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SEC Staff Issues Report on International Accounting Standards

On July 13 the Securities and Exchange Commission (SEC) released a report by its staff on the considerations for adoption of the International Financial Reporting Standards (IFRS) by U.S. companies. The staff offered no recommendations on possible decisions by the SEC about the direct use of IFRS by U.S. companies or alternative courses of action to incorporate IFRS into the U.S. accounting system. The SEC asked for comments on the report but did not set a deadline for their submission, nor did it set a timetable for future action.

Background

The development of a single set of high-quality accounting standards for all business enterprises has been considered essential to the goal of achieving comparability and transparency in financial reporting for investors. Progress has been made but much work remains to be done.

The International Accounting Standards Board (IASB) issued a set of international accounting standards (IFRS) that now are required or allowed 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 several times since) that it would work toward a common set of high-quality global standards. In November 2007, the SEC eliminated the requirement that foreign companies listed on U.S. exchanges file a reconciliation between the financial results prepared under IFRS and those that would be reported using U.S. GAAP. In August 2008, the SEC proposed a "roadmap" for the ultimate adoption of IFRS for U.S. entities that included milestones to be reached before such action would be taken. [See our September 5, 2008 *For Your Information.*] The SEC directed its staff in February 2010 to execute a work plan for conducting the research and outreach activities that would assist the agency in its decision-making process.

Highlights of the Staff Report

The report summarizes the work done by the staff under the February 2010 plan issued by the SEC. The staff's efforts included conducting research into the experiences of other jurisdictions that moved to incorporate IFRS into their system, reviewing financial statements prepared by foreign issuers reporting under IFRS and those issuers' relevant experiences, and soliciting comments from participants in the U.S. financial markets, including investors and companies of different sizes.

The following are some of the important points made in the report.

- The vast majority of participants in the U.S. capital markets do not support direct designation of IFRS as authoritative U.S. accounting guidance. Reasons for the opposition include the prospect of a loss of influence over future standard-setting decisions, concern over the significant cost and effort required for a company to move directly to IFRS, and the resulting need to change the references to U.S. GAAP embedded in laws, regulations, and private contracts.
- There is substantial support for finding other methods of incorporating IFRS into the U.S. system that would continue progress toward a single set of high-quality global accounting standards. Research into possible other methods became the focus of the staff's efforts. A report issued by the SEC in May 2011 discussed an endorsement approach that would have FASB work to converge U.S. GAAP with IFRS over a period of time.
- The standards issued by the IASB are generally perceived to be high-quality by the global community. The staff concluded that further development is needed in such areas as accounting for rate-regulated industries, insurers, and extractive industries.
- The IFRS Interpretations Committee (IFRIC) should try to address issues arising under current standards faster.
- The IASB should rely more heavily on national standard-setting bodies to access their particular expertise, to identify areas in which there is a need to narrow diversity in practice, and to assist with post-implementation reviews.
- The staff examined the statements prepared by entities in many countries and industries. It found that diversity in the application of IFRS presented difficulties in comparing the reported results. Some of the diversity was attributable to differences in the local standards themselves, different local interpretations of IFRS, different local law or regulations, and different options permitted within IFRS.
- The entity that provides funding for the IASB is a private, nonprofit organization that cannot require or compel funding. It failed to obtain the budget obligation allocated to the U.S. The staff is concerned that the approach to funding the work of the IASB relies too heavily on the contributions of large accounting firms.

Not in the Staff Report

The report did not address several issues of great interest to those who have been following the matter over these years. Contrary to their expectations, no recommendation was made as to:

- The ultimate decision to be made by the SEC, i.e., whether IFRS should be established as authoritative guidance for financial reporting in the U.S.
- Whether an alternative procedure consisting of endorsement by the FASB of the IFRS over a period of time as several other jurisdictions have done should be supported

- Whether to abandon the goal of a single set of high-quality accounting standards.

Also absent from the report was any analysis of a program of voluntary adoption of IFRS by U.S. companies. Such a program might be supported by large multinational firms who participate in capital markets on a global basis and must issue reports that comply with IFRS to meet foreign regulatory requirements.

Update on Accounting for Employee Benefits

The FASB and IASB once expressed a desire to work together on improving the standards governing accounting for employee benefits; however, they continue to address emerging issues separately and then react to one another's conclusions. The IASB responded to the FASB's Statement of Financial Accounting Standards No. 158 (FAS 158) with amended International Accounting Standard 19 *Employee Benefits* (IAS 19) and now IFRIC is looking at accounting for cash balance plans because the IASB did not address the subject in the new IAS 19. And just as the SEC's staff did not commit to a timetable for further work on the incorporation of IFRS into U.S. GAAP, the FASB has no current plans to review the work of the IASB on its amended standard for employee benefits, and the FASB and IASB have not indicated when they may start a joint effort to review the fundamental principles that should form the basis for such accounting.

In Closing

The FASB and IASB continue their work on a number of important joint projects listed in their Memo of Understanding that should result in a narrowing of differences between the standards. Progress has been slow, however, and self-imposed deadlines for completion have been periodically extended. The SEC has not indicated when it will resume its discussion of how to best to incorporate IFRS into the financial reporting system for U.S. companies. Many now anticipate, in light of the pending changes in the group of commissioners, that further discussion and research will not begin until 2013, with the implementation of any decisions coming several years thereafter.