

July 13, 2012

Work Plan for the Consideration of Incorporating
International Financial Reporting Standards into
the Financial Reporting System for U.S. Issuers

Final Staff Report



OFFICE OF THE CHIEF ACCOUNTANT
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

This is a paper by the Staff of the U.S. Securities and Exchange Commission.
The Commission has expressed no view regarding the analysis, findings,
or conclusions contained herein.

Introductory Note

The following report was prepared by the staff of the U.S. Securities and Exchange Commission to summarize the observations and analyses of the staff regarding six key areas identified for study in the Work Plan for global accounting standards. The Commission directed the staff to develop and execute the Work Plan in February 2010. At that time, the Commission issued a statement indicating that the information obtained through the Work Plan, among other considerations, would aid the Commission in evaluating the implications of incorporating International Financial Reporting Standards into the financial reporting system for U.S. issuers.

The Commission believes it is important to make clear that publication of the Staff Report at this time does not imply—and should not be construed to imply—that the Commission has made any policy decision as to whether International Financial Reporting Standards should be incorporated into the financial reporting system for U.S. issuers, or how any such incorporation, if it were to occur, should be implemented.

Although the Staff Report is constructive and an important contribution, the Work Plan did not set out to answer the fundamental question of whether transitioning to IFRS is in the best interests of the U.S. securities markets generally and U.S. investors specifically. Additional analysis and consideration of this threshold policy question is necessary before any decision by the Commission concerning the incorporation of IFRS into the financial reporting system for U.S. issuers can occur.

The Staff Report has not been approved by Commission action and does not necessarily reflect the views of the Commission or any Commissioner.

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Table of Contents

I.	Executive Summary	1
A.	Methodology	2
B.	Focus of the Staff’s Work	2
C.	Summary Findings	4
1.	Development of IFRS	4
2.	Interpretive Process	4
3.	IASB’s Use of National Standard Setters	5
4.	Global Application and Enforcement	5
5.	Governance of the IASB	5
6.	Status of Funding	6
7.	Investor Understanding	6
II.	Sufficient Development and Application of IFRS for the U.S. Domestic Reporting System	7
A.	Summary Observations	7
B.	Comprehensiveness of IFRS	8
1.	The Boards’ MoU and Other Joint Projects	10
2.	Standards with a Similar Objective, that Are Substantially Converged, or Both	13
3.	Fundamental Differences	14
4.	Industry Guidance	17
C.	Comparability Within and Across Jurisdictions	21
1.	Staff Analysis of IFRS in Practice	22
2.	Formal Interpretative Process	25
D.	Auditability and Enforceability	25
1.	Principles versus Rules	27
2.	Effect of Audit Firm Structure on Comparability	28
3.	Enforcement and Compliance	29
4.	International and Other Regulatory Bodies	32
III.	Independent Standard Setting for the Benefit of Investors	34
A.	Summary Observations	35
B.	Overview of the IASB’s Governance Structure	36
C.	Background on IFRS Foundation Trustee and Monitoring Board Reviews	37
1.	Trustees’ Strategy Review	37

	2.	Monitoring Board’s Governance Review	38
D.		Oversight of the IFRS Foundation.....	39
	1.	Current State of Governance Structure	39
	2.	Composition of the Monitoring Board.....	40
	3.	Monitoring Board Observers	40
	4.	Role of Application of IFRS and Funding in Monitoring Board Membership	41
	5.	Role of the Monitoring Board in Selection of Trustees.....	42
	6.	Role of the Monitoring Board in the IASB’s Standard-Setting Process...	44
E.		Composition of the IFRS Foundation and the IASB	45
	1.	IFRS Foundation Trustee Composition and Duties	45
	2.	IFRS Foundation Trustee Selection Process.....	47
	3.	Trustee Involvement in the Standard-Setting Process	47
	4.	Composition of the IASB.....	50
F.		Funding of the IFRS Foundation	52
	1.	Four Characteristics of a Funding Approach	52
	2.	Funding of the FASB	54
	3.	Monitoring Board Role in Funding.....	55
	4.	Approaches in Other Jurisdictions to Contribute to the IFRS Foundation	56
	5.	Contributions by the Large Accounting Firms	57
	6.	Funding from the United States	58
G.		IASB Standard-Setting Process	58
	1.	Focus of the Staff’s Review	58
	2.	IASB’s Standard-Setting Process	59
	3.	Pre-eminence of Investors — IASB’s Interaction with Investors	61
	4.	Timeliness	63
	5.	Objectivity.....	66
	6.	Observations on IASB’s Standard-Setting Process	68
IV.		Investor Understanding and Education Regarding IFRS.....	71
A.		Summary Observations	72
B.		Current Awareness and Knowledge of IFRS.....	74
C.		Investor Education Regarding Accounting Standards and Changes in Accounting Standards	75
D.		Investor Preparedness for Incorporation of IFRS	76

1.	Current Preparedness	76
2.	Necessary Time and Activities Needed by Investors in Order to Transition Successfully to IFRS	77
3.	Investor Preferences with Regard to Transition.....	78
E.	Other Investor Views	79
1.	Global Accounting Standards	79
2.	Ongoing Role of the FASB.....	80
V.	Regulatory Environment.....	82
A.	Summary Observations.....	83
B.	Manner in which the SEC Fulfills its Mission.....	84
1.	Ongoing Role of the FASB.....	84
2.	Analysis of Changes to the Commission’s Rules and Guidance	88
3.	Analysis of Changes to Commission’s Ability to Issue, Interpret, or Enforce Accounting Standards	89
C.	Industry Regulators.....	89
1.	Regulators Currently Tend to Use U.S. GAAP	90
2.	Commission Incorporation of IFRS Would Impact Regulators	90
3.	Regulators’ Impressions of IFRS.....	92
D.	Federal and State Tax Impacts.....	93
E.	Statutory Dividend and Stock Repurchase Restrictions	95
F.	Audit Regulation and Standard Setting.....	96
G.	Broker-Dealer and Investment Company Reporting	97
H.	Public versus Private Companies.....	99
VI.	Impact on Issuers	103
A.	Summary Observations.....	104
B.	Accounting Systems, Controls, and Procedures	104
1.	Systems, Controls, and Procedures.....	106
2.	Stable Platform.....	108
C.	Contractual Arrangements	109
1.	Types and Pervasiveness.....	109
2.	Effects on Issuers	110
D.	Corporate Governance and Other Regulatory Compliance	113
1.	Corporate Governance	113
2.	Other Effects	115
E.	Accounting for Litigation Contingencies.....	116

F.	Smaller Issuers versus Larger Issuers	118
VII.	Human Capital Readiness	121
A.	Summary Observations	121
B.	Education and Training	122
C.	Auditor Capacity	123
	Appendix A, Exhibits A – I	127

I. Executive Summary

In the *Commission Statement in Support of Convergence and Global Accounting Standards*,¹ the U.S. Securities and Exchange Commission (“SEC” or “Commission”) directed the staff of the Office of the Chief Accountant of the SEC, with appropriate consultation with other Divisions and Offices of the Commission (collectively, the “Staff”), to develop and execute a work plan (“Work Plan”).² The Staff published the Work Plan in February 2010.³ The purpose of the Work Plan is to consider specific areas and factors relevant to a Commission determination as to whether, when, and how the current financial reporting system for U.S. issuers should be transitioned to a system incorporating International Financial Reporting Standards (“IFRS”).⁴

Since February 2010, the Staff has dedicated significant resources to executing the Work Plan. Throughout this process, the Staff’s understanding of the potential impact and the related costs and benefits of transitioning to a financial reporting system incorporating IFRS for domestic issuers has grown significantly. However, this understanding actually began a number of years ago and has continued in many forms.⁵ This final Staff paper (“Final Staff Report”) represents a summary of what the Staff has learned in the areas covered by the Work Plan regarding the potential impact of any incorporation of IFRS into the financial reporting system for U.S. issuers. The Final Staff Report, together with such other matters as the Commission may consider, will inform any Commission determination on whether to incorporate IFRS and provide transparency to the public related to the Staff’s findings and observations pursuant to the Work Plan. Regardless of the outcome of the Commission decision on whether to incorporate IFRS, the Staff expects that the SEC and other U.S. constituents will continue to be involved with the development or application of IFRS, or both. This involvement may take many different forms including the Staff’s review of filings of foreign private issuers that prepare their financial statements in accordance with IFRS, participation in International Organization of Securities Commissions (“IOSCO”), interactions with other securities regulators on accounting matters, and review and commentary on the International Accounting Standards Board’s (“IASB”) standards.

¹ See SEC Release No. 33-9109 (Feb. 24, 2010), Commission Statement of Support of Convergence and Global Accounting Standards [75 FR 9494 (Mar. 2, 2010)] (“2010 Statement”).

² See SEC Office of the Chief Accountant, Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers (“Work Plan”).

³ The Work Plan was attached to the 2010 Statement. See 2010 Statement at Appendix A.

⁴ As used in this Final Staff Report, the term “IFRS” refers to “IFRS as issued by the IASB,” unless otherwise noted. Further, the term “IFRS” refers to the authoritative text of IFRS, which, according to the IFRS Foundation’s Constitution, is published in English. See “International Financial Reporting Standards (IFRSs) as issued at 1 January 2010, Preface to International Financial Reporting Standards.” “IFRSs” refers to more than one International Financial Reporting Standard. Throughout this document, the Staff uses the term “incorporation of IFRS” and similar phrases. Unless otherwise noted, these phrases refer to the incorporation of IFRS into the financial reporting system for U.S. issuers.

⁵ See, e.g., SEC Release No. 33-7801 (Feb. 16, 2000), SEC Concept Release: International Accounting Standards [65 FR 8896 (Feb. 23, 2000)].

A. Methodology

In executing the Work Plan, the Staff gathered information using a variety of methods, including, but not limited to: performing research; seeking comment from market place participants; considering academic research; and researching the experiences both of other jurisdictions that have incorporated or have committed to incorporate IFRS into their financial reporting systems and of foreign private issuers that currently report under IFRS. In the Staff's outreach to constituents, the Staff worked to solicit views from constituents with diverse characteristics.⁶ For example, in response to the Staff's comment solicitations, it received input from a number of large issuers, but there was less feedback from investors and smaller issuers. To supplement the Staff's outreach in this area, the Staff held a roundtable focused on the concerns of investors and small issuers.⁷ The Staff has also periodically issued documents updating the public on the Staff's progress in executing the Work Plan.⁸

B. Focus of the Staff's Work

In execution of the Work Plan, the Staff considered a wide spectrum of options on whether and, if so, how to incorporate IFRS. The spectrum spanned from no action, to incorporating IFRS, to pursuing the designation of the standards of the IASB as "generally accepted" for purposes of U.S. issuers' financial statements. However, early in the Staff's research, it became apparent to the Staff that pursuing the designation of the standards of the IASB as authoritative was, among other things, not supported by the vast majority of participants in the U.S. capital markets and did not appear to be consistent with the methods of incorporation employed by the other major capital markets around the world. Accordingly, the Staff focused

⁶ The Staff, in August 2010, issued two requests for comment. One was directed towards issuers: Release No. 33-9134 (Aug. 12, 2010), Notice of Solicitation of Public Comment on Consideration of Incorporating IFRS into the Financial Reporting System for U.S. Issuers [75 FR 51148 (Aug. 18, 2010)] ("Issuer Comment Request"). The other was directed towards investors: Release No. 33-9133 (Aug. 12, 2010), Notice of Solicitation of Public Comment on Consideration of Incorporating IFRS into the Financial Reporting System for U.S. Issuers [75 FR 51150 (Aug. 18, 2010)] ("Investor Comment Request"). The Staff also issued for comment a staff paper on one possible mechanism for incorporating IFRS. See SEC Office of the Chief Accountant, Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers: Exploring a Possible Method of Incorporation: A Securities and Exchange Commission Staff Paper (May 26, 2011) ("2011 May Staff Paper").

⁷ See Roundtable on International Financial Reporting Standards (Jul. 7, 2011) ("SEC IFRS Roundtable"). The SEC IFRS Roundtable was composed of three panels on different topics: (1) investor understanding and knowledge of IFRS; (2) smaller public companies; and (3) regulatory environment. See Agenda for Roundtable on International Financial Reporting Standards, July 7, 2011 (available at: <http://www.sec.gov/spotlight/ifrsroadmap/ifrsroundtable070711-agenda.htm>). See also Transcript, July Roundtable ("SEC IFRS Roundtable transcript") (available at: <http://www.sec.gov/spotlight/ifrsroadmap/ifrsroundtable070711-transcript.pdf>).

⁸ Attached to this Final Staff Report as appendices are copies of the documents that the Staff has previously issued in connection with the Work Plan. See SEC Office of the Chief Accountant, Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers: Progress Report (Oct. 29, 2010) ("2010 Progress Report"). The Staff also issued two staff papers: one compared U.S. GAAP to IFRS; and the other analyzed the application of IFRS in practice. See *infra* notes 21 and 69, respectively.

on other methods of potential incorporation, such as an endorsement mechanism or continued convergence of accounting standards issued by the Financial Accounting Standards Board (“FASB”) and the IASB. The basis of the Staff’s decision to expand the focus of its efforts to methods beyond the idea of a potential designation of the standards of the IASB as authoritative principally considered the following three factors:

- Influence on Standard Setting. As noted in the 2010 Progress Report, very few jurisdictions provide for the use of standards issued by the IASB without measures to ensure the suitability of those standards. Rather, most jurisdictions generally rely on some mechanism to incorporate IFRS into their domestic reporting system. Mechanisms range from converging a jurisdiction’s standards to IFRS without necessarily incorporating IFRS fully into its national framework, to various forms of endorsement approaches whereby IFRSs are incorporated into the national framework on a standard-by-standard basis, if the newly issued IFRS standard passes some prescribed threshold. There may be a number of reasons why a jurisdiction has adopted a specific approach. The reasons can be more technical in nature (e.g., to comply with an existing regulatory environment) and, in other instances, stem from the jurisdiction’s desire to maintain some level of control over accounting standard setting for the jurisdiction. In addition, an endorsement process may allow a jurisdiction to exert more influence over the standard-setting process because the threat of a potential rejection of a proposed accounting standard may influence the IASB decision on the scope of the accounting standard, how to account for a particular transaction, or the timing of the completion of an accounting standard-setting project.
- Burden of Conversion. In executing the Work Plan, the Staff received feedback from issuers on the implications of moving directly to IFRS. The majority of the issuers expressed concern that moving directly to IFRS had the potential to result in significant expense to the company and confusion for investors. Many of the issuers indicated that the costs of full IFRS adoption easily could be among the most significant costs ever required from an accounting perspective and questioned whether the corresponding direct benefits would justify such a full-scale transition. Issuers frequently cited the level of effort of moving directly to IFRS, including reconsidering and updating existing accounting policies and procedures, investing in updates to or new information systems, redesigning internal controls, educating existing accounting staff, and educating investors about the changes to their accounting policies. The Staff recognizes that any incorporation of IFRS could not occur without some amount of cost and effort expended; however, the Staff further recognizes that methods of incorporation other than direct incorporation could lessen the total costs required while extending any timeframe for incorporation.
- Reference to U.S. GAAP. The Staff’s outreach to the industry regulators, the legal profession, and others confirmed its understanding that U.S. GAAP is embedded throughout laws and regulations and in a significant number of private contracts. The effort that would be required to change the references from U.S.

GAAP to IFRS as issued by the IASB would be significant, if not nearly impossible, at least in any near-term time horizon.

For these reasons, there appears to be relatively less support within the U.S. financial reporting community for the designation of the standards of the IASB as authoritative for use by U.S. issuers for domestic reporting purposes. However, the Staff found there to be substantial support for exploring other methods of incorporating IFRS that demonstrate the U.S. commitment to the objective of a single set of high-quality, globally accepted accounting standards while addressing some of the aforementioned concerns. Therefore, the Staff focused its efforts on other potential incorporation methods of IFRS.

C. Summary Findings

The remainder of this Final Staff Report focuses on the results of the Staff's work and observations from the Staff. Some of the more significant themes that emerged from the Staff's analysis are summarized below.

1. Development of IFRS

Since its inception, the IASB has made significant progress in developing a comprehensive set of accounting standards. The progress includes recent efforts by the IASB, in concert with the FASB, to improve the standards related to the convergence projects, including revenue recognition and lease accounting. The standards that are issued by the IASB are generally perceived to be high quality by the global financial reporting community. However, there continue to be areas that are underdeveloped (e.g., the accounting for extractive industries, insurance, and rate-regulated industries). By comparison, U.S. GAAP also contains areas for which guidance is in need of continued development (e.g., push-down accounting and government grants), but the perception among U.S. constituents is that the "gap" in IFRS is greater.

2. Interpretive Process

One of the important roles of any standard setter is the adequate maintenance of its standards. The IFRS Interpretations Committee ("IFRS IC") is the interpretative body of the IASB.⁹ The mandate of the IFRS IC is to review, on a timely basis, widespread accounting issues that have arisen within the context of current IFRSs and to provide authoritative guidance on those issues. However, the Staff's outreach both domestically and internationally indicates that the IFRS IC should do more to address issues on a timely basis. The IFRS Foundation, the governing body of the IASB, has recently implemented changes that may assist in addressing this concern, but the changes were only recently implemented, and it is unknown at this point whether they will be effective.

⁹ The IFRS IC is responsible for interpreting the application of IFRSs and providing timely guidance on financial reporting issues not specifically addressed in IFRSs. Draft and final Interpretations developed by the IFRS IC are ratified by the IASB before publication.

