

# Support grows for keeping US GAAP but basing future standards on IFRS

### What you need to know

- ▶ The SEC staff is developing a recommendation for the Commission while it finishes its IFRS Work Plan in the coming months.
- ▶ The current approach of joint deliberations to achieve convergence on a project-by-project basis is not a viable long-term option, politically or practically.
- ▶ There is strong support for retaining US GAAP as the statutory basis for US financial reporting and for a gradual transition incorporating international standards into US GAAP.

The SEC will not make a decision on whether and, if so, how IFRS could or should be incorporated into the US financial reporting system by the end of 2011.

### Overview

Representatives of the Securities and Exchange Commission (SEC), the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) discussed the incorporation of IFRS into the US financial reporting system at the AICPA National Conference on Current SEC and PCAOB Developments (the Conference) in Washington D.C. last week.

The highlights included:

- ▶ Representatives of the SEC and the FASB both said the timing of convergence is not as important as establishing a strong framework for high-quality global accounting standards.
- ▶ The chairmen of the IASB and the FASB both said the current approach of joint deliberations is not sustainable.
- ▶ Hans Hoogervorst (IASB Chairman) emphasised the importance of a single global accounting language as the capital markets around the world become more interconnected and interdependent.
- ▶ Hans Hoogervorst also acknowledged the legitimate concerns regarding the inconsistency of the application of IFRS around the world and said that consistent application can only be achieved with one single accounting language.
- ▶ Support seems to be growing for a framework like the endorsement approach described in a May 2011 SEC Staff paper. The Financial Accounting Foundation (FAF), which oversees the FASB, recently stated in a comment letter to the SEC that it supports that approach, with certain refinements.<sup>1</sup>

### Background

SEC Chairman Mary Schapiro said in 2010 that she expected the SEC to make a decision in 2011 on whether and, if so, how IFRS should be incorporated into the US financial reporting system. By then, the SEC was expected to have completed its Work Plan<sup>2</sup> and the IASB and the FASB (collectively, the Boards) were expected to have completed their priority convergence projects. However, the Boards have extended their timelines in response to comments from constituents.

<sup>1</sup> The FAF comment letter is available at [http://www.accountingfoundation.org/cs/ContentServer?site=Foundation&c=Document\\_C&pagenam e=Foundation/Document\\_C/FAFDocumentPage&cid=1176159309272](http://www.accountingfoundation.org/cs/ContentServer?site=Foundation&c=Document_C&pagenam e=Foundation/Document_C/FAFDocumentPage&cid=1176159309272)

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

The SEC's Work Plan is intended to help the Commissioners make a well-informed decision. Two recent Staff Papers, for example, compare US GAAP and IFRS and analyse the use of IFRS in practice around the world.<sup>3</sup>

In May 2011, an SEC Staff Paper<sup>4</sup> outlining a possible approach for incorporating IFRS in the US financial reporting system attracted a lot of attention. The approach, which was first described by Deputy Chief Accountant Paul Beswick in December 2010 as "condorsement," would establish an endorsement protocol for the FASB to incorporate new or amended IFRSs into US GAAP. During a defined transition period (e.g., five to seven years), the FASB would work to eliminate differences between IFRS and US GAAP through standard setting.

#### **Progress on convergence projects and IFRS Work Plan**

In his remarks at the Conference this week, SEC Chief Accountant James Kroeker said "... execution of the convergence projects and the results of that work are important as the staff considers the issue of incorporation of IFRS."<sup>5</sup> The FASB and the IASB initially had a goal of June 2011 to complete their major convergence projects, but they have extended their timelines in response to comments from constituents.

Mr. Kroeker emphasised that the speed of convergence efforts and potential incorporation of IFRS into the US financial reporting system was less important than the quality of standard setting and/or the framework for incorporation. In discussing delays in the major convergence projects, he said that "... instead of focusing on a few additional sands of time, I believe success should be, and ultimately will be, measured by the quality of the resulting output."

Mr. Kroeker also noted that the SEC staff has completed what he considers to be the majority of the "field work" related to the Work Plan but needs "a few additional months" to produce a final report. "At the same time, the staff is in the process of developing an approach for Commission consideration," he said. He added that given the number of issues on the SEC staff's agenda, he could not predict precisely when the final report would be issued. "But what I can tell you is we will do so carefully and thoughtfully, being guided by an ideal that produces the maximum benefits for the investing public and the capital markets," he said.

Mr. Kroeker added that timing was less important than ensuring that the SEC establishes a strong and lasting framework that:

- ▶ Demonstrates a high level of support for the US commitment to continued development and use of "consistent" high-quality global accounting standards
- ▶ Provides clear US authority over standards that apply in the US capital markets
- ▶ Provides for and facilitates a strong US voice in the process of establishing global accounting standards
- ▶ Is responsive to the economic and other impacts of change
- ▶ Considers whether to retain US GAAP as the basis for US financial reporting, thereby mitigating the costs and complexity of introducing a new set of standards under regulatory regimes, contractual documents and US laws under which compliance with US GAAP is often specifically contemplated.

