[buck research]

fyi® for your information®

Volume 31 | Issue 57 | September 5, 2008

SEC Proposes Roadmap for U.S. Companies to Adopt International Accounting Standards

In an August 27 press release, the Securities and Exchange Commission (SEC) agreed to release for public comment a proposed "roadmap" to mandatory adoption of International Financial Reporting Standards (IFRS) by U.S. companies. The roadmap sets forth several milestones that, if met, could lead to the permitted or required use of IFRS by U.S. companies in their SEC filings beginning in 2014. The SEC plans to assess in 2011 whether the milestones have been achieved and whether to move forward with transitioning to IFRS.

Background

Given the global nature of today's capital markets, the development of a single set of accounting standards for all business enterprises is considered essential to provide investors with greater comparability and transparency in financial reporting.

The International Accounting Standards Board (IASB) has issued a set of international accounting standards (IFRS) that are now required or permitted to be used in more than 100 countries (including all of Europe) for financial reporting. The Financial Accounting Standards Board (FASB), which is responsible for setting the standards that comprise U.S. Generally Accepted Accounting Principles (U.S. GAAP), committed in 2002 (and reaffirmed in 2006) to work toward a common set of high quality global standards. In November 2007, the SEC eliminated the requirement for foreign companies that are listed on U.S. exchanges to file a reconciliation between financial results prepared under IFRS and those that would be reported using U.S. GAAP.

The SEC has now proposed a plan ("roadmap") that could lead to the required use of IFRS by U.S. issuers in financial reports filed with the SEC.

Proposed Roadmap

In the proposed roadmap, the SEC will determine in 2011 whether its milestones have been satisfied and whether to proceed with mandatory adoption of IFRS by all U.S. registrants. These prerequisites include assurance that there is independent funding of the international standard setting organizations, and that there has been adequate education and training on IFRS in the U.S.

Under the roadmap, filers would need to adopt IFRS between 2014 and 2016, with larger filers having the earlier deadlines. Further, publicly-held companies that are among the 20 largest in their industry on a global basis would be permitted to adopt IFRS earlier (if IFRS is used more often than any other accounting basis by those 20 companies).

The SEC would decide on the rules that would apply in the initial year or years of adopting IFRS. The rules that apply to first-time adoption of IFRS generally require that the opening balance sheet upon IFRS transition be prepared on the assumption that IFRS had always applied (except for the limited exemptions granted by IFRS 1). The cumulative effect of the change in accounting methods is recognized in the earliest year presented in the financial statements for the year of adoption. Under current SEC rules, that earliest year is usually the second preceding year. So, for example, a company that would be required to adopt IFRS for its 2014 fiscal year may need to produce results reflecting IFRS starting in 2012.

Impact of Convergence

Significant differences in U.S. GAAP and IFRS accounting now exist, including requirements for employee benefit plans and stock-based compensation programs. The FASB and IASB have worked together over the last several years toward convergence of their accounting standards. In some cases, the Boards assigned major projects, such as changes to the reporting of financial performance, to teams that include members of both staffs. In other situations, the Boards have decided to take on projects such as accounting for employee benefit plans individually, but have closely monitored each other's progress and have, at times, focused on different aspects of the subject matter. The differences between IFRS and U.S. GAAP will likely narrow during the SEC-proposed timetable for adoption of IFRS, lessening the impact of the change to IFRS.

A change in accounting standards from U.S. GAAP to IFRS would have a broad-based impact on U.S. corporate financial statements, including disclosures of amounts relating to employee benefits and executive and equity compensation. Employee benefits are accounted for under many FASB statements, including FAS 87, 88, 106 and 132(R). Under IFRS, employee benefits would be accounted for under IAS19. For a discussion on the differences between accounting under U.S. GAAP and IFRS for executive and equity compensation, see our Insight Out.

Conclusion

The SEC proposal provides further evidence that securities regulators will designate IFRS as the worldwide basis for financial reporting. This would achieve greater comparability of financial results for investors and more efficient allocation of capital in the global economy. Thus, it is important for U.S. employers to familiarize themselves with the concepts of IFRS and the manner in which their financial reports would be affected if IFRS were to apply.

Buck's consultants would be pleased to discuss the convergence of accounting standards and the SEC proposal for conversion to IFRS, and the potential impact on your company's financial statements.

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.