3. IASB's Use of National Standard Setters

In order to develop accounting standards that could be incorporated in multiple jurisdictions, the IASB needs to understand the intricacies of a number of distinct domestic reporting and regulatory systems. This challenge can be difficult in the best of circumstances. The IASB has a set of procedures for interacting with national standard setters on individual projects. In addition, a significant number of national standard setters meet with members of the IASB periodically to discuss accounting issues and current IASB projects. However, the IASB should consider greater reliance on national standard setters. The national standard setters could assist with individual projects for which they have expertise, perform outreach for individual projects to the national standard setter's home country investors, identify areas in which there is a need to narrow diversity in practice or issue interpretive guidance, and assist with post-implementation reviews.

4. Global Application and Enforcement

One of the perceived benefits of a single set of high-quality, globally accepted accounting standards is that investors can read a set of financial statements of any company, understand the financial results, and make comparisons to the results of other companies. However, in order to derive many of the key benefits of a single set of accounting standards, it is critical that those standards are applied and enforced on a consistent basis. The Staff conducted a review of financial statements prepared in accordance with IFRS to assess the consistency in application.¹⁰ The results of the Staff's review were consistent with its expectations and confirmed that, while the financial statements reviewed generally appeared to comply with IFRS, global application of IFRS could be improved to narrow diversity. Since IFRS is being incorporated into an increasing number of countries that will have perspectives about the application of IFRS, a greater emphasis will be placed on the Staff to work more cooperatively with regulators in other jurisdictions if IFRS is incorporated into the financial reporting system for U.S. issuers. An increased level of cooperation is important to allow regulators to share views on application and enforcement and, thus, foster global consistency. The Staff believes that the financial reporting community, including the SEC, can be a constructive influence on the consistent application and enforcement of IFRS.

5. Governance of the IASB

According to the Staff's assessment, the overall design of the governance structure of the IFRS Foundation appears to strike a reasonable balance of providing oversight of the IASB while simultaneously recognizing and supporting the IASB's independence. As is typical with a global organization, the IASB does not have a mandate to consider the establishment of standards with the focus of any single capital market. As it relates to considering the needs of U.S. investors and the U.S. capital markets, the Staff believes that it may be necessary to put in place mechanisms specifically to consider and to protect the U.S. capital markets—for example, maintaining an active FASB to endorse IFRSs.

¹⁰ The Staff published a paper documenting the results of its review. See *infra* note 69.

6. Status of Funding

The IFRS Foundation has made progress in developing a funding mechanism that is broad-based, compelling, open-ended, and country-specific. However, the IFRS Foundation is a private not-for-profit organization and ultimately has no ability to require or compel funding. Further, while the IFRS Foundation indicates that IFRS is used on some basis in more than 100 countries around the world, currently funding is provided to the IFRS Foundation by businesses, not-for-profits, and governments in fewer than 30 countries. Currently, the IFRS Foundation Trustees have been unsuccessful in obtaining the funding for the portion of the IASB budget allocated to the United States.¹¹ In theory, this shortfall should be somewhat offset by the services contributed to the IASB by U.S. sources, such as the FASB staff efforts on U.S. GAAP-IFRS convergence projects. The Financial Accounting Foundation (“FAF”) is committed to participating in discussions on the issue of funding from U.S. sources.¹² Notwithstanding the above observations, the Staff’s most significant concern about the funding approach is the continued reliance on the large public accounting firms to provide funds to the IASB.

7. Investor Understanding

The Staff has received helpful input from investors regarding how they participate in the standard-setting process. In the course of this outreach, the Staff observed that investor education on accounting issues and changes in the accounting standards is not uniform. The Staff understands that investors tend to rely generally on issuers, the large public accounting firms, and publications to understand recent changes to accounting standards. Regardless of the ultimate determination by the Commission as to whether to incorporate IFRS, the Staff will consider how investor engagement and education related to the development and use of accounting standards could be improved.

¹¹ See section III. for a discussion of the IASB governance structure, including the role of the IFRS Foundation and its Trustees, in general terms, and as it relates to funding responsibilities.

¹² See comment letter of the FAF on the 2011 May Staff Paper. The FAF is the parent organization of the FASB. (Commenters on the 2011 May Staff Paper cited throughout this document are identified in Appendix A: List of Commenters to the Summary of Comments on the 2011 May Staff Paper, which is attached as Exhibit E hereto (“Summary of Comments on the 2011 May Staff Paper”).)

II. Sufficient Development and Application of IFRS for the U.S. Domestic Reporting System

The 2010 Statement highlighted that the sufficient development and application of IFRS for the U.S. domestic reporting system was an important consideration in determining whether to incorporate IFRS.¹³ As noted in the Work Plan, the Staff believes that an evaluation of whether IFRS is sufficiently developed and applied to be the single set of high-quality, globally accepted accounting standards for U.S. issuers requires consideration of the following areas:

- The comprehensiveness of IFRS;
- The comparability of IFRS financial statements within and across jurisdictions; and
- The auditability and enforceability of IFRS.¹⁴

Based on its work to evaluate these three areas, the Staff has developed the observations described below.

A. Summary Observations

The IASB has made significant progress in improving the comprehensiveness of IFRS. The IASB has made improvements to IFRS through independent standard setting and through convergence efforts working with the FASB (together with the IASB, “Boards”). When the Commission issued the 2010 Statement, it was expected that the Boards would complete all of the joint projects on their Memorandum of Understanding (“MoU”) agenda.¹⁵ To date, the Boards have completed, either wholly or partially, a number of their joint projects, and they are continuing to work toward completion of certain of the remaining projects. However, there are several projects that both Boards acknowledge are in need of improvement, but the Boards are not currently devoting resources toward completion of those projects (e.g., financial instruments with the characteristics of equity). Further, IFRS is not comprehensive with respect to certain industries or types of common transactions (e.g., utilities). The absence of guidance may be problematic for issuers in certain U.S. industries for which financial reporting under existing U.S. GAAP standards provides users with more relevant information.

The increased incorporation of IFRS around the world appears to promote general comparability, particularly in relation to the alternative of comparing financial reports based upon local country accounting standards. Although the Staff found that financial statements it reviewed in executing the Work Plan generally appeared to comply with IFRS requirements, the Staff observed that the quality of preparers’ application of IFRS could be improved. In

¹³ See 2010 Statement.

¹⁴ See Work Plan.

¹⁵ See Boards, A Roadmap for Convergence between IFRSs and U.S. GAAP—2006-2008: Memorandum of Understanding between the FASB and IASB (Feb. 27, 2006) (available at: <http://www.ifrs.org/NR/rdonlyres/874B63FB-56DB-4B78-B7AF-49BBA18C98D9/0/MoU.pdf>).

particular, the Staff noted two themes in its evaluation of the application of IFRS: (1) the transparency and clarity of IFRS financial statements could be enhanced, and (2) diversity in application continues to be a challenge to comparability. Further, while global comparability appears to be increased, it is much less clear whether, in the absence of local interpretative guidance, comparability is increased or diminished within a jurisdiction. However, these themes may not necessarily be presumed to indicate that IFRS is not a sufficiently comprehensive body of accounting standards.

To improve the quality of application of IFRS, improvements could be made to the IFRS IC's approach to issuing application guidance. Specifically, an increase in the IFRS IC's activity could promote more consistent application, thereby potentially increasing comparability. Further, in the absence of or as a means to supplement the IASB interpretative process, there may be a need for continuing guidance (interpretative or other) within the United States to foster further comparability among issuers filing in the U.S. capital markets. The Staff will continue to monitor the progress of the IFRS IC.

In addition, regulators are working to improve consistency in the application of IFRS and to reduce jurisdictional variations of IFRS. IOSCO and other regional bodies (e.g., the European Securities and Markets Authority ("ESMA")¹⁶) are contributing to consistency in application through greater international coordination.¹⁷ The Staff is committed to working with the IASB, other securities regulators around the world, and the accounting profession to improve consistency in the application and enforcement of IFRS on a global basis.

B. Comprehensiveness of IFRS

In the 2008 proposed "roadmap" for the potential incorporation of IFRS into the U.S. financial reporting system, the Commission stated that "IFRS is not as developed as U.S. GAAP in certain areas."¹⁸ The Work Plan stated further:

The Commission and commenters have noted limited IFRS guidance in two respects. First, IFRS lacks broad guidance for: (1) certain topical areas, such as accounting for certain common control transactions, recapitalization transactions, reorganizations, acquisitions of minority shares not resulting in a change of control and similar transactions, and the push down of a new accounting basis in an entity's separate financial statements; (2) certain industries, such as those related to utilities, insurance, extractive activities, and investment companies; and

¹⁶ ESMA succeeded the Committee of European Securities Regulators ("CESR") on January 1, 2011 as a result of Regulation (EU) No 1095/2010 of the European Parliament of the Council (Nov. 24, 2010) (available at: http://www.esma.europa.eu/system/files/Reg_716_2010_ESMA.pdf).

¹⁷ See, e.g., ESMA, Public Statement, Sovereign Debt in IFRS Financial Statements (Nov. 25, 2011) (available at: http://www.esma.europa.eu/system/files/2011_397.pdf).

¹⁸ See SEC Release No. 33-8982 (Nov. 14, 2008), Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers [73 FR 70816 (Nov. 21, 2008)] ("2008 Roadmap").

(3) disclosures in order to provide better transparency regarding the application of accounting principles.

Second, where IFRS provides broad guidance, the IASB, as a matter of operating practice, has elected to make guidance less detailed and prescriptive than U.S. GAAP.¹⁹

To assess the comprehensiveness of IFRS, the Staff compared the written standards of IFRS to the text of U.S. GAAP and identified differences between the requirements of the two sets of standards. The differences identified by the Staff represent the more notable differences between IFRS and U.S. GAAP, based on the Staff's observations, and do not comprise a comprehensive list of differences.²⁰ The results of the Staff's comparison were documented in a staff paper released in November 2011.²¹ The GAAP Comparison Paper also highlights those areas for which IFRS does not provide guidance, including the prevalence of industry-specific guidance that is contained within U.S. GAAP.

The Staff used a comparative approach in assessing the comprehensiveness of IFRS to provide a context in which to frame its evaluation of IFRS, rather than to establish a minimum threshold of development that must be met for any incorporation of IFRS into the financial reporting system for U.S. issuers. The Staff used U.S. GAAP specifically as its reference point because: (1) it is the body of standards that currently applies to U.S. issuers and from which investors would be required to adjust their analyses of U.S. issuers' financial statements; and (2) it enables the Staff to minimize its consideration of areas in which IFRS currently has the same or similar accounting requirements as U.S. GAAP, as those IFRS requirements are presumably of sufficiently high quality. As a result, the Staff's review was focused on identifying areas in which the requirements of IFRS and U.S. GAAP differ. This review did not include an analysis of the impact that those differences, individually or collectively, may have on the quality of IFRS, but rather evaluated the assertion by some commenters that IFRS is not sufficiently comprehensive to be suitable for the U.S. capital markets.²² Further, the Staff reviewed, but generally did not analyze, the U.S. GAAP and IFRS requirements that are subject to the joint standard-setting efforts of the IASB and the FASB.

¹⁹ Work Plan (internal citations omitted).

²⁰ There are many readily available, comprehensive comparisons of IFRS and U.S. GAAP prepared by private sector entities. Rather than duplicating that work, the Staff focused on the areas it considered to be more significant.

²¹ See SEC Office of the Chief Accountant, Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers: A Comparison of U.S. GAAP and IFRS: A Securities and Exchange Commission Staff Paper (Nov. 16, 2011) ("GAAP Comparison Paper").

²² Cf. Donna L. Street, Criteria for an Independent Accounting Standard Setter: How Does the IASB Rate (Jun. 2011) (study commissioned by Council of Institutional Investors ("CII") and attached to the comment letter of CII on the 2011 May Staff Paper) ("CII Study"). The CII Study's first criterion notes some "key areas" where it asserts that "fundamental deficiencies" exist.

The Staff focused on the differences between U.S. GAAP and IFRS at the principle level, in part to understand whether the nature of the information communicated to investors was significantly different if one set of standards was applied as opposed to the other. In comparing U.S. GAAP to IFRS in this manner, the Staff identified numerous instances that could result in the accounting for and disclosure of similar transactions differing. However, the differences may not necessarily be presumed to have a direct or consistent correlation to the quality of IFRS. Further, the differences between U.S. GAAP and IFRS are not meant to be determinative that their elimination would be necessary before any Commission consideration of the incorporation of IFRS. However, the existence of differences indicates a need for the Staff to consider specifically such differences to determine whether investors and other users of the financial statements would be losing or gaining significant informational content and to determine the effect on transitional considerations if IFRS were to be incorporated.

The differences identified in the GAAP Comparison Paper can be grouped into several broad categories. For example, certain differences may exist but the objectives of the guidance are similar, the standards have been substantially converged, or both. Other differences exist that are more fundamental in nature and could significantly impact information provided to investors. The following categories of differences are discussed further below:

- The Boards' MoU and Other Joint Projects;
- Standards with a Similar Objective, that Are Substantially Converged, or Both;
- Fundamental Differences; and
- Industry Guidance.

1. The Boards' MoU and Other Joint Projects

The Boards have long supported the development of high-quality, globally accepted accounting standards. Since committing to the "Norwalk Agreement" after their joint meeting in September 2002, the Boards have been working toward that goal jointly.²³ In the Norwalk Agreement, the Boards:

acknowledged their commitment to the development of high-quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. At that meeting, both the FASB and IASB pledged to use their best efforts to (a) make their existing financial reporting standards fully compatible as soon as is practicable and (b) to coordinate their future work programs to ensure that once achieved, compatibility is maintained.²⁴

²³ See Boards, Memorandum of Understanding: "The Norwalk Agreement" (Sept. 18, 2002) ("Norwalk Agreement") (available at: <http://www.fasb.org/news/memorandum.pdf>). The Norwalk Agreement represents the first formal agreement between the Boards to work together on high-quality accounting standards and outlines the objectives for their work together towards the international convergence of accounting standards.

²⁴ Id.

In February 2006, the Boards issued the MoU.²⁵ In the MoU, eleven areas of focus (“Major Joint Projects”) were identified by the Boards as joint projects comprising accounting topics that warranted improvement.²⁶ The Boards also identified areas where differences between U.S. GAAP and IFRS could be eliminated through short-term standard-setting projects by either the FASB or the IASB, or on a joint basis (“Short-term Convergence Projects”).²⁷ The MoU also outlined the progress the Boards expected to achieve by 2008.

In September 2008, the Boards provided an update to the MoU.²⁸ The Boards highlighted that, when they established the MoU in 2006, they agreed on priorities and set milestones only through 2008, while expecting that all of the Major Joint Projects would not be completed by 2008. The Boards also updated their 2008 timetable for the Major Joint Projects to set milestones for completion to be achieved by June 2011.

In June 2010, the Boards modified the milestones outlined in prior statements on the MoU progress.²⁹ These changes gave priority to Major Joint Projects that the Boards perceived were in most need of improvement and allowed for more effective stakeholder outreach to increase the quality of those standards (“priority Major Joint Projects”).³⁰ To enable this increased focus on the priority Major Joint Projects, the Boards elected to reduce focus on the remaining Major Joint Projects.³¹ Further, in a progress report released in April 2012, the Boards

²⁵ See supra note 15.

²⁶ The Major Joint Projects included: business combinations; consolidations; fair value measurement; financial instruments with characteristics equity; financial statement presentation (including other comprehensive income and discontinued operations); post-retirement benefits (including pensions); revenue recognition; derecognition; financial instruments; intangible assets; and leases.

²⁷ The Short-term Convergence Projects included: fair value option, investment properties, research and development, and subsequent events (FASB); income taxes and impairment (joint); and borrowing costs, government grants, joint ventures, and segment reporting (IASB).

²⁸ See Boards, Update to the February 2006 Memorandum of Understanding: A progress report and timetable for completion (Sept. 2008) (available at: http://www.fasb.org/intl/MOU_09-11-08.pdf). A similar statement was issued in November 2009. See Boards, FASB and IASB Reaffirm Commitment to Memorandum of Understanding (Nov. 5, 2009) (available at: <http://www.ifrs.org/News/Press+Releases/IASB+and+FASB+Reaffirm+Commitment+to+Memorandum+of+Understanding.htm>).

²⁹ See Boards, Joint Statement by the IASB and the FASB on their Convergence Work (Jun. 2, 2010) (available at: <http://www.ifrs.org/News/Announcements+and+Speeches/IASB+and+FASB+issue+statement+on+their+convergence+work.htm>). See also Boards, Progress Report on Commitment to Convergence of Accounting Standards and a Single Set of High Quality Global Accounting Standards (Jun. 24, 2010) (available at: http://www.iasb.org/NR/rdonlyres/A8B4D5B7-E776-4D80-BA54-17563F1E2297/0/MOU_Status_Update_24June_2010_FINAL.pdf).

³⁰ The priority Major Joint Projects included: financial instruments; revenue recognition; leases; presentation of other comprehensive income; fair value measurement; insurance contracts; and converging disclosures on derecognition and consolidation.