<sup>3</sup> The recent SEC staff papers are available at <http://www.sec.gov/spotlight/globalaccountingstandards/ifrs-work-plan-paper-111611-gaap.pdf> and <http://www.sec.gov/spotlight/globalaccountingstandards/ifrs-work-plan-paper-111611-practice.pdf>. IFRS Developments Issue 19 provides a summary of these staff papers and is available at <http://www.ey.com/ifrs>.

<sup>4</sup> The SEC Staff Paper, Exploring a Possible Method of Incorporation, is available at <http://sec.gov/spotlight/globalaccountingstandards/ifrs-work-plan-paper-052611.pdf>. IFRS Developments Issue 4 summarises this staff paper and is available at <http://www.ey.com/ifrs>.

<sup>5</sup> SEC Chief Accountant James L. Kroeker's speech is available at <http://www.sec.gov/news/speech/2011/spch120511jlk.htm>.

"... we can only work towards consistent application if we have one single accounting language. If there is no global standard, consistency will always remain an illusion."  
- IASB Chairman Hans Hoogervorst"

### A 'single' set of high-quality global standards?

In remarks that he prepared for the Conference but did not deliver, the SEC's Mr. Beswick summarised the major themes from the feedback received on the May Staff Paper including strong support for the objective of a single set of high-quality globally accepted accounting standards with a general premise that an endorsement mechanism would be used to achieve this goal. He also noted that constituents believe "further progress should be made on the Boards' joint standard-setting projects before IFRS is incorporated into the U.S."<sup>6</sup>

Mr. Beswick wrote that many observers have asked whether a "single set" of accounting standards can be achieved if the FASB and the SEC retain the ability to deviate from an IASB standard. After noting that other jurisdictions have used an incorporation mechanism and that doing so might be challenging in the US, he wrote: "Would it (be) better to be 90% converged and understand the differences, or should the objective be abandoned?"

Respondents provided a "spectrum of views" as to the threshold that the FASB might use to consider whether to endorse an IASB standard, Mr. Beswick wrote.

IASB Chairman, Hans Hoogervorst said he believes the key to making a possible endorsement model work is "... setting an appropriately high threshold for endorsement. This ensures that any deviations are extremely rare. If we end up with non-endorsements and carve-outs left and right, the gains of adopting IFRS will remain elusive."

### How we see it

The SEC staff did not provide its views on what the threshold might be for consideration of whether to incorporate an international standard into US GAAP. We believe a framework for incorporating IFRS should address how an international standard would meet the needs of US investors rather than focus on a particular "threshold".

### The case for global standards - optional use of IFRS in the US

In his remarks at the Conference, Mr Hoogervorst emphasised how the world's capital markets have developed into a more interconnected and interdependent market in the past two decades, and a single reliable global accounting language is essential for the investors today. Currently, more than 100 countries require or permit the use of IFRS, including the majority of the G20.

In recognition of the challenges and significant pressures that the SEC faces in the process of making its decision, Mr. Hoogervorst urged the SEC to allow for an option for some large US companies to adopt IFRS. "From a global perspective, such a limited and early adoption to use IFRS would provide a clear signal of a US commitment to IFRS," he said.<sup>7</sup> While he acknowledged concerns about using two sets of accounting standards in the US, he said such an option could increase comparability if a company's competitors are using IFRS.

However, when questioned about allowing early adoption for certain companies, both Mr. Kroeker and FASB Chairman Leslie Seidman raised questions and concerns about the benefits of such an approach.

### FASB and IASB future joint convergence efforts

The lack of support for long-term convergence efforts was clear. Ms Seidman, in her remarks, noted that the FASB would like to work with the IASB to complete the priority projects on revenue recognition, leasing, financial instruments and insurance, but said "... we do not believe indefinite convergence is a viable option, politically or practically." Mr. Hoogervorst added that, while it is tempting to maintain the status quo, "... for the long term, the status quo is an unstable way of decision making that inevitably leads to diverged solutions or suboptimal outcomes."

Ms. Seidman and Mr. Hoogervorst nevertheless said the convergence process has been extremely useful both in improving both US GAAP and IFRS and moving them closer together.

### How we see it

Many questions remain about when the SEC will make a decision on whether and, if so, how IFRS will be incorporated into the US financial reporting system. Will the SEC wait until the major convergence projects are completed? Will the SEC proceed once the staff Work Plan is completed? What is clear is that there is strong support for an endorsement-type approach and the retention of US GAAP within the US.

<sup>6</sup> SEC Deputy Chief Accountant Paul A. Beswick's prepared remarks are available at <http://www.sec.gov/news/speech/2011/spch120511pab.htm>.

<sup>7</sup> The IASB Chairman Hans Hoogervorst's speech is available at <http://www.ifrs.org/Alerts/Conference/HH+speech+AICPA+6+Dec+2011.htm>

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