

THE NEWSLETTER FROM BDO'S NATIONAL ASSURANCE PRACTICE

# BDO KNOWS: IFRS



## SEC STAFF PUBLISHES PROGRESS REPORT ON WORK PLAN FOR GLOBAL ACCOUNTING STANDARDS

### ► EXECUTIVE SUMMARY

On October 29, 2010, the SEC's Office of the Chief Accountant and Division of Corporation Finance published their first progress report on the Work Plan related to the implications of incorporating International Financial Reporting Standards ("IFRS") into the financial reporting system for U.S. Domestic issuers (the "Progress Report").

In the Progress Report the Commission indicated that following successful completion of the Work Plan and the convergence projects of the Financial Accounting Standards Board ("FASB") and International Accounting Standards Board ("IASB"), it will be in a position in 2011 to determine whether to incorporate IFRS into the U.S. Domestic financial reporting system.

The Commission states in the Progress Report that many of the Staff's efforts are currently in process and are not expected to be completed until 2011, particularly as they relate to consideration of the sufficient development and application of IFRS for the U.S. domestic reporting system and the independence of standard setting for the benefit of investors.

This Progress Report was the first update on the Staff's efforts and observations under the Work Plan and the Staff expects to continue to report periodically on the status of the Work Plan.

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## ► BACKGROUND

The Staff published the Work Plan in February 2010. The purpose of the Work Plan is to consider specific areas and factors relevant to a Commission determination in 2011 as to whether, when, and how our current financial reporting system for U.S. Domestic issuers should be transitioned to a system incorporating IFRS.

### The Work Plan addresses the following areas:

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 Staff developed the Work Plan based on its understanding of the environment at the time of publication, with the expectation that the Work Plan would be re-assessed and adjusted as new information was obtained, developments occurred, or constraints were encountered, with the intention of accomplishing each section's stated objective to the maximum extent possible.

## ► THE PROGRESS REPORT

The Progress Report issued on October 29, 2010, by the SEC's Office of the Chief Accountant and Division of Corporation Finance, summarizes the objectives of each section of the Work Plan and discusses the Staff's efforts and preliminary observations to date, as applicable. Many of the Staff's efforts are currently in process and are not expected to be completed until 2011, particularly as they relate to consideration of the sufficient development and application of IFRS for the U.S. domestic reporting system and the independence of standard setting for the benefit of investors.

### 1. Sufficient development and application of IFRS for the U.S. domestic reporting system

The Work Plan identified three components for an evaluation of whether IFRS is sufficiently developed and ready to be applied as the single set of globally accepted accounting standards for U.S. issuers: i) the comprehensiveness of IFRS; ii) the auditability and enforceability of IFRS; and iii) the comparability of IFRS financial statements within and across jurisdictions.

The Staff is considering each of these three components by analyzing: (1) IFRS as issued by the IASB and (2) IFRS as applied in practice.

In considering the written standards, the Staff is evaluating the sufficiency of development of IFRS by comparing it to U.S. GAAP. The Staff is performing this comparison to provide a context in which to frame its evaluation, rather than to establish a minimum threshold of development that must be met for the incorporation of IFRS into the financial reporting system for U.S. issuers. In light of the Boards' [FASB and IASB] efforts to converge IFRS and U.S. GAAP through the Memorandum of Understanding ("MoU")<sup>1</sup>, this comparison focuses on those areas that are unaffected by the Boards' MoU projects.

The Staff's working assumption is that the results of the MoU projects, if finalized in accordance with the spirit and objectives of the MoU, will satisfy its considerations in those particular accounting areas.

The Staff currently is identifying possible approaches to the incorporation of IFRS into the U.S. financial reporting system; analyzing how other jurisdictions incorporate IFRS into their reporting systems and address concerns regarding the sovereignty of capital market regulators, national standard setters, and other bodies responsible for setting accounting standards; and evaluating the effect of these approaches on the comparability of IFRS financial statements on a global basis.