³¹ The remaining non-prioritized Major Joint Projects included: financial statement presentation (including discontinued operations); financial instruments with characteristics of equity; consolidations; and derecognition.

announced that they had extended their timetable for the remaining priority Major Joint Projects to mid-2013.³²

To date, the Boards have made progress on some of the priority Major Joint Projects and, for that, the Boards should be commended. However, work on these projects continues.³³ The Boards have, at times, struggled to reach converged conclusions in some areas, which has contributed to delays in project timing and, for several projects, to total suspension of efforts. The Boards' efforts have been further complicated by a number of challenges during the last several years, including a financial crisis and shifting priorities of investors and regulators. In an effort to minimize divergence caused by a variety of influences, the Boards have been deliberate in working together more closely, including increasing the frequency of the in-person joint Board meetings. There have been obvious and tangible benefits to the Boards working together to share ideas and deliberate issues together. However, through its outreach, the Staff has noted that the continued effectiveness of the Boards working jointly under the current structure is often cited as an area of concern.³⁴

The Staff has assessed, and will continue to assess, the Boards' progress and conclusions reached on the Major Joint Projects separate from its efforts on the Work Plan. Therefore, any analysis of the developing or completed standards related to the Major Joint Projects is separate from the Staff's efforts on the comparison analysis that were summarized in the GAAP Comparison Paper. The Staff's ongoing assessment of the Major Joint Projects includes monitoring the Boards' deliberations, reviewing exposure documents, and considering constituent comment letters, among other activities. The status of the Major Joint Projects and conclusions reached thereon remain factors, among many others, for the Commission to evaluate in its consideration of whether to incorporate IFRS into the financial reporting system for U.S. issuers.

Although the Boards have made significant progress related to a number of the Major Joint Projects, the extent of differences between U.S. GAAP and IFRS that exists today is greater than the Staff would have expected in 2010 when the Commission directed the Staff to embark upon the Work Plan. This has not led the Staff to conclude that consideration of incorporation of IFRS should be abandoned. Although not supporting abandonment, some commenters to the 2011 May Staff Paper expressed that the MoU should be completed before any decision is made by the Commission.³⁵ The Staff believes that due consideration should be given as to whether, in the absence of more fully converged standards, there are unique issues that should be considered to the extent that differences remain and whether there are any significant impediments to

³² See Boards, Joint Update Note from the IASB and FASB on Accounting Convergence, Note from IASB on Governance Enhancements (Apr. 5, 2012) (available at: http://www.financialstabilityboard.org/publications/r_120420d.pdf).

³³ A detailed description of the status of the Major Joint Projects can be found on the FASB and IASB websites. See FASB, FASB Technical Plan and Project Updates (available at: <http://www.fasb.org>). See also IASB, IASB Work Plan (available at: <http://www.ifrs.org>).

³⁴ See, e.g., SEC IFRS Roundtable transcript (comments of Gregory Jonas, Managing Director, Morgan Stanley).

³⁵ See, e.g., comment letters of Chevron; CSX; Dell; Emerson; and Intel on the 2011 May Staff Paper.

incorporation (including, but not limited to, (1) whether investors lose informational content and transparency in such non-converged areas, and (2) the impact on preparers from having to consider the additional remaining differences). The consideration of the unique issues could be accomplished in a number of ways, including through an endorsement mechanism whereby the FASB considers such differences, particularly when a more fundamental difference exists between the two sets of standards.

2. Standards with a Similar Objective, that Are Substantially Converged, or Both

In the GAAP Comparison Paper, the Staff noted a number of areas in U.S. GAAP and IFRS for which the standards have a similar objective, are substantially converged, or both. Some of these standards are converged as a result of the efforts of the Boards on MoU-related projects. Despite the similarities between the text of IFRS and U.S. GAAP, the Staff is not implying that the application of both standards would result in the same amounts or financial statement disclosures being reported to investors. Rather, the Staff would expect a change from U.S. GAAP to similar IFRS requirements to result in reported amounts and disclosures that are similar in nature to the information reported under U.S. GAAP. The following examples represent some of the more significant areas of similarity between IFRS and U.S. GAAP that were noted by the Staff.

Business Combinations

U.S. GAAP and IFRS contain similar principles and requirements for accounting for business combinations because of the collaborative efforts of the Boards in developing the current standards. However, certain differences continue to exist that could impact the recognition and measurement of certain transactions, including with respect to noncontrolling interests, contingent consideration, and common control transactions.³⁶

Debt

U.S. GAAP and IFRS have generally similar requirements for accounting for debt. Both standards require most financial liabilities to be measured at amortized cost on the balance sheet, with a fair value option available for qualifying instruments. The differences between the standards primarily relate to U.S. GAAP's provision of more arrangement- and industry-specific guidance than IFRS.³⁷

Share-Based Compensation

The guidance for share-based compensation transactions has largely been converged because of the Boards' collaboration. The overall objectives of both sets of standards are the same. However, the scoping of the standards is different, and there is an increased level of illustrative and application guidance under U.S. GAAP. These differences could give rise to

³⁶ For more information, see Section III.X of the GAAP Comparison Paper.

³⁷ For more information, see Section III.R of the GAAP Comparison Paper.

differences in classification, measurement dates, and expense recognition for transactions accounted for under IFRS as compared to U.S. GAAP.³⁸

Compensation – Excluding Share-Based Payments

U.S. GAAP and IFRS contain requirements for the accounting for and reporting of various compensation arrangements. The principle-level objectives of the standards are generally similar, with differences arising in some of the detailed requirements of the relevant standards.³⁹

Earnings Per Share

U.S. GAAP and IFRS contain similar requirements for calculating earnings per share. There are differences in the detailed requirements, which could result in differences in the amounts reported under U.S. GAAP and IFRS.⁴⁰

3. Fundamental Differences

In the GAAP Comparison Paper, the Staff noted the existence of some more fundamental differences between U.S. GAAP and IFRS. These differences exist for various reasons. First, in some cases, the Boards had different objectives in developing the standards—either because the Boards reached different conclusions about how best to communicate the economics of a transaction to investors or because the standards were developed at different times when the objectives of standard setting in general were different. Second, in some cases, standard setting that has occurred by one Board or the other in response to market or regulatory structures has resulted in differences in the standards (e.g., accounting for certain nonfinancial liabilities and last-in, first-out (“LIFO”) inventory costing). Third, in some instances, the differences were the result of anti-abuse protections developed in the United States (e.g., the accounting provisions for sales of real estate, as currently codified in Accounting Standards Codification (“ASC”) Subtopic 360-20). Finally, in some cases, although the standards’ objectives may appear to be similar, the underlying guidance diverges, resulting in differences that are more fundamental in nature. The following represents some of the more significant areas that were noted by the Staff. In some cases, the resolution of these differences will be individually challenging (e.g., removal of, or any change to, LIFO), and any attempt by the SEC or others to resolve these differences in a time period even as long as five to seven years may prove to be difficult.

Impairment

The impairment models for property, plant, and equipment (“PP&E”), inventory, and intangible assets are summarized in the GAAP Comparison Paper. For each of these topics, the impairment methodology for recognizing and measuring an impairment loss differs between U.S.

³⁸ For more information, see Section III.T of the GAAP Comparison Paper.

³⁹ For more information, see Section III.S of the GAAP Comparison Paper.

⁴⁰ For more information, see Section III.B of the GAAP Comparison Paper.

GAAP and IFRS. The IFRS models allow for reversals of impairments up to a certain amount if there is an indication that an impairment loss has decreased; whereas, the U.S. GAAP models preclude reversals of impairments. This distinction could result in differences in the timing and extent of recognized impairment losses. U.S. issuers could experience greater income statement volatility if the IFRS models were incorporated (flowing from recoveries of values previously written down).⁴¹

Certain Nonfinancial Liabilities

The recognition of certain nonfinancial liabilities (e.g., contingencies and environmental liabilities) is governed by the probability that a liability has been incurred under both U.S. GAAP and IFRS. However, U.S. GAAP and IFRS differ in their definitions of what is “probable.” For example, for contingencies, IFRS defines probable as “more likely than not to occur.” By contrast, U.S. GAAP defines it as “the future event or events are likely to occur.” “Likely” is considered to be a higher threshold than “more likely than not,” meaning U.S. GAAP has a higher recognition threshold than does IFRS. The effect of this difference is that, under IFRS, a liability often will be recognized earlier than under U.S. GAAP.

In addition, under U.S. GAAP, an obligation for a cost associated with exit or disposal activities generally is recognized in the period in which the liability is incurred. By contrast, costs may be accrued under IFRS at an earlier date—for example, when a restructuring is announced or commences. The lower threshold under IFRS for certain nonfinancial liabilities could lead companies to record provisions earlier under IFRS than they would have under U.S. GAAP.⁴²

Measurement of Certain Asset Classes

Under IFRS, certain assets (e.g., capitalized acquired intangibles and PP&E) are initially recognized at cost. For subsequent measurement, entities must make an accounting policy election by asset class to continue with a cost model or to revalue the assets within each class to fair market value (less any subsequent accumulated amortization or depreciation). U.S. GAAP precludes use of a revaluation model.

Under IFRS, an entity can also make an election to adopt either the fair value model or the cost model to account for investment properties.⁴³ U.S. GAAP generally only allows for the

⁴¹ For more information, see Sections III.K (PP&E), III.H (inventory), and III.J (intangible assets) of the GAAP Comparison Paper.

⁴² For more information, see Section III.P of the GAAP Comparison Paper.

⁴³ The FASB currently has a standard-setting project that was initiated to obtain convergence in this area. However, if the FASB’s project were finalized consistent with deliberations to date, differences would remain between IFRS and U.S. GAAP. See FASB, Exposure Draft, Proposed Accounting Standards Update – Real Estate—Investment Property Entities (Topic 973) (Oct. 21, 2011) (“IPE Exposure Draft”) (available at: <http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176157086783>).

cost model, unless the entity meets certain criteria.⁴⁴ The optionality permitted under IFRS could result in significant differences in the carrying value of assets as compared to U.S. GAAP.⁴⁵

Inventory

IFRS does not allow for the use of the LIFO costing methodology for inventory, which is permitted under U.S. GAAP. The Staff's research indicates that this difference could have a significant impact on the operating results and income taxes payable of certain U.S. issuers. With respect to income taxes, the Internal Revenue Service ("IRS") has conformity provisions such that certain methods of accounting are allowed for tax purposes only if the entity also uses that method for financial reporting purposes—LIFO is one such method subject to conformity provisions. Thus, absent a change in IRS rules, eliminating LIFO from U.S. GAAP would, in effect, eliminate its use for tax purposes as well. Several stakeholders have commented on this difference and the potential significant tax impact that eliminating LIFO would have on U.S. issuers.⁴⁶ The Staff believes that this difference is more of an issue of tax policy rather than of financial reporting, but the effect remains an element of the Staff's overall consideration of the incorporation of IFRS.⁴⁷

Research and Development

Costs for research and development activities are generally expensed as incurred under U.S. GAAP. Costs for research activities are expensed as incurred under IFRS, but costs for development activities that meet certain criteria are capitalized. This difference in expense recognition could potentially impact U.S. issuers and result in a change in the timing of recognition (e.g., capitalization of certain costs upon development and subsequent amortization of that asset over its useful life).⁴⁸

Income Taxes

U.S. GAAP and IFRS require income taxes to be accounted for using an asset and liability approach that recognizes both the current tax effects and the expected future tax consequences of events that have been recognized for financial or tax reporting (i.e., deferred

⁴⁴ Investment properties are recorded at fair value under U.S. GAAP in the following instances: (1) the entity determined that it is an investment company in accordance with ASC Topic 946; (2) the entity is controlled by a pension plan that is required to measure its investments at fair value; or (3) the entity follows industry practices that have developed over time allowing fair value measurement for real estate investments without regard to investment company attributes or pension plan ownership. These instances of fair value measurement were noted by the FASB staff in the IPE Exposure Draft.

⁴⁵ For more information, see Sections III.J and III.K of the GAAP Comparison Paper.

⁴⁶ See, e.g., comment letter of TLIFOC (the LIFO Coalition) on the 2011 May Staff Paper. The commenter noted that if U.S. issuers adopt IFRS they would be forced to violate the IRS conformity requirements. The LIFO Coalition requested the SEC to provide a carve-out for LIFO accounting, in the event the SEC decides to require U.S. issuers to adopt IFRS.

⁴⁷ For more information, see Section III.H of the GAAP Comparison Paper.

⁴⁸ For more information, see Section III.V of the GAAP Comparison Paper.

taxes) each period. However, certain fundamental differences exist. For example, IFRS does not specifically address the accounting for uncertain tax positions. Rather, the general contingency model is followed under IFRS. Leveraging the contingency model was historically the practice under U.S. GAAP as well; however, the FASB subsequently issued specialized guidance on this topic. These differences in methodology may result in differing outcomes under IFRS as compared to U.S. GAAP. The difference in methodology also necessitates different disclosure requirements for uncertain tax positions.⁴⁹

Property, Plant, and Equipment

Under IFRS, each part of an item of PP&E with a cost that is significant in relation to the total cost of the item is required to be depreciated separately (i.e., as if each part was a separate asset). This notion is frequently referred to as “asset componentization.” Under U.S. GAAP, an item of PP&E that has multiple parts is generally depreciated over a useful life attributed to the item as a whole. The approach required under IFRS is not precluded from use under U.S. GAAP; however, the Staff understands it is not an approach commonly applied currently by U.S. issuers. Further, the Staff’s research highlights that the approach required under IFRS for asset componentization could significantly impact issuers upon application of IFRS.⁵⁰

4. Industry Guidance

Commenters on the 2008 Roadmap and the 2011 May Staff Paper discussed the importance of certain industry-specific guidance in accounting standards.⁵¹ U.S. GAAP is a mature body of standards that has been specifically tailored to the needs of the business, reporting, and regulatory environment in the United States over its development. By contrast, the IASB has not historically issued industry-specific guidance, preferring instead that issuers use its generally-applicable (i.e., industry-neutral) principles.

Authoritative U.S. GAAP historically was developed from the collective efforts of various standard setters that served different purposes. The different types of standards issued—for example, FASB Statements, American Institute of Certified Public Accountants (“AICPA”) industry Audit and Accounting Guides, consensus positions of the Emerging Issues Task Force (“EITF”), and FASB staff implementation guidance (i.e., Q&As)—had different levels of authority, as prescribed by AICPA Statement on Auditing Standards No. 69, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*, and subsequently by FASB Statement No. 163, *The Hierarchy of Generally Accepted Accounting Principles*. The accounting guidance issued by several of these standard setters was intended to address industry-specific matters, particularly for situations in which the appropriate application of more general guidance was unclear or deemed to result in less relevant information for companies operating in certain industries. Although the FASB has since created a single source of authoritative U.S.

⁴⁹ For other examples and for more information, see Section III.W of the GAAP Comparison Paper.

⁵⁰ For more information, see Section III.K of the GAAP Comparison Paper.

⁵¹ See, e.g., comment letters of AGA; Ameriprise; API; Chevron; CMS; Duke; Exxon; FEI; IMA; PPL; Progress; SIFMA; Southern; Williams; TransCanada; and Zions on the 2011 May Staff Paper.

GAAP—in the ASC (or “Codification”)—the Codification nonetheless was compiled from the aforementioned historical standards that included specific guidance for many industry issues. By contrast, IFRS has been developed by a much smaller number of standard setters that generally have focused on developing principles that are to be applied by entities in all industries.

The amount of industry guidance impacts the comprehensiveness of IFRS in situations for which: (1) U.S. GAAP has a complete standard or series of standards intended to address the accounting within one particular industry and IFRS does not (e.g., U.S. GAAP has more fully-developed standards addressing insurance accounting); or (2) U.S. GAAP contains industry guidance for a specific transaction despite also containing a broadly-applicable (i.e., industry-neutral) standard. Several commenters on the 2011 May Staff Paper communicated concerns about how industry-specific guidance would be impacted by any incorporation of IFRS.⁵² Those commenters indicated that the guidance included in category (1) above has been beneficial to investors and preparers. In general, commenters on the 2011 May Staff Paper did not indicate as clearly whether the guidance included in category (2) is beneficial. In either case, the Staff believes that the industry guidance should not be removed from U.S. GAAP until the IASB has had the ability to evaluate fully the guidance for each particular industry, including performing outreach to investors, considering the effects of removing such guidance, and developing guidance, as appropriate, to the extent a void is identified in IFRS.

The remainder of this subsection discusses four of the most significant areas, based on feedback received by the Staff, for which U.S. GAAP provides industry-specific guidance and IFRS does not, and the impact that a transition to IFRS would have if the U.S. GAAP guidance is not retained. These areas are:

- utilities that engage in rate-regulated activities;
- oil and gas;
- investment companies; and
- broker-dealers.

Utilities that Engage in Rate-Regulated Activities

U.S. GAAP, as outlined in ASC Topic 980, *Regulated Operations*, permits a utility company to accrue assets or liabilities based on future cash inflows or outflows permitted or required by the utility’s regulator. The Staff notes that IFRS does not currently include a standard for rate-regulated activities and, therefore, may appear not to permit the recognition of rate-regulated assets or liabilities as does U.S. GAAP.⁵³ Several commenters expressed the need

⁵² See *id.*

⁵³ In 2009, the IASB published an exposure draft addressing rate-regulated activities (available at: <http://www.ifrs.org/Current+Projects/IASB+Projects/Rate+regulated+activities/Exposure+draft+and+Comment+Letters/Exposure+draft+and+Comment+Letters.htm>). In September 2010, the IASB concluded that it could not resolve the matter quickly and decided to develop an agenda proposal for consideration for its future agenda.

for rate-regulated guidance under IFRS because the results of such accounting is informative and important to investors' and other users' understanding of rate-regulated entities.⁵⁴ Other commenters noted that, if regulated entities were required to adopt IFRS, regulators could compel rate-regulated entities to maintain a second set of accounting records to account for rate-regulated assets.⁵⁵

Oil and Gas

U.S. GAAP and SEC guidance address financial accounting and reporting for activities related to exploration and production of crude oil and natural gas, and production of condensate and natural gas liquids. In addition to the U.S. GAAP requirements included in the Codification, SEC guidance contains provisions related to the full cost method of accounting for oil and gas contracts. IFRS 6, *Exploration for and Evaluation of Mineral Resources*, was developed by the IASB as an interim measure to allow (with some limitations) entities adopting IFRS to continue to apply their existing accounting policies for exploration and evaluation expenditures.

