



## SEC Publishes IFRS Roadmap

*The proposed SEC IFRS roadmap is not final until approved by the full commission.*

November 14, 2008 — The Securities and Exchange Commission (SEC) published for comment its proposed roadmap outlining key activities that need to be completed before the SEC decides whether to require the adoption of International Financial Reporting Standards (IFRS) for U.S. filers. In this publication, the SEC acknowledged that IFRS as issued by the International Accounting Standards Board (IASB) “has the potential to best provide the common platform on which companies can report and investors can compare financial information.” According to the proposed roadmap, the SEC will evaluate progress against these milestones in 2011. At that time, it will decide whether to require mandatory use of IFRS as issued by the IASB, beginning in 2014, and whether to expand the group of companies permitted to adopt IFRS early. The proposed roadmap seeks feedback on whether or not the SEC should stage mandatory adoption based on market capitalization, with large accelerated filers required to file using IFRS in 2014, accelerated filers in 2015 and non-accelerated filers in 2016. The SEC will publish the proposal in the Federal Register in the next one to two weeks with a 90-day comment period.

### BACKGROUND

In August 2007, the SEC issued a Concept Release soliciting input on whether U.S. issuers should be permitted to prepare their financial statements using IFRS as published by the IASB. Based on the comments received, discussion during recent roundtables and pressure on U.S. market regulators, the SEC has steadily moved in the direction of mandatory filing by U.S. issuers under IFRS with an option for selected companies to adopt early. In February 2008, SEC Chairman Christopher Cox directed the Commission to develop a roadmap, including a series of rule-making efforts, to migrate U.S. issuers to IFRS. The roadmap provides the SEC, Public Company Accounting Oversight Board (PCAOB), Financial Accounting Standards Board (FASB) and other stakeholders with an outline of the key steps required for U.S. markets to make this transition. The SEC clearly states in the proposed roadmap that if an IFRS conversion were made, it favors mandatory adoption of IFRS by all U.S. filers as opposed to an extended period where filing is optional.

In addition, until recently, the United States has accepted financial statements prepared under IFRS, as long as the Foreign Private Issuer (FPI) reconciled financial information to U.S. GAAP in its SEC filings. At its November 15, 2007, meeting, the SEC voted to eliminate the reconciliation requirement, signaling to many that the SEC accepts that IFRS could be the “high-quality” accounting standards for financial reporting.

### KEY POINTS

#### SEC plan

The SEC plan outlines the overall approach for the mandatory adoption of IFRS by U.S. filers. Before mandating a transition date in 2014, the SEC will review progress against a series of

prerequisites in 2011. These milestones include:

- Improvements in accounting standards
- Accountability and funding of the IASC Foundation
- Improvement in the ability to use interactive data for IFRS reporting
- Education and training
- Limited early use of IFRS where this would enhance comparability for U.S. investors
- Anticipated timing of future rulemaking by the Commission
- Implementation of the mandatory use of IFRS

### **Proposed roadmap**

The proposed roadmap would require all U.S. public companies to file their financial statements using IFRS, beginning with financial statements ending on or after December 15, 2014. As noted above, the SEC is considering staging mandatory adoption of IFRS as issued by the IASB based on market capitalization.

The SEC indicated it is leaning toward requiring three years of comparable data. As the release states, “if we decide to move forward with rulemaking for the use of IFRS by U.S. registrants, we expect to continue to require that issuers provide three years of audited annual financial statements.”

In addition, under Item 301(a) of Regulation S-K, issuers must provide five years of selected financial data. As part of the proposal, the SEC is proposing to add a temporary instruction to Item 301 to clarify that an IFRS issuer shall present selected financial data, based on IFRS as issued by the IASB, with a transition provision to allow companies to provide three years of selected financial data in the MD&A section of the initial filing, four years in the subsequent year filing and five years thereafter.

In addition, the proposed roadmap would require entities subject to the Industry Guides that refer to U.S. GAAP pronouncements, should provide disclosure that satisfies the objective of the Industry Guide disclosure requirements based in IFRS.

The SEC also proposed to permit the early adoption of IFRS for companies that meet two criteria. First, IFRS would have to be the most-often-used set of standards by the 20 largest companies (worldwide) in an industry. Second, the entity must be among the largest 20 public companies by market capitalization in its industry. The roadmap notes that as IFRS adoption increases around the world, more and more industries would qualify as IFRS industries and, therefore, the number of U.S. companies qualifying to use IFRS would naturally increase. Eligible companies would be permitted to file financial statements based on IFRS for fiscal years ending after December 15, 2009. The SEC notes that the initial filing would have to be made at the end of an annual period (i.e., the initial filing could not be made for a quarter on Form 10-Q).

