



## SEC Publishes IFRS Roadmap

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

August 27, 2008 — The Securities and Exchange Commission (SEC) proposed a roadmap outlining key activities that need to be completed before the SEC requires the adoption of International Financial Reporting Standards (IFRS) for U.S. filers. 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 International Accounting Standards Board (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 issue the proposal in the Federal Register in the next one to two weeks with a 60-day comment period.

In addition to proposing a roadmap for the adoption of IFRS, the SEC voted to finalize rules that modernize specific foreign registration requirements and processes. These include:

- allowing foreign filers to take an automatic 12(g) exemption if the company's primary trading market is foreign and disclosure is provided in English on the Internet or via another electronic delivery mechanism
- determining foreign private issuer (FPI) eligibility on the last business day of the second fiscal quarter
- increasing FPI disclosures
- reducing the filing deadline for form 20-F from six months after the end of the fiscal year to four months after the end of the fiscal year
- providing guidance regarding cross-border tender offers and business combinations

### 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 rulemaking 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 proposed roadmap continues to move

U.S. financial markets toward the goal of greater integration of global financial markets.

In addition, until recently, the United States has accepted financial statements prepared under IFRS, as long as the FPI reconciled 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 IFRS as a “high-quality” accounting standard.

## KEY POINTS

### SEC plans

The roadmap’s key elements include:

- Identification of the companies allowed to adopt IFRS early
- Prerequisites to SEC action in 2011 to maintain a mandatory transition date in 2014, including:
  - Improving specific accounting standards
  - Improving the structure and funding of the IASB
  - Facilitating the use of interactive data under IFRS
  - Updating the education and licensing of U.S. accountants
  - Evaluating the early adoption experiences of a limited group of companies
  - Timing of future rulemaking
  - Sequencing of companies required to use IFRS

### Companies affected

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

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 in an entity’s industry. Second, the entity must be among the largest 20 public companies by market capitalization in its industry. The proposing release will contain a method for determining eligibility and a process for requesting a letter of no-objection to file using IFRS (as published by the IASB) from the SEC’s Division of Corporate Finance. Industry is defined by a company’s two-digit SIC code. The Commissioners noted 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. Qualifying companies would be permitted to file financial statements based on IFRS for fiscal years ending after December 15, 2009.

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 option highlights the reconciliation between U.S. GAAP and IFRS in an effort to assist investors in understanding the impact of applying the new standards. Commissioner Elisse B. Walter noted that 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.

### **Improving specific accounting standards**

The SEC's timeline also requires FASB to carry out its convergence plan with the IASB. FASB and the IASB are currently updating their convergence work-plan to make improvements to a series of seven or eight pressing accounting issues. SEC Chief Accountant Conrad Hewitt identified revenue recognition as one example of a pressing issue. The objective is for the Boards to issue identical standards in these specific areas in advance of the SEC's reconsideration of the progress made toward the milestones in 2011.

### **Improving the structure and funding of the IASB**

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. Chief Accountant Hewitt noted that many jurisdictions are currently instituting levy systems to provide secure and stable funding to the IASB and noted that "FASB was not independently funded until SOX [Sarbanes-Oxley]."

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 proposed creation of a monitoring group consisting 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 the endorsement of 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.

### **Facilitating the use of interactive data under IFRS**

The SEC also included the ability to file financial data based on IFRS in an interactive data format in the roadmap. It was noted that sufficient progress is being made on the IFRS data taxonomy and implied that mandatory filing of IFRS-based financial information will be done in an eXtensible Business Reporting Language (XBRL) format.

### **Updating the education and licensing of U.S. accountants**

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

that it has initiated conversations with the states and 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 that 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.

### **The timing of future rulemaking**

During the IFRS transition phase, several regulatory changes need to occur with 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.

Conrad Hewitt also noted during deliberations regarding the proposed roadmap 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 a SOX-like fire drill. 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 roadmap 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 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 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 attest to financial statements, 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 Business Development Manager.**

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