The IASB issued a discussion paper in 2010 on the accounting for extractive activities.⁵⁶ The Staff's research indicates that the approach outlined in the discussion paper differs from the accounting methods permitted by U.S. GAAP and the SEC.

Investment Companies

U.S. GAAP contains specific guidance for investment companies. In contrast, IFRS does not provide accounting standards or guidance specific to the investment company industry. Under IFRS, investment companies apply the same accounting standards followed by other companies. These standards may not clearly reflect the nature of investment companies' investing activities and operations. Under U.S. GAAP, investment companies generally measure all investments, including those in controlled entities, at fair value with changes in fair value reflected in earnings. U.S. GAAP does not require separate classification of the investments as required under IFRS (i.e., held to maturity, available for sale, or trading). This difference could

⁵⁴ See comment letters of AGA (citing Edison Electric Institute's White Paper on the topic, and noting the reduction of equity, increased volatility, increased non-GAAP measures, and increased cost of capital that a mass write-off could cause—all passed on to rate payers); CMS; Duke; FERC (“[T]he SEC and the FASB staff should carefully examine and propose accounting mechanisms, similar to the mechanisms in [FASB Statement No.] 71 that now allow regulatory accounting and GAAP to converge.”); PPL; Progress; Southern; TransCanada; Williams on the 2011 May Staff Paper.

⁵⁵ See comment letters of AGA and Duke Energy on the 2011 May Staff Paper.

⁵⁶ In April 2010, the IASB published a discussion paper titled *Extractive Activities*. See IASB, Discussion Paper DP/2010/1, *Extractive Activities* (Apr. 2010) (available at: <http://www.ifrs.org/NR/rdonlyres/735F0CFC-2F50-43D3-B5A1-0D62EB5DDDB99/0/DPEExtractiveActivitiesApr10.pdf>). As part of its agenda-setting process in 2012, the IASB plans to decide whether the Extractive Activities project should be added to its active agenda. If the IASB decides to add the project to its agenda, the project's objective would be to develop an IFRS on accounting for extractive activities that would supersede IFRS 6, *Exploration for and Evaluation of Mineral Resources*. Separately, on October 19, 2011, the IASB issued IFRIC 20, *Stripping Costs in the Production Phase of a Surface Mine*.

give rise to changes in the classification and measurement of investments under IFRS as compared to U.S. GAAP.

Moreover, IFRS does not currently require disclosures that are required by U.S. GAAP or Article 6 of Regulation S-X. For example, U.S. investment companies are required to disclose a schedule of investments and financial highlights, and to present separately the amount of net realized gains/losses and the change in unrealized appreciation/depreciation from investments. IFRS does not have these required disclosures; however, IFRS has other requirements generally not required under U.S. GAAP (e.g., a statement of cash flows).

The Boards are working on a joint project to address investment company accounting. Despite the joint efforts, the FASB and IASB separately issued exposure drafts in October 2011 and August 2011, respectively.⁵⁷ The Boards are jointly considering the feedback on both exposure drafts. The current exposure drafts are tentatively converged on many aspects of investment company accounting. However, if the Boards finalize the guidance contained in each exposure draft based on tentative decisions reached by each Board, differences would remain between U.S. GAAP and IFRS. The differences generally relate to the scope of entities that must apply investment company accounting, how an investment company would evaluate whether to consolidate another investment company, and whether investment company accounting would be retained in consolidation by a non-investment company parent.

Based on the Staff's research, it appears that U.S. investment companies believe that the current U.S. GAAP accounting and disclosure requirements more accurately present the investing activities and operations of investment companies to investors. One commenter on the 2011 May Staff Paper emphasized the importance of the exclusion of U.S. investment companies from any transition to IFRS,⁵⁸ while another requested that the FASB and SEC not rush to abandon the industry-specific guidance for investment companies.⁵⁹ Stakeholders commented that they did not believe converting investment companies to IFRS would advance the overall goal of global comparability that has been one of the main drivers of a single set of accounting standards.⁶⁰

⁵⁷ See IFRS, Investment Entities, Exposure draft on investment entities [Aug 2011] (available at: <http://www.ifrs.org/Current+Projects/IASB+Projects/Consolidation/IE/investment+entities+ED+Aug+2011/ED+and+comment+letters.htm>). See also FASB, Exposure Draft, Proposed Accounting Standards Update – Financial Services—Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements (Oct. 21, 2011) (available at: http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=1176157178020#%23).

⁵⁸ See comment letter of ICI on the 2011 May Staff Paper.

⁵⁹ See comment letter of SIFMA on the 2011 May Staff Paper.

⁶⁰ Specifically, ICI's comment letter on the 2011 May Staff Paper asserted that U.S. securities laws limit or discourage investment by U.S. persons in foreign funds and U.S. tax rules discourage foreign investment in U.S. investment companies. Therefore, there is limited cross-border sale of investment companies both in and out of the United States, such that investors generally do not have a need to compare a U.S. investment company using U.S. GAAP with a non-U.S. investment company using IFRS. Thus, transitioning U.S. investment companies to IFRS would not facilitate greater comparability.

The concern about converting investment companies to IFRS is not unique to the United States. For example, Canada provided an exception from incorporating IFRS for investment companies—largely because IFRS does not provide accounting guidance specific to that industry.⁶¹

Broker-Dealers

U.S. GAAP provides guidance for broker-dealers that is specific to the nature of the activities undertaken by broker-dealers and to their regulatory environment. By contrast, IFRS does not provide guidance specific to broker-dealers. Broker-dealers, like investment companies, measure investments at fair value, with changes recorded in earnings each reporting period. If broker-dealers were required to apply IFRS, they may be required to change the classification and measurement of investments held.

In addition, under U.S. GAAP, broker-dealers record all regular-way securities⁶² on a trade-date basis. IFRS permits broker-dealers an option of recording regular-way securities on a trade-date or settlement-date basis, which could result in more variability in the accounting for regular-way securities under IFRS. This difference can affect the calculation of metrics that are important to U.S. broker-dealers, including net capital and other regulatory metrics.

C. Comparability Within and Across Jurisdictions

The Commission remarked in the 2010 Statement that “[c]onsistent and high-quality implementation is necessary for investors to benefit from a set of high-quality global accounting standards.”⁶³ In the Work Plan, the Staff committed to “analyze for the Commission’s benefit the extent to which financial statements prepared under IFRS are comparable within and across jurisdictions. . . .”⁶⁴

The Work Plan specifically noted that the Staff will consider the comparability of financial statements prepared under IFRS by, among other things, analyzing factors that may influence the degree of comparability of financial statements prepared under IFRS on a global basis, and assessing the extent to which financial statements prepared under IFRS may not be comparable in practice and how investors manage these situations.⁶⁵

⁶¹ See CSA Staff Notice 81-320 (Revised), Update on International Financial Reporting Standards for Investment Funds (Mar. 23, 2011) (available at: http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20110323_81-320_update-on-ifrs.htm).

⁶² Regular-way securities trades are defined in the ASC Master Glossary as “contracts that provide for delivery of a security within the period of time (after the trade date) generally established by regulations or conventions in the marketplace or exchange in which the transaction is being executed.”

⁶³ See 2010 Statement.

⁶⁴ See Work Plan.

⁶⁵ See *id.*

1. Staff Analysis of IFRS in Practice

The Staff analyzed the fiscal 2009⁶⁶ annual consolidated financial statements of 183 companies, including both SEC registrants (foreign private issuers) and companies that are not SEC registrants, which prepare financial statements under IFRS.⁶⁷ The population reviewed comprised companies from 22 countries and 36 industries.⁶⁸ At the time of the project, 47 companies in the sample were SEC registrants, while another 29 companies previously had been SEC registrants.

The Staff documented its observations regarding the application of IFRS in practice in a Staff paper in order to inform the public of the Staff's Work Plan efforts and to provide the Commission with information to assist it in its future determination of whether and, if so, how, to incorporate IFRS.⁶⁹ The IFRS Application Paper was not intended to, and did not, compare the application of IFRS to the application of U.S. GAAP. Accordingly, similar observations may be present among companies reporting under U.S. GAAP. In addition, the observations in the IFRS Application Paper were not intended to be determinative as to whether or not IFRS is positioned for incorporation into the financial reporting system for U.S. issuers.⁷⁰

The Staff also included in the IFRS Application Paper observations from comments that the Division of Corporation Finance ("DCF") issued in its reviews of the most recent SEC filings of approximately 140 of the approximately 170 foreign private issuers⁷¹ that are registered with the Commission and that disclosed that they prepared their financial statements in accordance with IFRS as issued by the IASB.

⁶⁶ Generally, the most recent annual consolidated financial statements available at the time of the analysis were the fiscal 2009 financial statements for each of the companies. In light of the anticipated time frame for issuing a Staff paper with the analysis and findings and given the number of companies to be analyzed, the availability of financial statements, and the time needed to complete the analysis and synthesize the results, the Staff determined that fiscal 2009 financial statements would be used for purposes of the analysis.

⁶⁷ The 183 companies are the members of the Global Fortune 500 that prepare their financial statements in accordance with IFRS and for which English translations of the financial statements were readily available. The sample included financial statements prepared under IFRS (without qualifiers), IFRS as issued by the IASB, IFRS as adopted by the European Union ("EU"), and IFRS as adopted in Australia.

⁶⁸ Eighty-one percent of the companies were from the EU.

⁶⁹ See SEC Division of Corporation Finance, Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers: An Analysis of IFRS in Practice: A Securities and Exchange Commission Staff Paper (Nov. 16, 2011) ("IFRS Application Paper").

⁷⁰ See IFRS Application Paper for a further explanation of how the analysis was performed.

⁷¹ The 47 SEC registrants noted above to be in the sample of 183 companies that the Staff analyzed are also part of the 140 foreign private issuers reviewed.

In the IFRS Application Paper, the Staff found that company financial statements generally appeared to comply with IFRS requirements. This observation, however, should be considered in light of the following two themes that emerged from the Staff's analysis:

- First, across topical areas, the transparency and clarity of the financial statements in the sample could be enhanced. For example, some companies did not provide accounting policy disclosures in certain areas that appeared to be relevant to them. Also, many companies did not appear to provide sufficient detail or clarity in their accounting policy disclosures to support an investor's understanding of the financial statements, including in areas they determined as having the most significant impact on the amounts recognized in the financial statements. Some companies also used terms that were inconsistent with the terminology in the applicable IFRS. Further, some companies referred to local guidance, the specific requirements of which were often unclear. Consequently, certain disclosures presented challenges to understanding the nature of a company's transactions and how those transactions were reflected in the financial statements.

In some cases, the disclosures (or lack thereof) also raised questions as to whether the company's accounting complied with IFRS. As the analysis conducted for the IFRS Application Paper was not part of the Division of Corporation Finance's disclosure review program, the Staff was unable to obtain additional information from those companies that could have resolved many of these questions.

- Second, diversity in the application of IFRS presented challenges to the comparability of financial statements across countries and industries. This diversity can be attributed to a variety of factors. In some cases, diversity appeared to be driven by the standards themselves, either due to explicit options permitted by IFRS or the absence of IFRS guidance in certain areas. In other cases, diversity resulted from what appeared to be noncompliance with IFRS.

The diversity arising from the standards themselves was, at times, mitigated by guidance from local standard setters or regulatory bodies that narrowed the range of acceptable alternatives already permitted by IFRS or provided additional guidance or interpretations. This diversity also was mitigated by a tendency by some companies to carry over their previous home country practices in their IFRS financial statements. While country guidance and carryover tendencies may promote comparability within a country, they may diminish comparability on a global level.⁷²

⁷² IFRS Application Paper. In the IFRS Application Paper, the Staff focused on highlighting the areas for which it appeared that there was diversity in practice. This focus was selected as a way of understanding the potential

[Footnote continued on next page]

For a complete discussion of the Staff's observations, please refer to the IFRS Application Paper.⁷³

The issue of non-comparability across jurisdictions was highlighted by the Chairman of the IASB in a speech at the 2011 IFRS Foundation/AICPA conference. In his prepared remarks, Chairman Hoogervorst noted:

A more compelling criticism of IFRSs is that inconsistent application of the standards makes international comparison more difficult.

There is certainly some truth in this argument, as we have witnessed with the accounting for Greek sovereign debt. However, the same is true when you have different accounting standards. You can only work towards consistent application if you have one single language. We are very much committed to working with securities regulators and the accounting profession to enhance consistent application around the world. It will take time, but it can be done. If you do not have a single language, international consistency in financial reporting will always remain an illusion.⁷⁴

The Staff's recent interaction with other regulators indicates an increased focus by regulators on facilitating consistent application across jurisdictions. This increased attention to international comparability, including with respect to the accounting for sovereign debt, may help facilitate regulatory cooperation in addressing areas of divergence.⁷⁵

The members and staff of the IASB have indicated on numerous occasions their desire to limit the amount of application guidance and the amount of prescription in standards. In their strategy review, the Trustees of the IFRS Foundation acknowledged that the IASB needs to "establish formalised co-operation arrangements with securities regulators, audit regulators and national standard-setters to receive feedback on how IFRSs are being implemented and to

impact of an incorporation of IFRS. The Staff did not engage in an analysis of areas where there is consistent application, nor did it determine the relative amount of inconsistent relative to consistent application. The Staff's identification of diversity in practice was also not intended to imply that local regulators are not concerned about consistency in application across jurisdictions (as opposed to consistency only within the regulator's own jurisdiction).

⁷³ See supra note 69.

⁷⁴ Comments of Hans Hoogervorst, Remarks at IFRS Foundation/AICPA Conference, Boston (Oct. 2011) (available at: <http://www.ifrs.org/NR/rdonlyres/511C82B8-02F4-4E93-93B8-B84534E590C9/0/HHoogervorstBostonOctober2011.pdf>).

⁷⁵ Cf. CII Study (noting, with respect to criterion #2, that the transparency and comparability of IFRS depends on the way in which standards are implemented; that IFRS Foundation Trustees have acknowledged the risk of divergent practices and that they have proposed several steps to address that issue; and that "capital market regulation and enforcement of standards determine the quality of a country's financial reporting at least as strongly as the quality of the accounting standards utilized").

encourage actions aimed at addressing divergence.”⁷⁶ These objectives cause tension between having standards that are less prescriptive (often referred to as principle-based) and the amount of diversity one might expect when evaluating how such standards are applied. Once again, this does not necessarily suggest that IFRS is not suitable for incorporation in the United States on this basis alone. However, the Staff has considered carefully the effect that the IASB’s objective for less prescriptive standard setting could have on any incorporation of such standards in the United States, including whether it would be desirable or necessary for the FASB, SEC, or others to provide interpretive guidance to minimize diversity among companies filing within the U.S. capital markets.

2. Formal Interpretative Process

The IFRS IC assists the IASB in improving financial reporting through timely identification, discussion, and resolution of financial reporting issues within the framework of IFRSs. Its work is aimed at reaching consensus on the appropriate accounting treatment and providing authoritative interpretations of IFRS. The Staff received feedback indicating, and independently observed, that improvements could be made to the IFRS IC’s approach to issuing application guidance. Such improvements could better promote comparability of financial statements prepared in accordance with IFRS and improve consistency in the audit and regulation of those statements and companies issuing those statements. Specifically, commenters to the 2011 May Staff Paper indicated that the IFRS IC would need to become more active in its standard setting to reduce diversity in practice in the application of IFRS and to increase comparability.⁷⁷ As one commenter stated:

We perceive that the IASB has been reluctant to interpret its standards and we encourage the IFRS Interpretations Committee to become more active. While we applaud principle-based standards, principle-only standards are problematic whenever practice interprets the standards differently, and resulting reporting is excessively diverse. In those cases, interpretation/guidance is needed to narrow practice to acceptable levels of diversity.⁷⁸

The Staff further considered the IFRS IC’s process in the context of its analysis of the IASB’s standard-setting process, as described in section III.G.4.b., below.

D. Auditability and Enforceability

The Work Plan noted that the Staff will gather data concerning the auditability and enforceability of IFRS by:

⁷⁶ Report of the Trustees’ Strategy Review – IFRSs as the Global Standard: Setting a Strategy for the Foundation’s Second Decade, see infra note 121. See also subsection III.C.1. and related footnotes for a discussion of the IFRS Foundation’s Trustees’ Strategy Review and related findings.

⁷⁷ See, e.g., comment letters of Exxon; IBM; and IMA on the 2011 May Staff Paper.

⁷⁸ Comment letter of IMA on the 2011 May Staff Paper.