For those organizations that are eligible and choose to adopt IFRS on a voluntary basis, two alternatives for their initial filings have been proposed with respect to reconciliation to U.S. GAAP:

- 1) Provide a one-time reconciliation from GAAP to IFRS for the year of transition only in an audited footnote (consistent with IFRS 1, *First-Time Adoption of International Financial Reporting Standards*)
- 2) On an annual ongoing basis, provide three years of comparable financial statement information in the form of an unaudited reconciliation between U.S. GAAP and IFRS

The first highlights the reconciliation between U.S. GAAP and IFRS in an effort to assist investors in understanding the impact of applying the new standards. The second option provides U.S. filers that adopt IFRS early with the ability to revert to U.S. GAAP should the SEC decide to reconsider the mandatory use of IFRS.

Private companies are expected to follow by 2016-2018. While private companies are not within the SEC's jurisdiction, it is widely assumed that market dynamics will drive their rate of IFRS adoption. The pressure on private issuers to make the transition is likely to increase as IFRS-educated accounting graduates leave school, regulators embed IFRS into rules and banks become more proficient at using IFRS for credit decisions.

### **Improvements in accounting standards**

The SEC urges FASB to continue its convergence plan with the IASB as documented in the 2006 Memorandum of Understanding between the two Boards. FASB and the IASB are currently updating their convergence work-plan to make improvements to a series of pressing accounting issues. SEC Chief Accountant Conrad Hewitt has identified revenue recognition as one example of a pressing issue. An objective of the Boards is to issue identical standards in these specific areas in advance of the SEC's reconsideration of the progress made toward the milestones in 2011. The overall objective of the Boards is to converge the two sets of standards into one high quality, comprehensive set of standards.

### **Accountability and funding of the IASC Foundation**

Prior to the mandatory adoption of IFRS in the United States, the SEC hopes to see the IASB develop an independent funding mechanism. Currently, the IASB is funded by large international companies that use international standards. The SEC wants the funding to be independent – not coming from users of the standards – and sustainable.

IASB standards need to be developed in a robust and independent fashion that avoids jurisdictional modifications. The assumption is that a more robust standard-setting process will lead to greater acceptance of the standards and less localization. To that end, the IASB has proposed creating a monitoring group that would consist of representatives of securities regulators from around the world. The group would have the power to nominate board members and consult on rulemaking. SEC staff anticipates that these changes to IFRS governance will be completed over the next year.

The SEC also wants to work with foreign securities regulators to develop a process for endorsing international standards without modification. The SEC is working with other regulatory bodies such as the International Organization of Securities Commissions and the Committee of European Securities Regulators to monitor the consistent application of IFRS to understand those areas where divergence is occurring in practice.

### **Improvement in the ability to use interactive data for IFRS reporting**

The SEC also included in the roadmap a provision for filing financial data based on IFRS in an interactive data format, implying that mandatory filing of IFRS-based financial information will be done in an eXtensible Business Reporting Language (XBRL) format. The comment period on the proposed rule that would require organizations to file financial data in XBRL expired August 1, 2008. SEC staff members are currently analyzing the comments received, and are considering the IASB's progress in developing IFRS taxonomies before the SEC proceeds with final rulemaking on IFRS for all U.S. issuers.

### **Education and training**

The entire accounting education and certification process needs updating. The SEC noted it

has initiated conversations with the states and other industry bodies to incorporate IFRS content into the CPA exam. These are preliminary conversations according to the SEC staff.

The roadmap recognizes that many large, institutional investors are currently familiar with and use IFRS. It's assumed these stakeholders have both the means and desire to educate their employees. They will be able to review the early adopters' initial reconciliations between U.S. GAAP and IFRS and leverage that information to improve staff training.