To accomplish these objectives, the Staff is researching the financial reporting framework used in a sample of jurisdictions. These jurisdictions span six continents and encompass over 90 percent of world gross domestic product ("GDP"). The Staff is examining each jurisdiction's accounting laws and regulations, as well as public statements and press releases made by the jurisdiction's regulators and accounting standard setters. The Staff also is examining the World Bank's Reports on the Observance of Standards and Code (ROSC) – Accounting and Auditing and the United Nations Conference on Trade and Development's Practical Implementation of International Financial Reporting Standards: Country Case Studies on IFRS, as well as submissions by jurisdictions' professional accounting organizations to the International Federation of Accountants' Member Compliance Program.

<sup>1</sup> The Memorandum of Understanding ("MoU") was issued in 2006 (updated in 2008) by the FASB and IASB to set forth the relative priorities within the FASB-IASB joint work program in the form of specific milestones to be reached. For an updated listing of projects covered under the MoU, refer to: [http://www.fasb.org/cs/ContentServer?c=Document\\_C&pagename=FASB%2FDocument\\_C%2FDocumentPage&cid=1175801856967](http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1175801856967).

Based on the Staff's research to date, the majority of the Staff's sample of jurisdictions has incorporated or intends to incorporate IFRS either in full or to some extent into their reporting requirements for listed companies. However, the manner in which these jurisdictions incorporate IFRS into their financial reporting systems covers a broad spectrum of approaches.

Generally, jurisdictions have incorporated IFRS by either:

- (1) Use of IFRS as issued by the IASB or
- (2) Use of IFRS after some form of a national incorporation process, which could lead to the full use of IFRS as issued by the IASB or some local variation.

The first category could be viewed as representing the purest form of "adoption of IFRS." Under this first approach, countries make no changes to the standards issued by the IASB, because there is no mechanism to make a change. Based on the Staff's research thus far, a very small minority of the largest jurisdictions currently follows this approach.

The second category consists of countries that use IFRS after some form of a national incorporation process. In most cases, these jurisdictions have the objective of full IFRS adoption, but some jurisdictions following this approach have not necessarily adopted the standards as issued by the IASB or done so in the same periods, resulting in the potential for difference in application. A large number of jurisdictions in the Staff's sample use a version of this called the "Endorsed Approach" because this is the basis used by the European Union.

The Staff also has been examining the role of the national standard setter under the above approaches to further consider the existence of jurisdictional variations of IFRS and to identify potential roles for the FASB, should the Commission decide to incorporate IFRS into the financial reporting system for U.S. issuers.

The Staff has observed to date that the majority of these jurisdictions retain their national standard setter subsequent to incorporating IFRS into their financial reporting systems. In these cases, the national standard setter's ongoing role may involve, depending on the jurisdiction's approach to incorporation, converging local standards with IFRS, adopting IFRS standards after IASB issuance, issuing interpretations of IFRS for application in their jurisdiction, contributing to the IASB standard setting process, facilitating a dialogue between the IASB and constituents in their jurisdiction, and providing advisory assistance to the securities regulator in each jurisdiction, respectively.

The Staff has also observed that the national standard setter also may be involved in issuing standards for entities not required to apply IFRS, such as certain private companies, not-for-profit entities, and governmental entities, and for statutory reporting purposes.

## 2. The independence of standard setting for the benefit of investors

Pursuant to the Work Plan, the Staff is considering a number of components 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.

However, subsequent to the date of publication of the Work Plan, the Monitoring Board, which oversees the IFRS Foundation, committed to a review of its governance framework and that of the IFRS Foundation and, in doing so, has established a working group to conduct the review.

In light of the timing of the Monitoring Board's governance review, the Staff expects to perform a significant portion of the work on most of these components in early 2011.

The Staff has made preliminary observations on funding of the IFRS Foundation and in this regard, the Staff is considering approaches utilized by other jurisdictions; mechanisms used to fund the FASB; and other potential alternatives, as provided by relevant legal statutes, such as the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley Act").