- Analyzing factors that may influence the auditability of financial statements prepared under, and the enforceability of, IFRS.
- Evaluating factors that may influence the consistent audit of financial statements prepared under, and the enforcement of, IFRS.
- Identifying potential changes to improve the auditability and enforceability of financial statements prepared under IFRS and to facilitate their consistent audit and enforcement.⁷⁹

The Staff performed outreach to audit firms and foreign regulators, met internally with personnel from various Offices and Divisions of the Commission, and researched academic studies and other publicly-available information on global regulatory structures to understand the auditability and enforceability of IFRS. Evaluating the auditability and enforceability of IFRS proved to be one of the most difficult parts of the Work Plan. In part, this was because the Staff has very little direct insight into audits performed of financial statements prepared in accordance with IFRS. The Public Company Accounting Oversight Board (“PCAOB”) inspects very few audits of financial statements prepared in accordance with IFRS, such that any results would not be a sufficient sample from which to draw conclusions. Likewise, the Commission has not had sufficient enforcement exposure with individuals or companies that prepared their financial statements using IFRS, so it is difficult to draw any conclusions from actual experience.

Several commenters to the 2011 May Staff Paper noted the need for greater global enforcement of standards, consistency in audits, and international cooperation by regulators for more consistent application of standards.⁸⁰ In particular, rigorous enforcement is important to avoid “false comparability: where the requirements of the standards in each jurisdiction are the same but the interpretations and practices are inconsistent.”⁸¹ In addition, consistency in interpretation and enforcement pushes interpretations into the open, toward due process, rather than behind closed doors.⁸²

⁷⁹ Work Plan.

⁸⁰ See comment letters of ABA; CalPERS; CFA; Dell; Deloitte (calling on the SEC to increase efforts to coordinate consultation and monitoring activities with other countries’ regulators); Exxon (calling for the Commission to consider the robustness of home country regulatory environments, the development of high-quality global auditing standards, and an active interpretive body); FEI; GM (calling on EITF and IFRS IC to address translation and cultural differences in interpretation and application, and the SEC and IASB to address “short-cuts and noncompliance” not in line with “rigorous application of high-quality standards”); IMA (urging SEC global outreach); KPMG; PwC (“the regulatory and standard-setting mechanisms that would facilitate improved consistency in application are, for the most part, not yet in place or do not yet operate at a sufficiently high level”) on the 2011 May Staff Paper.

⁸¹ See comment letter of FEI (expressing hesitation to support “condorsement” absent “significant global development” in infrastructure and calling on the Commission to research the strengths and weaknesses of other global bodies that regulate the enforcement and auditing of IFRS) on the 2011 May Staff Paper.

⁸² See comment letters of ABA and Exxon (“false sense of comparability”) on the 2011 May Staff Paper.

1. Principles versus Rules

The Staff's research indicates that many assert that IFRS is a more principles-based set of standards than U.S. GAAP. However, others assert that IFRS and U.S. GAAP are equally based on principles but that U.S. GAAP includes more guidance to aid practice in reaching comparable conclusions. Commenters on the 2008 Roadmap stated that IFRS allows for increased flexibility as compared to U.S. GAAP, which may result in standards that are less enforceable—a factor which would not be in the public interest.⁸³ Other commenters had concerns related to comparability because of inconsistency in application and the impact on auditability. For example, one commenter stated:

The international standards (IFRS) are widely viewed as less specific and providing less prescriptive guidance than U.S. GAAP (i.e., IFRS are more principles based), as well as more subjective primarily due to more use of fair value measurements. The downgrading of verifiability as a key concept guiding accounting standard setting and the resulting focus on fair value measurement significantly impairs the ability of an auditor to limit opportunistic actions of management and improve financial reporting.⁸⁴

The Staff observes that the difference between principles- and rules-based standards is not always clear. Although U.S. GAAP is perceived by many to be more rules-based, and IFRS to be more principles-based, the Staff finds both sets of standards to be a combination of both approaches. Indeed, the FASB has recently trended toward issuing objectives-based standards that require greater judgment to be exercised in application. Objectives-based standards provide an underlying objective that is supplemented with additional detail to form comprehensive guidance.⁸⁵ For example, in 2009, the FASB issued FASB Statement No. 167, *Consolidation of Variable Interest Entities* ("SFAS 167"). This standard, which is less prescriptive than predecessor guidance, requires significant judgment to be applied in determining the primary beneficiary of a variable interest entity. The early experience under SFAS 167 also illustrates that objectives-based standards are not necessarily problematic in their auditability or enforceability. The Staff's initial experience with SFAS 167 indicates that preparers, auditors, and regulators are able to apply and enforce this standard.

⁸³ See, e.g., comment letter of National Association of State Boards of Accountancy on the 2008 Roadmap.

⁸⁴ Comment letter of American Accounting Association, Financial Accounting Standards Committee on the 2008 Roadmap.

⁸⁵ See SEC Office of the Chief Accountant and Office of Economic Analysis, Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System (Jul. 25, 2003) (available at: <http://www.sec.gov/news/studies/principlesbasedstand.htm>).

2. Effect of Audit Firm Structure on Comparability⁸⁶

The Staff conducted outreach to six major international public accounting organizations to understand their infrastructure as it relates to the application and interpretation of IFRS.⁸⁷ Through this outreach, the Staff sought to further its understanding of processes that the large public accounting organizations currently employ to foster quality and comparability and that could be employed if IFRS were incorporated into the financial reporting system in the near future. Overall, the Staff's outreach indicated that large public accounting organizations could improve processes to facilitate greater cross-border comparability of IFRS.

In general, the IFRS infrastructures of the six accounting organizations with which the Staff met broadly comprise three principal tiers: a senior global policy and leadership group, a core IFRS technical group, and a broader consultation network. The groups generally are engaged in establishing and overseeing the execution of policies, supporting consistent global application of IFRS within the member firms, and fostering consensus on viewpoints. Representatives with whom the Staff met believe that the IFRS infrastructures that are currently in place would generally be suitable for an environment in which IFRS is incorporated into the financial reporting framework for U.S. issuers. However, some organizations indicated that they likely would need to increase the number of IFRS-qualified resources based in the United States to address consultation demands and to maintain a high level of quality in the consultation process.

The Staff was informed by some of the representatives with whom it met that individuals from some or all of the six accounting organizations periodically attend various inter-organization IFRS meetings. The general purpose of the meetings is to share each organization's respective views and perspectives on certain IFRS topics. Similar meetings and discussions occur in the United States where these same organizations discuss issues regarding U.S. standard setting and questions on the application of U.S. GAAP. These meetings help in understanding the viewpoints of the various accounting organizations and, to some extent, the meetings serve as a forum for identifying potential items to be considered by the IFRS IC through its agenda process.

⁸⁶ See also section VII of this Final Staff Report.

⁸⁷ The Staff contacted representatives from the U.S. legal entities of the following six major organizations: BDO International Limited, Deloitte Touche Tohmatsu Limited, Ernst & Young Global Limited, Grant Thornton International Ltd., KPMG International Cooperative, and PricewaterhouseCoopers International Limited. These accounting organizations worldwide are structured as networks of distinct member firms that share common brand names. The U.S. member firm for each of the respective organizations listed above is as follows: BDO USA, LLP; Deloitte LLP; Ernst & Young U.S. LLP; Grant Thornton LLP; KPMG LLP; and PricewaterhouseCoopers LLP. The extent to which the member firms in each network are integrated (e.g., through common audit methodologies) varies by network. Throughout this Final Staff Report, these accounting organizations (among others) are referred to using different terms. Terms such as "member firms" or "firms" refer generally to individual legal entities that provide professional services to third parties, likely within a country or limited number of countries. Terms such as "organizations" or "networks" refer to broader, and often, global networks of the individual firms.

However, because the largest accounting organizations are structured as networks of independent member firms, member firms develop viewpoints on, for example, a question of IFRS interpretation through voluntary cooperation and consensus-building among the member firms. The absence of a top-down decision-making model creates the possibility that a member firm can reach its own conclusions on accounting for certain transactions while other member firms within the same network reach different conclusions. This approach differs from the approach that the Staff generally understands to be historically employed among large U.S. accounting firms related to the application of U.S. GAAP whereby the conclusion of a firm's national technical accounting group (i.e., the "national office") on U.S. GAAP matters is to be applied consistently (e.g., the Los Angeles field office cannot override or reach differing conclusions than the national office). Thus, it appears that the large accounting organizations could implement more robust control procedures to help ensure that conclusions reached by the core IFRS technical groups are disseminated and followed by each member firm in order to facilitate compliance and foster comparability.

In addition to the Staff's outreach to the largest accounting firms, the Staff also performed outreach to smaller accounting firms. A number of the smaller accounting firms had generally limited exposure to IFRS because the firms had no or few clients currently applying IFRS, and several of the firms are not part of an international network. Some of the firms have provided basic IFRS training for many of their employees and a small number also have made advanced training available. However, a number of the firms that have provided training believe that much of the value of that training may have been lost through deterioration of knowledge in the absence of practical application and due to changes to standards that will have occurred before any incorporation of IFRS in the United States.

Further, a number of the smaller firms indicated they do not have their own interpretative accounting guidance. Of those firms that do, most have not updated that guidance for IFRS and have no plans to do so before a decision is made by the SEC regarding incorporation of IFRS. A minority of the firms have IFRS resources, such as illustrative financial statements and training materials, available within their networks.

3. Enforcement and Compliance

The Staff's research highlights that accounting standards are not the only factor influencing comparability of financial statements. Other factors, such as the enforcement structure of a jurisdiction, can greatly impact comparability. Many commenters have made similar observations. For example, one commenter stated that "accounting standards are just one factor influencing the degree of comparability reflected in companies' financial reports; other factors such as managers' reporting incentives, regulatory enforcement, and auditing also significantly affect the comparability of financial reports."⁸⁸

Through its outreach, the Staff has determined that enforcement structures around the world differ widely by jurisdiction. For example, certain jurisdictions have a governmental securities regulator, others have a governmental body, and still others are regulated by an

⁸⁸ Comment letter of the FAF on the 2008 Roadmap.

exchange accountable to a government regulator or by an independent enforcer that is overseen by the government. The structure of the regulator can impact the enforcement mechanisms available.

Limited information exists regarding the current enforcement of accounting standards on a global basis. Through its outreach, the Staff obtained some information regarding the frequency of financial statement reviews and the enforcement mechanisms available. The Staff determined that, in general, regulators maintain some form of financial statement review program, though the frequency of review and the methods of selecting financial statements for review varied greatly. For example, regulators may review financial statements based on a referral, on a periodic schedule or rotation (e.g., every five years), on an assessment of risk, or at random.

Using the member states of the EU as an example, the Staff generally observed the use of periodic and risk-based reviews. Within the EU, ESMA, and previously CESR, has collected and provided information publicly about EU-wide enforcement of IFRS. In one report, CESR noted that a full review was performed on 1,200 companies and a partial review was performed on 900 companies during 2009 (approximately 17% of listed (public) companies in Europe).⁸⁹ The partial reviews are generally selected by European regulators for specific accounting topics or industries. Of the 2,100 total reviews, approximately 900, or 43%, resulted in some type of action: 19 restatements, approximately 160 public corrective notices, approximately 560 required corrections in future financial statements, and 170 other, less severe, actions.⁹⁰ For 2010, ESMA reported that the numbers of reviewed companies had declined somewhat, with full reviews performed on 1,000 companies (15% of listed (public) companies in Europe) and partial reviews performed on 700 companies (10% of listed (public) companies in Europe). Enforcement numbers varied: restatements and public corrective notices increased over 2009 (with 22 and 220, respectively), while required corrections in future financial statements declined to 380.⁹¹

By comparison, for the fiscal year ended September 30, 2009, DCF conducted reviews on 4,720 issuers (40% of total issuers), including 370 initial public offering reviews.⁹² For the calendar year ended December 31, 2009, there were 674 restatements by 630 issuers,⁹³ though

⁸⁹ See CESR, Activity Report on IFRS enforcement 2009 (Sept. 23, 2010) (available at: http://www.esma.europa.eu/documents/overview/10?title=activity+report+on+IFRS+enforcement&doc_reference=§ion=All&doc_type=All&x=0&y=0).

⁹⁰ See id.

⁹¹ See ESMA, Activity Report on IFRS Enforcement in 2010 (Oct. 21, 2011) (available at: http://www.esma.europa.eu/documents/overview/10?title=activity+report+on+IFRS+enforcement&doc_reference=§ion=All&doc_type=All&x=0&y=0).

⁹² See Wayne Carnall et al., Current Developments in the Division of Corporation Finance (Dec. 8, 2009) (slides presented to the AICPA Conference on SEC and PCAOB Developments) (available at: <http://www.sec.gov/news/speech/2009/spch120809wc.pdf>). Section 408 of the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley Act”) requires the SEC to review the annual report (e.g., Form 10-K or Form 20-F) of an issuer at least once every three years.

⁹³ See Audit Analytics, 2009 Financial Restatements: A Nine Year Comparison (Feb. 2010).

this includes both restatements as a result of the DCF reviews and restatements initiated by the issuer or auditor. The Staff was unable to determine how many issuers received a full or partial DCF review and how many of those received ‘correct in future filings’ comments from DCF during the period, which would be necessary for a valid comparison with the EU enforcement results.⁹⁴ For the fiscal year ended September 30, 2010, DCF conducted reviews of 4,575 existing issuers (44% of the total issuers at the beginning of the fiscal year) as well as 935 reviews of new issuers including initial public offerings. For the calendar year ended December 31, 2010, there were 735 restatements by 699 issuers.⁹⁵

The EU and DCF review data illustrates differences in the review practices by a jurisdiction that could give rise to less consistency in the enforcement of IFRS financial statements. The Staff believes that an active review program has improved the comparability and quality of the application of accounting standards—at least within the jurisdiction executing the review program. An active review program can have a greater impact on the consistent application of an accounting standard than the standard itself.⁹⁶ The Staff also believes that a robust review program similar to the SEC review program would have a positive impact on the consistency in the enforcement of IFRS globally. That said, however, greater coordination of review programs across jurisdictional boundaries may be necessary to improve global consistency in application.

The Staff conducted an analysis of how any incorporation of IFRS might impact the Commission’s enforcement program. The Staff conducted its analysis by reviewing a sample of Commission enforcement actions involving accounting violations and financial fraud during the last several years. The objective was to assess the Commission’s ability to have made the accounting allegations and to have filed those enforcement actions (had IFRS been applicable),⁹⁷ as well as to assess the potential impact that IFRS may have on enforcement cases.

The Staff estimated that a significant majority of the accounting allegations would have still been brought even if IFRS were previously incorporated into the U.S. financial reporting system. However, it is important to note that the actual effect of incorporating IFRS on the Commission’s enforcement regime could be different from the Staff’s analysis and will depend on the particular accounting standards involved, facts and circumstances, and quality of the evidence obtained during the investigations.

Separate from any Commission decision to incorporate IFRS, the Boards are continuing or, in some instances, have completed their efforts, to reduce the extent of the specific

⁹⁴ A very rough idea of the volume of “correct in future filings” correspondence may be obtained through a search of EDGAR’s full-text database for the term “future filings,” which, when filtered for correspondence (CORRESP) and limited to calendar year 2009, yields approximately 4,300 results.

⁹⁵ See Audit Analytics, 2010 Financial Restatements: A Ten Year Comparison (May 2011).

⁹⁶ See Christian Leuz, Different Approaches to Corporate Reporting Regulation: How Jurisdictions Differ and Why, 40 ACCT. & BUS. RESEARCH 229 (2010).

⁹⁷ The Staff considered IFRSs in effect at the time the analysis was performed. The standards applied may have varied from those in effect as of the dates of the alleged violations.

differences between IFRS and U.S. GAAP for the accounting areas subject to the priority Major Joint Projects. Ongoing convergence activities could significantly impact the accounting for revenue, leasing, and financial instruments, among other accounting standards. Assuming the standards are converged when issued, the implications for enforcing compliance with the accounting requirements in these final standards within the U.S. financial reporting system would be expected to be similar irrespective of a decision to incorporate IFRS.

Finally, as discussed in other sections of this Final Staff Report, the method of incorporation could significantly mitigate a number of the concerns that any incorporation of IFRS could have on the Commission's ability to enforce accounting standards. The FASB, in acting as an endorser, could serve an important role to ensure that any standard incorporated into the U.S. financial reporting system is of sufficient quality such that the standard would not adversely impact the Commission's enforcement of the federal securities laws.

4. International and Other Regulatory Bodies

The Staff has identified the following mechanisms that may contribute to more consistent enforcement of IFRS financial statements:

- IOSCO; and
- Regional bodies.

IOSCO is a global body of securities regulators seeking to achieve a common mission of investor protection through collaborative efforts and information sharing among members.⁹⁸ With respect to its role in accounting, IOSCO sponsors Committee 1, which focuses on multinational disclosure and accounting issues. To support consistent enforcement of IFRS, Committee 1 activities include sponsoring:

- A database of previous decisions taken by members, allowing other members to browse specific fact patterns and understand the basis for the accounting decision;
- Periodic conference calls with members to address both emerging accounting issues and individual no-name fact patterns; and
- Joint comment letters to the IASB on exposure drafts of IFRS.

In addition to IOSCO, the Staff notes that other regional bodies exist to promote consistent enforcement of IFRS financial statements. Most notable is ESMA, an EU-wide institution designed to promote collaboration and consistency among the individual national securities regulators of EU member states. The creation of ESMA on January 1, 2011 further strengthened the role of an EU-wide securities enforcer within the EU governance structure. In addition, ESMA sponsors the European Enforcers Coordination Session ("EECS") group that is specifically focused on accounting and increasing convergence among enforcement activities in

⁹⁸ For additional information, see IOSCO, About IOSCO (available at: <http://www.iosco.org/about>).