### **Limited early use of IFRS where this would enhance comparability for U.S. investors**

The eligibility provision of the proposed roadmap is comprised of two elements, both based on the SEC's objective of identifying those categories of U.S. issuers for which the use of IFRS would promote comparability within a registrant's industry group. An organization would be eligible if IFRS were used as the basis of financial reporting more often than any other basis of financial reporting by the 20 largest listed companies worldwide within that organization's industry, determined as follows:

- 1) Determine the organization's industry by the North American Industry Classification System (NAICS) code at the three-digit level, the Standard Industrial Classification (SIC) codes at the two-digit level, or the International Standard Industrial Classification (ISIC) at the "division" level.
- 2) Then, determine whether IFRS is used as the basis of financial reporting more than any other basis of financial reporting by the 20 largest listed companies worldwide within its industry, first by identifying by market capitalization the 20 largest listed organizations globally within the industry, and then reviewing the published audited annual financial statements of those organizations to ascertain which standards were used to prepare the statements.

If a company qualifies for early adoption, it must file a request for no objection from the SEC. Assuming the SEC issues no objection, the registrant would have three years in which to file using IFRS before it would need to recalculate the determining measure and file the request with the SEC again.

The SEC estimates that approximately 110 U.S.-based companies will be eligible for early adoption of IFRS as issued by the IASB. In connection with the proposal for early adoption, the SEC is seeking comment on proposed amendments/modifications to Regulations S-X and S-K to accommodate the population of companies that will adopt early.

### **Anticipated timing of future rulemaking by the Commission**

The SEC believes that during the IFRS transition phase, several regulatory matters need to be addressed by the IRS, banking regulators and other state legislative bodies.

At FASB's IFRS implementation roundtable in June 2008, participants noted that financial institutions provide the Federal Deposit Insurance Corporation and other prudential regulators with financial information regarding the institution's safety and soundness based on U.S. GAAP. A transition to IFRS would affect banking regulatory-surveillance models, capital standards, prudential review filters, lending limits, etc. In setting standards, state and federal banking regulators must institute standards that are at least as stringent as U.S. GAAP.

In addition, SEC Chief Accountant Hewitt has noted in past discussions that the IRS will have to address the issue of the use of LIFO inventory valuation methods in the U.S. Currently, U.S. companies are allowed to use LIFO as an inventory valuation method under U.S. GAAP, which also enables them to use LIFO for U.S. tax purposes. IFRS does not permit the use of

LIFO, and as such, the mandatory transition to IFRS may also require companies to end the practice for tax purposes. The IRS will need to provide guidance on this issue.

## **IMPACT TO BUSINESSES**

Starting preparations for an orderly and staged approach to IFRS now allows companies to take advantage of the current time available and avoid the SOX-like fire drill the SEC hopes to avoid. Most accelerated filers completed their initial-year SOX efforts with a “just do it” mentality that left companies cleaning up messes and streamlining processes in ensuing years. The current timeline offers companies the opportunity to begin the journey toward IFRS in a different fashion — allowing them to control the timelines, resources and decision making and avoid the “under-the-gun” efforts that made SOX such a negative experience.

Companies should begin with a series of assessments. These include assessments to determine the impact to financial statements, organizational readiness, policy consistency, etc. Based on that information they can lay out a plan to train staff, develop and implement global policies, procedures and processes, and convert specific entities before making a final transition to IFRS for SEC reporting. All companies can begin preparations for the ultimate transition to IFRS by making investments to streamline those processes, technologies and controls affected by the ultimate transition to IFRS. The key is to begin readiness activities now and convert once the option to adopt IFRS is made available or mandated.

As companies initiate their analysis of the effects of IFRS, it is important to consider not only what the financial statements will look like, but also how IFRS affects the infrastructure used to obtain those financial statements. IFRS, and any optional timeline for implementation, provides finance leaders with a reason to re-examine and possibly simplify accounting policies, processes and technologies across the enterprise. Companies with an eye toward the future can leverage IFRS to build a truly efficient and flexible accounting infrastructure that streamlines cost, leverages global strengths and enhances enterprisewide decision making.

Now is the time to begin working with the audit committee, financial management and other stakeholders to begin preparing for this transition.

## **HOW JEFFERSON WELLS CAN HELP**

Jefferson Wells is a global provider of comprehensive financial reporting and technical accounting services, including research, documentation, ongoing SEC reporting compliance and knowledge transfer. Jefferson Wells can provide clients with the skills required to assess and implement IFRS – including:

- Technical accounting
- Project management
- Policy and procedure review and development
- Tax strategy and implementation
- Risk management
- Internal control assessment and implementation
- Continuous controls monitoring
- Business performance management
- Shared service center optimization
- Financial process improvement
- Technology planning

Because Jefferson Wells does not perform attest services, we are positioned to support issuers in making the transition to IFRS without conflict-of-interest issues.

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**For additional information, please contact your local Business Development Manager.**

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