The Staff's review thus far has shown that contributions to the IFRS Foundation are generated through several methods. Some countries contribute from the general funds of their financial sector regulators (e.g., securities commission, central bank, ministry of finance or equivalent body), stock exchanges, or national standard setters. In other countries, these bodies may assess a levy on listed companies and make their contribution from this assessment.

The Staff will continue to gather additional information about contribution alternatives, including the funding mechanisms used in other jurisdictions. For example, in several jurisdictions, the national standard setters may participate in efforts to develop contributions, either through a direct payment or by assisting with fundraising activities. Several other alternatives, such as creating a separate fee or authorizing the Commission to use appropriated funds to contribute to the IFRS Foundation and the IASB, could potentially require Congressional action. The Staff's consideration also will be informed by the legislative history concerning the funding mechanism established for the FASB, which appears to express a preference against mechanisms that could result in pressures on its standard setting, such as funding from contributions from the accounting industry or through direct Congressional appropriations.

### 3. Investor understanding and education regarding IFRS

The Staff is assessing U.S. investors' current familiarity with IFRS and how investors currently become educated about changes to accounting standards in order to assess the scope of, timing of, and approach to changes that would be necessary for effective incorporation of IFRS into the financial reporting system for U.S. issuers.

The Staff had previously issued a request soliciting public comment to aid in the Staff's analysis. The comment period ended on October 18, 2010, and the Staff is reviewing the input from the comment letters received and determining the nature of further public input. In addition, the Staff will consider whether further outreach with investors and others, including those who responded to the request for comment, would facilitate the Staff's understanding of investors' perspectives on these three components.

### 4. Examination of the U.S. regulatory environment that would be affected by a change in accounting standards

The Staff's assessment of the transitional considerations for regulatory regimes primarily will be performed through outreach to the various affected parties. These discussions have commenced with numerous regulators and will continue into 2011. Based on the outreach to date, the Staff has identified a consistent area of concern and focus for many regulators. That is, the method of any incorporation of IFRS is exceedingly important due to the prominence of "U.S. GAAP" references currently in U.S. laws, contractual documents, regulatory requirements and guidelines, and similar documents.

Therefore, regulators have expressed that if U.S. GAAP is the mechanism used for incorporation of IFRS into the financial reporting system for U.S. issuers, this would resolve a number of the more significant issues currently identified in the Staff's outreach.

### 5. The impact on issuers, both large and small, including changes to accounting systems, changes to contractual arrangements, corporate governance considerations, and litigation contingencies

The Staff is in the process of comparing IFRS to U.S. GAAP for non-MOU projects. Upon completion, the Staff intends to assess the extent of, logistics for, and estimated time necessary to undertake changes to issuer accounting systems, controls, and procedures.

The Staff intends to issue a request for comment seeking input that will facilitate its understanding of the time and effort necessary to undertake any changes to issuer accounting systems, controls, and procedures as they relate to non-MoU projects. The FASB separately has issued a discussion paper requesting comments on effective dates and transition issues associated with the MoU projects. This input will be incorporated into the Staff's analysis on potential transition methods. The Staff also intends to engage in constituent outreach in those jurisdictions that have previously incorporated IFRS to assess the magnitude of these changes.

The Staff also solicited public comment to aid in the Staff's analysis of the effects on contractual arrangements and corporate governance, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. Domestic issuers. The comment period ended on October 18, 2010, and the Staff is analyzing the input from the comment letters received and determining the nature of further public input.

The staff has stated that they will continue to review the effects on accounting and disclosure requirements for litigation contingencies, as well as obtain an understanding of the different impact on smaller issuers compared to larger issuers.

### 6. Human capital readiness

The Staff initially has determined that the assessment of human capital readiness is most efficiently conducted after the Staff has progressed further on the Work Plan.

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#### ►FOR MORE INFORMATION

For more information on the Progress Report, see the SEC's report at <http://www.sec.gov/spotlight/globalaccountingstandards/workplanprogress102910.pdf>

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