Europe. In order to promote consistent enforcement of IFRS, the EECS periodically publishes enforcement decisions made by individual member states on a no-name basis. These published decisions are designed to contribute to a consistent application of IFRS in the EU.⁹⁹

In the Asia-Oceanic region, the accounting standard setters formed the Asian-Oceanian Standard-Setters Group (“AOSSG”) in 2009. Among its objectives is the promotion of consistent application of IFRSs by jurisdictions in the region.¹⁰⁰ To support this goal to date, AOSSG has held education sessions for members. In the future, AOSSG envisions closer collaboration via committees, conferences calls, databases, or other mechanisms to discuss and disseminate views on accounting matters.

⁹⁹ See ESMA, 11th Extract from the EECS’s Database of Enforcement (Aug. 16, 2011) (available at: <http://www.esma.europa.eu/page/IFRS-Enforcement-0>).

¹⁰⁰ For additional information, see AOSSG, About Us (available at: <http://www.aossg.org/about-us>).

III. Independent Standard Setting for the Benefit of Investors

The 2010 Statement noted that an “important element for a set of high-quality global accounting standards is whether the accounting standard setter’s funding and governance structure support the independent development of accounting standards for the ultimate benefit of investors.”¹⁰¹ To provide information necessary to consider the independence of the IASB as it relates to potential incorporation of IFRS for U.S. issuers, the Work Plan focused on four areas in particular:

- Oversight of the IFRS Foundation;
- Composition of the IFRS Foundation and the IASB;
- Funding of the IFRS Foundation; and
- IASB standard-setting process.¹⁰²

In the Work Plan, the Staff noted that effective oversight of the IASB is critical to any decision to incorporate IFRS into the financial reporting system for U.S. issuers.¹⁰³ Therefore, in executing the Work Plan, the Staff considered the extent to which the IFRS Foundation’s Monitoring Board’s (“Monitoring Board”) policies and procedures support the independent development of accounting standards for investors.

As to the second area, in accordance with the Work Plan, the Staff analyzed the composition of the IFRS Foundation and the IASB and its effect on the IASB’s ability to develop independently accounting standards for the ultimate benefit of investors.¹⁰⁴

As to the third area, the Staff analyzed: (1) the extent to which the IFRS Foundation’s sources of funding promote the independence of the IASB; and (2) possible funding mechanisms to provide the U.S.-based contribution to the IFRS Foundation.¹⁰⁵

As to the final area, the Staff analyzed the extent to which the IASB’s standard-setting process is independent and objective. Pursuant to the Work Plan, the Staff focused on three components in the IASB’s standard-setting process: (1) preeminence of investors; (2) timeliness; and (3) objectivity.¹⁰⁶

¹⁰¹ 2010 Statement.

¹⁰² Work Plan.

¹⁰³ See id.

¹⁰⁴ See id.

¹⁰⁵ See id.

¹⁰⁶ See id.

A. Summary Observations

In general, the Staff found the overall design of the governance structure of the IFRS Foundation to strike a reasonable balance of providing oversight of the IASB while at the same time recognizing and supporting its independence. As is typical with a global organization, the IASB does not have a mandate to consider the establishment of standards with the focus of any single capital market. As it relates to considering the needs of U.S. investors and the U.S. capital markets, the Staff believes that it may be necessary to put in place mechanisms specifically to consider and to protect the U.S. capital markets—for example, maintaining an active FASB to endorse IFRS standards.

As to funding, since the founding of the IASB, U.S. sources have consistently been the largest contributors to the IASB in terms of gross dollars. In addition, the United States has contributed significant resources to support the joint standard-setting efforts of the IASB and the FASB under their MoU. However, recently the IFRS Foundation Trustees have not been successful in obtaining the funding goal they have set for U.S. sources. In the FAF's comment letter in response to the 2011 May Staff Paper, the FAF noted the importance of finding an appropriate means of funding the U.S. portion of the IFRS Foundation's operating budget.¹⁰⁷ In addition, the FAF offered to "lend its support to efforts to develop a suitable funding mechanism for an appropriate U.S. share of the IASB's annual operating expenses."¹⁰⁸ Notwithstanding the above observations, the Staff's most significant concern about the funding approach is the continued reliance on the large accounting firms to provide funds to the IASB.

As to the IASB's standard-setting process, the Staff believes that the IASB has made improvements over time in its efforts to obtain feedback from investors on its standard-setting agenda and on individual projects. Because there are often relatively few formal comment letters from investors or investor groups on IASB exposure documents, it is critical for the IASB to find other ways to reach those stakeholders, and the IASB appears to have put forth the effort to do so. Through its monitoring of IASB projects, the Staff notes that when the IASB staff is using other mechanisms (such as reaching out directly to investors to inform the feedback on IASB exposure documents), the IASB staff frequently provides a public summary of the results of outreach to investors as well as a summary of public comment letters.

Through the Staff's experience in monitoring the IASB's and IFRS IC's activities, the Staff believes enhancements are needed regarding the timeliness in which the IASB addresses emerging issues. This view is similar to constituent input on the IFRS Foundation's Trustees' strategy review, which noted the output from the IFRS IC is not meeting the needs of stakeholders.¹⁰⁹ The IFRS Foundation recently implemented changes to address this concern.

¹⁰⁷ See comment letter of the FAF on the 2011 May Staff Paper.

¹⁰⁸ Id.

¹⁰⁹ See IFRS Foundation Staff, Analysis of the Responses received following the Second Public Consultation held between April and July 2011 (Oct. 2011) ("IFRS Foundation Staff Comment Summary") (available at: <http://www.ifrs.org/The+organisation/Governance+and+accountability/Strategy+Review/Due+process+docs.htm>).

As changes were only recently implemented (or are in the process of being implemented), it is unknown at this time whether these changes are or will be effective.

The Staff observes that the IASB's due process is heavily based on consultation and gathering of facts and views, open deliberation, analysis, and the explanation of its decisions to the public. The Staff has noted that IASB member deliberations and re-deliberations on technical projects involve extensive debate and analysis regarding possibilities to recognize, measure, present, and disclose financial information. The Staff believes, based on its monitoring, that IASB members decide on the resolution of issues in projects based on the technical merits and overall usefulness for investors and other users of financial statements, and the Staff is not aware of instances in which IASB members have not acted in the public interest or have failed to exercise independence of judgment in setting IFRS.

B. Overview of the IASB's Governance Structure

The IASB is a private standard-setting body that is responsible for the development of IFRSs. The governance structure for the IASB is a three-tier structure. The IASB is overseen by the IFRS Foundation, which is a not-for-profit, private-sector organization governed by 22 Trustees.¹¹⁰ The IFRS Foundation is responsible for the activities of the IASB and other work that centers on IFRS, such as initiatives related to translation of IFRS from the English language, education about IFRS, and development of interactive data taxonomies for IFRS. The IFRS Foundation, in turn, is subject to public oversight by the Monitoring Board. The current members of the Monitoring Board are the Emerging Markets and Technical Committees of IOSCO, the European Commission ("EC"), Financial Services Agency of Japan ("JFSA"), and the Commission.¹¹¹ The Monitoring Board was established in 2009, and the Trustees amended the IFRS Foundation's Constitution to reflect the formation of the Monitoring Board. A Memorandum of Understanding ("MB MoU") in April 2009 formally linked the IFRS Foundation and the Monitoring Board.¹¹² Before the establishment of the Monitoring Board, the IFRS Foundation did not have an oversight link with any national securities regulators or public capital market authorities.

The Trustees have a Due Process Oversight Committee ("DPOC") that is responsible for approving due process and overseeing the IASB's compliance with due process, and for reviewing the Trustees' fulfillment of their oversight function in accordance with the IFRS

¹¹⁰ For additional information, see IFRS, Trustees (available at: <http://www.ifrs.org/The+organisation/Trustees/Trustees.htm>).

¹¹¹ A listing of Monitoring Board members is available at: http://www.iosco.org/monitoring_board.

¹¹² For more information on the mission, duties, structure, and operation of the Monitoring Board, see "Charter of the IASCF Monitoring Board" ("MB Charter") (available at: http://www.iasb.org/NR/rdonlyres/28B9BB17-79C8-4623-B043-B15F8D7A774D/0/Monitoring_Board_Charter.pdf). See also "Memorandum of Understanding To Strengthen the Institutional Framework of the International Accounting Standards Committee Foundation" ("MB MoU") (Apr. 2009) (available at: <http://www.iasb.org/NR/rdonlyres/67B0EE51-56B8-4183-9958-CDAC52BC505C/0/MGMou060409.pdf>).

Foundation's Constitution.¹¹³ The IFRS Foundation's *Due Process Handbook for the IASB* details procedures to be followed by the IASB when setting standards, with an emphasis on how each stage of the process must address transparency and accessibility, extensive consultation and responsiveness, and accountability.¹¹⁴ The IASB solicits views and seeks input from the public throughout the standard-setting process, including when selecting items for its agenda and by developing and publishing a discussion paper or exposure draft, or both, before issuing a final standard.¹¹⁵

C. Background on IFRS Foundation Trustee and Monitoring Board Reviews

1. Trustees' Strategy Review

The IFRS Foundation's Constitution requires that the Trustees undertake regular reviews of the IFRS Foundation's structure and effectiveness.¹¹⁶ In July 2010, the Trustees initiated a comprehensive review of the organization's strategy ("Trustees' Strategy Review"). The IFRS Foundation issued two papers for public consultation: (1) the November 2010, *Status of Trustees' Strategy Review* ("2010 Public Consultation"),¹¹⁷ and (2) the April 2011, *Report of the Trustees' Strategy Review – IFRSs as the Global Standard: Setting a Strategy for the Foundation's Second Decade* ("2011 Public Consultation").¹¹⁸ Both public consultation papers focused on and requested public comment about the IFRS Foundation and the IASB in four areas: Mission, Governance, Process, and Financing. Comment summaries from the IFRS Foundation staff were published in May 2011¹¹⁹ and October 2011.¹²⁰ The Trustees published their final report in February 2012.¹²¹

¹¹³ For additional information about the DPOC see IFRS, [Due Process Oversight Committee \(DPOC\)](http://www.ifrs.org/DPOC/DPOC.htm) (available at: <http://www.ifrs.org/DPOC/DPOC.htm>).

¹¹⁴ See IFRS Foundation, [Due Process Handbook for the IASB](http://www.ifrs.org/NR/rdonlyres/C3D78611-8792-441F-B426-6AF5189C83B8/0/DueProcessIASB2011.pdf) ("DP Handbook") (available at: <http://www.ifrs.org/NR/rdonlyres/C3D78611-8792-441F-B426-6AF5189C83B8/0/DueProcessIASB2011.pdf>). In May 2012, the IFRS Foundation published for public comment an updated version of the DP Handbook. The press release and additional information are available at: <http://www.ifrs.org/Alerts/PressRelease/DueProcessHandbook.htm>. The Staff had not completed its evaluation of the proposed updates prior to the release of this Final Staff Report.

¹¹⁵ See id.

¹¹⁶ See IFRS Foundation Constitution (available at: <http://www.ifrs.org/NR/rdonlyres/0B820728-7F10-4877-8068-7B65D2A3058B/0/ConstitutionDec2010.pdf>).

¹¹⁷ See IFRS Foundation, Consultation Document, [Paper for Public Consultation, Status of Trustees' Strategy Review](http://www.ifrs.org/The+organisation/Governance+and+accountability/Strategy+Review/Due+process+docs.htm) (Nov. 5, 2010) (available at: <http://www.ifrs.org/The+organisation/Governance+and+accountability/Strategy+Review/Due+process+docs.htm>). The extended comment period ended February 24, 2011.

¹¹⁸ See IFRS Foundation, Consultation Document, [Report of the Trustees' Strategy Review – IFRSs as the Global Standard: Setting a Strategy for the Foundation's Second Decade](http://www.ifrs.org/The+organisation/Governance+and+accountability/Strategy+Review/Due+process+docs.htm) (Apr. 2011) (available at: <http://www.ifrs.org/The+organisation/Governance+and+accountability/Strategy+Review/Due+process+docs.htm>). The comment period ended July 25, 2011.

¹¹⁹ See IFRS Foundation Staff, [Strategy Review Response Analysis](#) (May 2011) ("IFRS Foundation Staff Response Analysis") (available at: [http://www.ifrs.org/Alerts/PressRelease/StrategyReviewResponseAnalysis.htm](#)).

In the Strategy Review Final Report, the Trustees largely affirmed the principles and recommendations that were outlined in the 2011 Public Consultation. The Trustees noted that the independence of the IASB in its standard-setting decision-making process must be maintained, and they noted that the current three-tier governance structure is appropriate for the organization's mission.¹²² The Trustees also concluded that the funding system for the IASB must maintain the independence of the standard-setting process, while providing organizational accountability, and that the existing base of financing should be expanded to enable the IFRS Foundation to serve the global community better.¹²³ The Trustees noted that the IASB's due process should continue to be reviewed and regularly enhanced.¹²⁴ The Trustees outlined several specific recommendations to build on the existing due process framework and to support the IFRS Foundation's interest in consistent application of IFRSs.¹²⁵ Additional information about the results of the Trustees' Strategy Review is discussed throughout this section of the Final Staff Report.

2. Monitoring Board's Governance Review

In April 2010, the Monitoring Board committed to a review of its governance framework and that of the IFRS Foundation and, in doing so, established a working group to conduct the review ("MB Governance Review"). The MB Governance Review was conducted concurrently with the Trustees' Strategy Review. The MB Governance Review focused primarily on institutional aspects of governance, particularly the composition and respective roles and responsibilities of the Monitoring Board, Trustees, and the IASB. In contrast, the Trustees' Strategy Review placed emphasis on the operational aspects of governance, particularly the standard setter's due process.

In February 2011, the Monitoring Board published a report, *Consultative Report on the Review of the IFRS Foundation's Governance* ("MB Consultative Report").¹²⁶ The Monitoring Board also conducted public stakeholder meetings at four venues¹²⁷ in March 2011 to reach out

<http://www.ifrs.org/The+organisation/Governance+and+accountability/Strategy+Review/Due+process+docs.htm>.

¹²⁰ See IFRS Foundation Staff Comment Summary.

¹²¹ See IFRS Foundation, Report of the Trustees' Strategy Review 2011: IFRSs as the Global Standards: Setting a Strategy for the Foundation's Second Decade (Feb. 2012) ("Strategy Review Final Report") (available at: <http://www.ifrs.org/The+organisation/Governance+and+accountability/Strategy+Review/Strategy+Review.htm>)

¹²² See Strategy Review Final Report.

¹²³ See id.

¹²⁴ See id.

¹²⁵ See id.

¹²⁶ IFRS Foundation Monitoring Board, Consultative Report on the Review of the IFRS Foundation's Governance (Feb. 7, 2011) (available at: http://www.iosco.org/monitoring_board/pdf/Review_of_the_IFRS_Foundation_Governance_Report.pdf). The public consultation period ended April 7, 2011.

¹²⁷ The four venues were Brussels, Tokyo, Kuala Lumpur, and Palo Alto, CA.

to a wide range of stakeholders. The Monitoring Board issued a summary of comments received on the MB Consultative Report in September 2011.¹²⁸

The Monitoring Board published its final report in February 2012.¹²⁹ In the MB Final Report, the Monitoring Board reaffirmed its purpose, which is to provide a link between the IFRS Foundation and authorities that are responsible for setting the form and content of financial reporting for use in their jurisdictions' capital markets.¹³⁰ The Monitoring Board decided to increase the size of its membership and to include as criteria for membership on the Monitoring Board the "domestic use of IFRS in the relevant jurisdiction and financial contribution by the jurisdiction to the setting of IFRSs."¹³¹ The Monitoring Board also decided that the current provisions of the MB MoU will be maintained, allowing the Monitoring Board to refer issues to the Trustees and the Chairman of the IASB for their consideration. The Monitoring Board and Trustees plan to agree on an appropriate feedback mechanism to ensure that all levels of the governance framework are fully aware of each other's concerns and reactions.¹³² Additionally, the Monitoring Board decided that it will conduct periodic reviews of the governance structure in coordination with the IFRS Foundation's five-yearly Constitution reviews, in order to provide an efficient means of ensuring the continuing relevance of and improvements in the governance framework.¹³³ Additional information about the results of the MB Governance Review is discussed throughout this section of the Final Staff Report.

D. Oversight of the IFRS Foundation

1. Current State of Governance Structure

As a result of both the Trustees' Strategy Review and the MB Governance Review, the Trustees and the Monitoring Board have concluded that the current three-tier governance structure for the IASB is appropriate and should be maintained.¹³⁴ An overwhelming majority of respondents to the 2011 Public Consultation supported the proposal to maintain the current three-tier governance structure.¹³⁵ Respondents noted that the current structure has served the organization well and balanced the needs of public accountability and the independence of the

¹²⁸ See Monitoring Board Working Group, Summary of Comments to the Consultative Report on the Review of the IFRS Foundation's Governance (Sept. 2011) ("MB Comment Summary") (available at: http://www.iosco.org/monitoring_board/pdf/20110908%20Final%20Draft%20Summary%20of%20Comments.pdf).

¹²⁹ See IFRS Foundation Monitoring Board, Final Report on the Review of the IFRS Foundation's Governance (Feb. 9, 2010) ("MB Final Report") (available at: http://www.iosco.org/monitoring_board/pdf/Final%20Report%20on%20the%20Review%20of%20the%20IFRS%20Foundation's%20Governance.pdf).

¹³⁰ See MB Final Report.

¹³¹ *Id.*

¹³² See *id.*

¹³³ See *id.*

¹³⁴ See Strategy Review Final Report.

¹³⁵ See IFRS Foundation Staff Comment Summary.

