/2010/33-9109.pdf>.

³ The SEC staff's Progress Report is available at <http://www.sec.gov/spotlight/globalaccountingstandards/workplanprogress102910.pdf>.

In the endorsement process, the FASB would have the authority to modify or add to the requirements of IFRSs. However, the staff said it expects modifications to be rare. Any modifications would be subject to an established protocol, which could consider whether a standard meets an established threshold (e.g., a threshold that considers the public interest and the protection of investors). The FASB would also retain the authority to add supplemental or interpretive guidance to US GAAP as needed.

Role of the SEC

The SEC would continue to oversee the FASB and would actively follow – but not directly oversee – the IASB’s standard-setting activities. The staff notes that, under any incorporation approach, the SEC would continue to be responsible for protecting investors, maintaining fair, orderly and efficient markets and facilitating capital formation. The SEC would therefore maintain its authority to prescribe accounting principles and standards for US issuers. However, the staff would expect to issue guidance or interpretations infrequently to avoid conflict with IFRS.

Role of US constituents

To ensure that US constituents have a voice in the IASB’s standard-setting process, the staff says they would have to engage with the IASB, as they now do with the FASB. While the FASB would continue to operate and would work with the IASB, individual constituents should not rely on the FASB’s interaction with the IASB to ensure that their opinions are heard.

Transition to IFRS

The Staff Paper describes a possible transition period during which current US guidance would be replaced with the guidance in IFRS. IFRS would be fully incorporated into US GAAP following an implementation programme developed and executed by the FASB, under the oversight of the SEC. The paper discusses possible transition plans for three categories of standards.

MoU projects

The FASB and IASB plan to complete certain joint projects described in the Memorandum of Understanding (MoU) in 2011. The Staff Paper assumes that the projects will result in reasonably converged standards.

IFRSs subject to standard setting

The FASB would identify IFRSs expected to be issued or significantly modified in the near term. The FASB would participate in the IASB’s standard-setting process for these standards, and US GAAP in these areas would remain unchanged until the IASB issues new or modified standards. The FASB would review the new or modified standards to assess how to incorporate them into US GAAP.

IFRSs not subject to standard setting

The FASB would first assess IFRSs that are not subject to standard-setting for incorporation into US GAAP. The FASB would then determine whether these IFRSs should be incorporated into US GAAP at the same time or whether they should be phased in. If the FASB chose to phase them in, the FASB would need to carefully manage the transition. The transition plan for these IFRSs would allow for prospective application when possible.

Benefits and risks

The Staff Paper describes the benefits and risks of this approach, including:

- ▶ The framework may allow for a flexible transition that is tailored to the needs of US constituents, but any benefits might evaporate if the transition plan is not well-developed, comprehensive and responsive to changing circumstances.
- ▶ The framework could provide a gradual transition that would cost less than incorporating all of IFRS at a point in time, but some US issuers may prefer full adoption or the option to adopt IFRS on a single date. A gradual transition also could be perceived as a lack of US commitment to IFRS and could potentially confuse US constituents during the transition period.
- ▶ The framework could provide greater investor protection than direct incorporation of IFRS. However, if modifications to IFRS are more than infrequent, the US would risk developing its own version of IFRS.
- ▶ The framework retains US GAAP as the basis of financial reporting for US issuers, which would be significant because of US laws, regulations and contracts that cite US GAAP.

How we see it

Many questions remain about how this approach would be implemented. The transition the staff envisages, for example, might conflict with the general premise of IFRS 1⁴, which requires companies to apply IFRS as if it had always been followed. Because of this requirement, it may be difficult for US issuers to meet the staff’s stated goal of asserting compliance with IFRS as issued by the IASB. Also unclear is how the FASB would determine what is in the best interest of the public and investors and what would happen if the FASB and the IASB cannot agree.

⁴ IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

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