IASB's standard-setting process.¹³⁶ Almost all respondents to the 2011 Public Consultation strongly supported the principle that the independence of the IASB is paramount. Many noted that without independence, IFRSs would lose their legitimacy and credibility internationally. "Almost all of the respondents noted that the IASB's independence had to be coupled with a high degree of accountability and transparency, demonstrated by extensive outreach, appropriate due process, and full and frank feedback."¹³⁷

Although the Trustees believe the current governance structure for the IASB remains appropriate, the Trustees recommended that the roles and responsibilities of each element of the organization's governance should be clearly defined.¹³⁸ The vast majority of respondents to the 2011 Public Consultation agreed, acknowledging the need for greater clarification and definition of the respective roles of the IFRS Foundation, the Monitoring Board, and the IASB, so as to remove any confusion and to ensure greater transparency.¹³⁹

2. Composition of the Monitoring Board

The Monitoring Board's membership is currently confined to capital markets authorities, which are defined as those authorities responsible for setting the form and content of financial reporting for use in the capital markets in respective jurisdictions.¹⁴⁰ As a result of the MB Governance Review, the Monitoring Board has concluded that full membership should continue to be confined to that group of authorities.¹⁴¹ A large majority of respondents to the MB Consultative Report agreed with limiting Monitoring Board membership to capital markets authorities, at least in part because of the congruence of the mission of capital markets authorities generally and the IFRS Foundation's mission.¹⁴² The Staff acknowledges that a minority of respondents to the MB Consultative Report disagreed with limiting membership to capital markets authorities. Those respondents believe the Monitoring Board should represent a broader range of public policy interests in IFRSs, including banking supervision, insurance supervision, macro-prudential supervision, and tax authority.¹⁴³

3. Monitoring Board Observers

Under the MB Charter, the Monitoring Board members may, by consensus, admit certain organizations to be observers to the Monitoring Board.¹⁴⁴ Observers, by MB Charter, do not

¹³⁶ See *id.*

¹³⁷ *Id.*

¹³⁸ See Strategy Review Final Report.

¹³⁹ See IFRS Foundation Staff Comment Summary.

¹⁴⁰ See MB Charter.

¹⁴¹ See MB Final Report.

¹⁴² See MB Comment Summary.

¹⁴³ See *id.*

¹⁴⁴ See MB Charter.

have the right to vote in Monitoring Board decisions but may share their views with the Monitoring Board members.¹⁴⁵ The only current observer is the Basel Committee on Banking Supervision (“BCBS”).¹⁴⁶ In the MB Consultative Report, the Monitoring Board considered whether and, if so, how, to increase the involvement of other public authorities and international organizations in the Monitoring Board’s activities, such as by extending observer status to groups of prudential authorities and international organizations, holding more formalized dialogue with those groups, or establishing an advisory body composed of those groups.¹⁴⁷

While most respondents to the MB Consultative Report broadly supported increased interaction with other parties with a stake in IFRSs, views varied broadly as to how to achieve this.¹⁴⁸ In the MB Final Report, the Monitoring Board decided to retain the current observer status of the BCBS, and noted that it will continue to explore the most appropriate and expedient means to engage prudential and other authorities in the governance of the IFRS Foundation.¹⁴⁹ The Monitoring Board did not explain in its public report why the BCBS remains an observer. The Monitoring Board also decided to define more clearly the role and nature of an observer.¹⁵⁰

The Staff believes that dialogue with and input from public authorities who are not Monitoring Board members or observers can be achieved and obtained through other means, such as through advisory councils and the opportunities for public input that already exist through the IFRS Foundation and the IASB.

4. Role of Application of IFRS and Funding in Monitoring Board Membership

Under the existing MB Charter, there is no requirement for Monitoring Board members to “use” IFRSs in their jurisdictions.¹⁵¹ Members must have a responsibility to protect and advance the public interest and be strongly committed to supporting the development of high-quality international accounting standards.¹⁵² In the MB Consultative Report, the Monitoring Board proposed that the use of IFRSs in a jurisdiction, and the contribution of the jurisdiction to the funding of the IFRS Foundation, should be considered in selecting members.¹⁵³ After considering comments on its proposal, the Monitoring Board, in the MB Final Report, decided to include as membership criteria the domestic use of IFRSs in the relevant jurisdiction and

¹⁴⁵ See *id.*

¹⁴⁶ See MB Consultative Report.

¹⁴⁷ See *id.*

¹⁴⁸ See MB Comment Summary.

¹⁴⁹ See MB Final Report.

¹⁵⁰ See *id.*

¹⁵¹ Cf. MB Charter.

¹⁵² See *id.*

¹⁵³ See MB Consultative Report.

participation in funding the setting of IFRSs.¹⁵⁴ However, the Monitoring Board did not define or further describe the principles or factors it will use to assess “use of IFRSs.” The Monitoring Board plans to develop and document in the MB Charter a definition for the criterion “use of IFRSs.”¹⁵⁵ The Staff will participate in this work of the Monitoring Board and will continue to assess the implications of Monitoring Board membership to the governance structure supporting IFRS. Further, the Monitoring Board plans to review regularly its member eligibility given the new membership criteria, and it expects to begin the first assessment of eligibility in early 2013.¹⁵⁶

The Staff notes that respondents to the MB Consultative Report generally agreed that use of IFRSs should be a consideration, but such respondents were not clear how to interpret “use” since the concept was not well-defined.¹⁵⁷ However, some respondents expressed the view that the criterion should be near- or medium-term intentions to adopt or converge with IFRSs and that acceptance of IFRSs is also relevant.¹⁵⁸

The Staff notes that most respondents to the MB Consultative Report did not address the issue of the relevance of funding of the IFRS Foundation to membership in the Monitoring Board. As noted in the MB Comment Summary:

Some [commenters] cautioned that the link between membership and funding should not undermine governance but rather should be viewed as an indicator of the jurisdiction’s support for the [IFRS] Foundation’s stable, independent financing.¹⁵⁹

5. Role of the Monitoring Board in Selection of Trustees

Under the MB MoU, the principal responsibilities of the Monitoring Board include participation in the Trustee nominations process and approval of Trustee nominees.¹⁶⁰ The MB MoU states that the criteria for the selection or reappointment of a Trustee are those contained in the IFRS Foundation’s Constitution.¹⁶¹ Under the MB MoU, the Trustees shall establish procedures for Trustee positions, including advertising vacant positions, and the selection process will be administered by the Trustees in a transparent manner.¹⁶² The Trustees will propose a candidate for each open Trustee position, and the Monitoring Board may submit

¹⁵⁴ See MB Final Report.

¹⁵⁵ See id.

¹⁵⁶ See id.

¹⁵⁷ See MB Comment Summary.

¹⁵⁸ See id.

¹⁵⁹ MB Final Report.

¹⁶⁰ See MB MoU.

¹⁶¹ See id.

¹⁶² See id.

names for the Trustees' consideration.¹⁶³ Each Trustee candidate must be approved by the Monitoring Board, and the Trustees will nominate a Chair from among their members, subject to the approval of the Monitoring Board.¹⁶⁴

In the MB Consultative Report, the Monitoring Board recommended that the Trustees devise formal procedures and clearer criteria for the nomination of candidates and appointment of Trustees in line with the stated objectives for the IFRS Foundation.¹⁶⁵ After considering the comments, the Monitoring Board concluded in the MB Final Report that: (1) the process and criteria for the selection of the Trustees will be documented and made public; (2) due consideration will be given to changes that may be required to the selection criteria from time to time; and (3) the Monitoring Board will continue to participate in the process, including by agreeing with the Trustees on a set of selection criteria and approving Trustee candidates.¹⁶⁶

The Staff notes that many respondents to the MB Consultative Report agreed with the proposal because transparency increases stakeholders' confidence in the nomination process and in the Trustees and also enhances the accountability and independence of the IFRS Foundation and the IASB, both in fact and appearance.¹⁶⁷ Some respondents believe the current process is not well understood by constituents who are not involved in the process, and it is therefore important to clarify and formalize the procedures and criteria.¹⁶⁸ The Staff acknowledges that some respondents disagreed with the proposal because they were not aware of problems with the current process and had concerns that too much transparency could be a disincentive to candidates.¹⁶⁹ Many respondents acknowledged the need to strike a balance between transparency and respect for and protection of the privacy of individual candidates.¹⁷⁰

The Staff also considered the views of respondents who commented on the involvement of the Monitoring Board in the nomination process. Although there were some mixed views regarding whether there should be more or less involvement by the Monitoring Board in the Trustee selection process, many respondents expressed the view that the current arrangements are appropriate.¹⁷¹ Some respondents noted that the role and influence of the Monitoring Board in the process should be more transparent and formalized.¹⁷²

¹⁶³ See *id.*

¹⁶⁴ See *id.*

¹⁶⁵ See MB Consultative Report.

¹⁶⁶ See MB Final Report.

¹⁶⁷ See MB Comment Summary.

¹⁶⁸ See *id.*

¹⁶⁹ See *id.*

¹⁷⁰ See *id.*

¹⁷¹ See *id.*

¹⁷² See *id.*

6. Role of the Monitoring Board in the IASB's Standard-Setting Process

As noted previously, the Trustees have the direct and primary responsibility to oversee the IASB, and the Trustees' DPOC is responsible for approving due process and overseeing the IASB's compliance with due process.¹⁷³ Under the MB MoU, the Monitoring Board's responsibilities related to the IASB's standard-setting process are to review the Trustees' oversight of the IASB's standard-setting process, in particular with respect to its due process arrangements, and to refer, through the IFRS Foundation, matters of broad public interest related to financial reporting for consideration by the IASB.¹⁷⁴ The MB MoU also specifies that the Monitoring Board will confer with the Trustees regarding their oversight responsibilities in several areas, including the IASB's agenda-setting process and adequacy of its resources in light of its work program, the adequacy of the IASB's procedures to ensure prompt and fair consideration of changes to IFRSs to take into account emerging accounting issues and changing business practices, the IASB's process for carrying out impact assessments and cost-benefit analyses, and the IASB's efforts to improve the accuracy and effectiveness of financial reporting and to protect investors.¹⁷⁵

The MB MoU provides that the Monitoring Board may refer accounting issues to the Trustees and the IASB Chair and may confer with those parties regarding such issues.¹⁷⁶ The MB MoU also states that the Trustees will work with the IASB to ensure these issues are addressed in a timely manner.¹⁷⁷ Additionally, if the IASB determines that consideration of the issues identified by the Monitoring Board is not advisable or that the issues cannot be resolved within the time frame suggested by the Monitoring Board, the Trustees should call on the IASB to undertake all reasonable efforts to consider the issues in a manner consistent with the public interest, and to explain its position through the Trustees, and the Trustees should promptly notify the Monitoring Board of the IASB's position.¹⁷⁸

In the MB Consultative Report, the Monitoring Board asked the public to comment as to whether the Monitoring Board's current ability to refer matters to the IASB for consideration, requiring feedback, is sufficient, or whether an explicit role should enable the Monitoring Board to place an item on the IASB agenda.¹⁷⁹ A large majority of respondents expressed the view that they are opposed to the Monitoring Board's direct involvement in the IASB agenda-setting with compulsory power.¹⁸⁰ In general, those respondents commented that the current arrangement for Monitoring Board involvement in agenda-setting is appropriate, and further involvement of the

¹⁷³ See subsection III.B., above.

¹⁷⁴ See MB MoU.

¹⁷⁵ See *id.*

¹⁷⁶ See *id.*

¹⁷⁷ See *id.*

¹⁷⁸ See *id.*

¹⁷⁹ See MB Consultative Report.

¹⁸⁰ See MB Comment Summary.

Monitoring Board should be avoided in order not to damage the standard setter's independence in terms of both substance and appearance.¹⁸¹ Respondents to the 2011 Public Consultation expressed similar views.¹⁸² However, some respondents expressed strong support for the Monitoring Board's direct involvement in the IASB's agenda-setting, under the belief that the Monitoring Board should have a compulsory power to place an item on the IASB agenda in order to reflect public perspectives on the standard setter's work programs.¹⁸³

In the MB Final Report, the Monitoring Board decided to maintain the current approach whereby the Monitoring Board may refer issues to the Trustees and the IASB Chair, who together will ensure that these issues are addressed in a timely manner.¹⁸⁴ The Monitoring Board also decided to develop in concert with the Trustees a feedback mechanism to ensure that in the event the IASB determines not to take up an issue that was referred by the Monitoring Board, the IASB will demonstrate to the Trustees and the Monitoring Board that adding the matter to the IASB agenda would be inconsistent with the IASB's standard-setting responsibilities established in the IFRS Foundation's Constitution.¹⁸⁵ Considering the views from respondents, the Monitoring Board also noted that, in all cases, it is understood that the Monitoring Board will neither influence the decision-making process nor challenge the decisions made by the IASB with regard to its standard setting.¹⁸⁶ The Monitoring Board also noted that it will continue to observe carefully the outcome of the ongoing improvements in the IASB's agenda-setting process and will take due account of such improvements in its periodic reviews.¹⁸⁷

E. Composition of the IFRS Foundation and the IASB

The Staff analyzed the IFRS Foundation and IASB's governance and other documents, as supplemented by the results of the MB Governance Review and the Trustees' Strategy Review and constituent views thereon, to assess the composition of the IFRS Foundation and the IASB.

1. IFRS Foundation Trustee Composition and Duties

The governance of the IFRS Foundation primarily rests with its Trustees. The IFRS Foundation is currently governed by 22 trustees, which is the maximum number allowed under the IFRS Foundation's Constitution.¹⁸⁸ Trustees are appointed for a term of three years that is renewable once.¹⁸⁹ The IFRS Foundation's Constitution reflects the requirement to have a mix

¹⁸¹ See *id.*

¹⁸² See IFRS Foundation Staff Comment Summary.

¹⁸³ See MB Comment Summary.

¹⁸⁴ See MB Final Report.

¹⁸⁵ See *id.*

¹⁸⁶ See *id.*

¹⁸⁷ See *id.*

¹⁸⁸ See IFRS Foundation Constitution.

¹⁸⁹ See *id.*

of Trustees that broadly reflects the world's capital markets, is geographically diverse, and provides an appropriate balance of professional backgrounds: six of the Trustees must be selected from the Asia/Oceania region, six from Europe, six from North America, one from Africa, one from South America, and two from any area, subject to maintaining overall geographical balance.¹⁹⁰ Under the IFRS Foundation's Constitution, the Trustees are responsible for undertaking a review of the structure and effectiveness of the IFRS Foundation every five years, and that review is to include consideration of changing the geographical distribution of Trustees in response to changing global economic conditions.¹⁹¹ The Trustees also must comprise individuals that, as a group, include auditors, preparers, users, academics, and officials serving the public interest.¹⁹² Normally, two of the Trustees should be senior partners of prominent international accounting firms.¹⁹³

All Trustees are required to show a firm commitment to the IFRS Foundation and the IASB as a high-quality global standard setter, to be financially knowledgeable, and to have the ability to meet the time commitment.¹⁹⁴ Each Trustee must also have an understanding of, and be sensitive to, the challenges associated with the adoption and application of high-quality, global accounting standards developed for use in the world's capital markets and by other users.¹⁹⁵

The duties of the Trustees are outlined in the IFRS Foundation's Constitution. The Trustees are broadly responsible for establishing and maintaining operating procedures and financing for the IFRS Foundation.¹⁹⁶ The Trustees are responsible for appointing the members of the IASB, the IFRS IC,¹⁹⁷ and the IFRS Advisory Council¹⁹⁸ and for establishing operating procedures, consultative arrangements, and due process for each of those bodies.¹⁹⁹ The Trustees review annually the strategy of the IFRS Foundation and the IASB and its effectiveness and approve annually the IFRS Foundation's budget.²⁰⁰ The Trustees review broad strategic issues affecting financial reporting standards, promote the IFRS Foundation and its work, and promote

¹⁹⁰ See id.

¹⁹¹ See id.

¹⁹² See id. Some commenters have expressed a view that investors (i.e., users) should be more heavily represented among the Trustees. See comment letter of CFA on the 2011 May Staff Paper.

¹⁹³ See id.

¹⁹⁴ See id.

¹⁹⁵ See id.

¹⁹⁶ See id.

¹⁹⁷ See id.

¹⁹⁸ See id. The IFRS Advisory Council provides a forum for participation by organizations and individuals with an interest in IFRSs with the objective of giving advice to the IASB on its agenda and projects and giving other advice to the IASB and the Trustees. Commission Staff participate as an observer to the IFRS Advisory Council.

¹⁹⁹ See id.

²⁰⁰ See id.

the objective of rigorous application of IFRSs.²⁰¹ The Trustees foster and review the development of educational programs and materials that are consistent with the IFRS Foundation's objectives.²⁰² However, the Trustees are required to be excluded from involvement in technical matters relating to financial reporting standards; those matters are reserved for the IASB.²⁰³ The Trustees are responsible for developing rules and procedures to ensure that the IASB is, and is seen to be, independent.²⁰⁴

2. IFRS Foundation Trustee Selection Process

As previously stated, the Trustees are responsible for establishing procedures for filling Trustee positions, including advertising vacant positions, and the selection process is to be administered by the Trustees in a transparent manner.²⁰⁵ Trustees should be selected after consultation with national and international organizations of auditors, preparers, users, and academics.²⁰⁶ Individuals are also permitted to put forward their own names.²⁰⁷ The Trustees propose a candidate for each open Trustee position, and the Monitoring Board may submit names for the Trustees' consideration.²⁰⁸ The Monitoring Board is responsible for the approval of all Trustee appointments and reappointments.²⁰⁹ The Chair of the Trustees and up to two Vice-Chairs are appointed by the Trustees from among the Trustees, subject to the approval of the Monitoring Board.²¹⁰

As discussed in subsection III.D.5., the Monitoring Board concluded, as a result of the MB Governance Review, that there should be enhancements to the Trustee selection process. In particular, the Monitoring Board decided that the process and criteria for the selection of the Trustees will be documented and made public.²¹¹

3. Trustee Involvement in the Standard-Setting Process

a. DPOC

As noted earlier, the Trustees have the direct and primary responsibility to oversee the IASB. The Trustees established the DPOC in 2006 to play a more active and visible role in the

²⁰¹ See *id.*

²⁰² See *id.*

²⁰³ See *id.*

²⁰⁴ See *id.*

²⁰⁵ See MB MoU; see also IFRS Foundation Constitution.

²⁰⁶ See IFRS Foundation Constitution.

²⁰⁷ See *id.*

²⁰⁸ See MB MoU.

²⁰⁹ See MB MoU; see also IFRS Foundation Constitution.

²¹⁰ See IFRS Foundation Constitution.

²¹¹ See MB Final Report.

oversight of the IASB's due process.²¹² The DPOC meets with the IASB regularly to monitor its compliance with due process procedures, to review complaints regarding the IASB's due process, and to assess other areas of concern related to the IASB's due process activities.²¹³ As noted earlier, the Trustees are excluded from involvement in technical matters that are reserved for the IASB.

As a result of the Trustees' Strategy Review, the Trustees decided that the framework for oversight of the IASB's due process should be clarified.²¹⁴ In particular, the Trustees' DPOC should review and discuss due process compliance regularly throughout the standard-setting process and at the end of the process before a standard is finalized.²¹⁵ The DPOC should report regularly on these activities to the Trustees and in its annual report.²¹⁶ Respondents to the 2011 Public Consultation on the whole expressed overwhelming support for the need for the Trustees' DPOC to monitor due process throughout the entire standard-setting process, rather than reviewing the process only at the end.²¹⁷ Respondents supported the idea that due process should be reviewed and further enhanced regularly.²¹⁸

b. Post-Implementation Reviews

According to the DP Handbook, the IASB, rather than the Trustees, is responsible for carrying out post-implementation reviews of new IFRSs and major amendments.²¹⁹ Post-implementation reviews are normally to be conducted two years after new requirements in IFRSs have become mandatory and have been implemented.²²⁰ Such reviews are supposed to be limited to important issues identified as contentious during the development of the pronouncement with consideration given to any unexpected costs or implementation problems encountered.²²¹

²¹² See Strategy Review Final Report.

²¹³ See *id.*

²¹⁴ See *id.*

²¹⁵ See *id.*

²¹⁶ See *id.*

²¹⁷ See IFRS Foundation Staff Comment Summary.

²¹⁸ See *id.* See also comment letter of TCHA on the 2011 May Staff Paper ("We note that the Trustees of the IFRS Foundation have established a special committee, the Due Process Oversight Committee, with the task of regularly reviewing and, if necessary, amending the procedures of due process in light of experience and comments from the IASB and constituents. We believe this ongoing review is essential to continue to ensure that the IASB's standard-setting process is robust, accessible and transparent.").

²¹⁹ See Strategy Review Final Report (citing DP Handbook).

²²⁰ See *id.*

²²¹ See *id.*

In July 2011, the IASB launched its first formal public agenda consultation on its future work plan.²²² In the 2011 Agenda Consultation, the IASB described its current process for post-implementation reviews of IFRSs, consistent with the DP Handbook. Many respondents to the 2011 Agenda Consultation expressed the view that the current scope of the IASB's post-implementation reviews is too narrow and should be expanded to consider issues such as whether or not the objective of the IFRS was achieved and whether the IFRS or major amendment has resulted in more useful information for investors and other users.²²³ Similar comments were made by some respondents to the 2011 Public Consultation as part of the Trustees' Strategy Review.²²⁴ Additionally, some respondents to the 2011 Agenda Consultation suggested that the post-implementation review process should be altered in a manner to give it greater transparency and independence.²²⁵ Some suggested that the IASB should not be involved in the process in order to enhance the credibility of the work.²²⁶ In particular, some suggested that the post-implementation review process should be steered by the IFRS IC or by a committee drawn from the Trustees that reports directly to them.²²⁷ Comments in response to the Trustees' 2011 Public Consultation included a recommendation that the post-implementation review be carried out by national standard setters or other accounting bodies, which would improve the IASB's and the IFRS Foundation's public accountability.²²⁸

The Staff notes that post-implementation reviews of FASB standards are conducted by the FAF, and the process is designed to be independent of the FASB's standard-setting process. The staff who conduct the post-implementation reviews of FASB standards report to the FAF Board of Trustees and the FAF President/CEO, but members are drawn from experienced FASB and GASB staff.²²⁹

The Staff believes the IFRS Foundation and Trustees should consider altering the reporting structure for post-implementation reviews of IFRSs. As suggested by commenters, the Staff believes that the staff working on the post-implementation reviews should report directly to

²²² See IASB, Agenda Consultation 2011: Request for Views (Jul. 2011) ("2011 Agenda Consultation") (available at: <http://www.ifrs.org/Current+Projects/IASB+Projects/IASB+agenda+consultation/IASB+agenda+consultation.htm>).

²²³ See IASB Staff Paper, Agenda Paper 5A: Request for Views—Agenda Consultation 2011: Comment letter summary (Jan. 2012) ("IASB Staff Paper—Request for Views") (available at: <http://www.ifrs.org/Meetings/IASB+January+2012.htm>).

²²⁴ See IFRS Foundation Staff Comment Summary.

²²⁵ See IASB Staff Paper—Request for Views.

²²⁶ See id.

²²⁷ See id.

²²⁸ See IFRS Foundation Staff Comment Summary.

²²⁹ See FAF, The FAF's Post-Implementation Review Process (available at: <http://www.accountingfoundation.org/cs/ContentServer?site=Foundation&c=Page&pagename=Foundation%2FPage%2FFAFSectionPage&cid=1176159625382>).

the Trustees rather than the IASB. The public will likely regard the post-implementation reviews as more credible if the IASB is not directly reviewing its own work.

4. Composition of the IASB

The IASB is currently composed of 14 full-time members.²³⁰ Under the IFRS Foundation's Constitution, the number of IASB members will increase to 16 no later than July 1, 2012, of which up to three members may be part-time.²³¹ Members serve five-year terms subject to one re-appointment.²³² Members appointed after July 2, 2009 have terms that are renewable once for a period of three years, with the exception of the Chair and a Vice-Chair, who may serve a second term of five years.²³³ All members are required to meet appropriate guidelines of independence established by the Trustees.²³⁴ Full-time members are required to sever all employment relationships and positions that may give rise to economic incentives that might call into question a member's independence of judgment in setting financial reporting standards.²³⁵

Unlike the FASB, the IASB is permitted to include up to three part-time members who would not be required to sever their existing employment arrangements.²³⁶ Although this is limited to a small minority of members and does not appear to have resulted in an actual issue in the past, the presence of such relationships does pose the possibility of including board representation of individuals who are not viewed as objective.

The Trustees select IASB members based on criteria in the IFRS Foundation's Constitution, with a focus on professional competence and practical experience.²³⁷ The Trustees select members so that the IASB will comprise a group of people representing, within that group, the best available combination of technical expertise and diversity of international business and market experience in order to contribute to the development of high-quality, global accounting standards.²³⁸ Additionally, Trustees must ensure a geographical mix on the IASB, with four members drawn from each of the Asia/Oceania region, Europe, and North America; one member from South America; one member from Africa; and two members from any area, subject to maintaining overall geographical balance.²³⁹ The Trustees must also seek an appropriate mix such that the IASB as a group reflects recent practical experience among auditors, preparers,

²³⁰ See IFRS Foundation Constitution.

²³¹ See *id.*

²³² See *id.*

²³³ See *id.*

²³⁴ See *id.*

²³⁵ See *id.*

²³⁶ See *id.*

²³⁷ See *id.*

²³⁸ See *id.*

²³⁹ See *id.*

users, and academics.²⁴⁰ Currently, the IASB members come from at least ten countries and have a variety of backgrounds.²⁴¹

As part of the MB Governance Review, the Monitoring Board addressed the composition of the IASB. In the MB Consultative Report, the Monitoring Board proposed that the IFRS Foundation undertake concrete efforts to improve identification of candidates to ensure IASB membership from diverse geographical and professional backgrounds in order to provide for further objectivity and impartiality in the decision-making process, while maintaining professional competence and practical experience as the primary qualifications.²⁴² Many respondents to the MB Consultative Report agreed or partially agreed with the proposal, expressing the view that further efforts to ensure diversity of IASB membership would address concerns from others about legitimacy of the IASB and enhance the IASB's credibility.²⁴³ However, some respondents noted that diversity should not be pursued at the expense of technical competence of IASB candidates.²⁴⁴ Further, some respondents do not believe there are problems with the current composition and do not see the need for further efforts around diversity.²⁴⁵

In the MB Final Report, the Monitoring Board maintained its proposals, noting that, while there were many strong arguments by respondents to ensure diversity of the IASB in geographical and professional backgrounds, priority should be placed on nominees' professional competence and experience in dealing with IFRSs.²⁴⁶ The Monitoring Board rejected suggestions that the Trustees should limit IASB members to individuals from jurisdictions using IFRSs, as the Monitoring Board found such an approach to be in conflict with the intention to focus on individuals' merits.²⁴⁷

²⁴⁰ See id.

²⁴¹ See IFRS, Members of the IASB, for IASB member biographical information (available at: <http://www.ifrs.org/The+organisation/Members+of+the+IASB/Members+of+the+IASB.htm>). Information is current as of May 2012.

²⁴² See MB Consultative Report.

²⁴³ See MB Comment Summary. Cf. comment letter of CFA on the 2011 May Staff Paper (seeking greater investor representation on the IASB, but seeking a smaller IASB size overall, "to mitigate political negotiation and comprises that reduce the quality of standards").

²⁴⁴ See MB Comment Summary. See also CII Study (expressing concern, in criterion #4, that existing practices already inappropriately elevate geographic considerations over technical expertise); and comment letter of Pfizer on the 2011 May Staff Paper ("Our concerns around governance of the IASB relate to. . . [among other things] the large number of board members, where expertise can be uneven and where interests and concerns may diverge widely.").

²⁴⁵ See MB Comment Summary.

²⁴⁶ See MB Final Report.

²⁴⁷ See id. But cf. comment letter of TCHA on the 2011 May Staff Paper ("To that end, we believe it is of the utmost importance that there be adequate representation of stakeholders in the governing bodies of the IFRS Foundation and the IASB and that the composition of these bodies ensures adequate representation and experience from countries and regions committed to the use of IFRS.").

F. Funding of the IFRS Foundation

In the 2010 Statement, the Commission recognized the importance of independent funding to support a standard-setting process free of undue influence for the benefit of investors.²⁴⁸ The Commission previously has noted that the IASB may be subject to a perceived, or potentially an actual, connection between the availability of funding and the outcome of the IASB's standard-setting process.²⁴⁹ As noted in the Work Plan, the Staff recognizes that the United States has a significant interest in the stable funding of the IFRS Foundation²⁵⁰ and is committed to exploring strategies to address this issue. In executing the Work Plan, the Staff analyzed for the Commission's benefit: (1) the extent to which the IFRS Foundation's sources of funding promote the independence of the IASB; and (2) possible funding mechanisms to provide the U.S.-based contribution to the IFRS Foundation.²⁵¹ Specifically, the Staff:

- Evaluated whether the Trustees' four characteristics governing the establishment of a funding approach are appropriate.
- Monitored the IFRS Foundation's funding arrangements to determine whether voluntary funding from individual organizations continues to be reduced and a stable, independent funding platform is secured.
- Explored alternatives for funding mechanisms in the United States.²⁵²

1. Four Characteristics of a Funding Approach

As noted in the Work Plan:

Until 2008, the IFRS Foundation financed IASB operations largely through voluntary contributions from a wide range of market participants from across the

²⁴⁸ See 2010 Statement.

²⁴⁹ See 2008 Roadmap. See also SEC Release No. 33-8879 (Dec. 21, 2007), Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP ("2007 FPI Adopting Release"). See also Report of the Financial Crisis Advisory Group (Jul. 28, 2009) (available at: http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176156365880). The Financial Crisis Advisory Group ("FCAG") was formed to advise the FASB and the IASB about the standard-setting implications of the financial crisis and potential changes in the global regulatory environment. The members of the FCAG are senior leaders with broad international experience in the financial markets, observed by key global banking, insurance, and securities regulators.

²⁵⁰ In 2010, 27 companies based in the United States (not including the international accounting firms) provided financial support to the IFRS Foundation; amounts contributed varied widely. See IFRS Foundation, Annual Report 2010: Financial reporting for the world's interconnected financial markets (2011) ("2010 Annual Report") (available at: <http://www.ifrs.org/The+organisation/Governance+and+accountability/Annual+reports/2010Annual+Report.htm>).

²⁵¹ See Work Plan.

²⁵² See id.

world's capital markets, including from a number of firms in the accounting profession, companies, international organizations, central banks, and governments. Funding commitments were made for the period 2001–2005 and then were extended for an additional two years through 2007. In June 2006, the Trustees agreed on four characteristics that should govern the establishment of a funding approach designed to enable the IFRS Foundation to remain a private-sector organization with the necessary resources to conduct its work in a timely fashion. The IFRS Foundation has no authority to impose funding regimes on countries, but the Trustees have worked closely with regulatory and other public authorities and key stakeholder groups on the creation of national regimes.²⁵³

The four characteristics that the Trustees agreed upon that should govern the establishment of a funding approach are described as (1) broad-based, (2) compelling, (3) open-ended, and (4) country- or jurisdiction-specific.²⁵⁴

Based on the feedback to the 2011 Public Consultation, the IFRS Foundation reaffirmed their desired funding model.²⁵⁵ In the Trustees' Strategy Review, the Trustees described a global funding system that has the following features, consistent with the four principles outlined above:

- Long-term commitment: Funding should not be dependent on annual appropriations and not contingent on fulfilling any conditions that would compromise independence.
- Public sponsorship: There should be direct or implicit governmental or regulatory support. The "public" element will remove any perception of undue interference by private sector interest groups through the financing process.
- Flexibility: Funding should be flexible to take into account agreed increases in the budget and financing regimes that suit the legal frameworks and cultural backgrounds of the national jurisdictions. There should be a designated institution with which the IFRS Foundation should liaise in each funding jurisdiction. The Trustees believe a sensible formula would be a levy on users and beneficiaries of IFRSs (such as listed companies and investment companies).
- Proportionality: Funding should be shared by the major economies of the world on a proportionate basis, using GDP as the determining measure.

²⁵³ Id. (internal citations omitted). Additional information is available at: IFRS, Financing, at <http://www.ifrs.org/The+organisation/Governance+and+accountability/Financing/Financing.htm>.

²⁵⁴ See IASC Foundation, Annual Report 2006 (available at: <http://www.iasb.org/NR/rdonlyres/D95B6BF3-A12A-4C6C-BDA1-BDC98B4F2A45/0/IASCFoundationAnnualReportFinal.pdf>).

²⁵⁵ See Strategy Review Final Report.

- Public accountability: The Trustees should publish annually how they seek to use the funds raised by national and international financing mechanisms. The final approval of the budget should include a review of the budget with the Monitoring Board.²⁵⁶

A number of commenters have raised concerns about the IASB achieving a stable source of funding.²⁵⁷

2. Funding of the FASB

As a point of reference, in the United States, the federal securities laws provide the Commission with broad authority and responsibility to prescribe accounting standards for public companies.²⁵⁸ To assist it in meeting this responsibility, the Commission historically has looked to private-sector standard-setting bodies to develop accounting principles and standards.²⁵⁹ When the FASB was formed in 1973, the Commission recognized FASB standards as “authoritative” in the absence of any contrary determination by the Commission.²⁶⁰

Before enactment of the Sarbanes-Oxley Act, funding for the FASB was provided through the FAF via a combination of fundraising contributions and publication revenue. This model generated concerns both as to the potential or perceived risks that contributions could be affected by FASB actions, as well as the involvement of accounting firms in the funding process.²⁶¹

The legislative history of the Sarbanes-Oxley Act indicates that a stable and independent funding source without reliance upon voluntary contributions by accounting firms and companies was an important consideration for lawmakers when evaluating the FASB’s independent funding provisions.²⁶² There also were concerns that funding through legislative

²⁵⁶ See 2011 Public Consultation.

²⁵⁷ See CII Study. See also, e.g., comment letters of ABA; CFA; Chamber; IMA; and TCHA on the 2011 May Staff Paper.

²⁵⁸ See Securities Act of 1933, § 19; Securities Exchange Act of 1934, § 13(b).

²⁵⁹ See Accounting Series Release (“ASR”) No. 4 (Apr. 25, 1938); ASR No. 150 (Dec. 20, 1973); Release No. 33-8221, Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter (Apr. 25, 2003) [68 FR 23333 (May 1, 2003)] (“2003 Policy Statement”).

²⁶⁰ See ASR No. 150 (Dec. 20, 1973).

²⁶¹ See 148 CONG. REC. S6633 (Jul. 11, 2002) (statement of Sen. Sarbanes) (“[The FASB’s] problem in the past has been that they are voluntarily funded from the industry. They have to go to them and beg for money in order to carry out their activities. And if the industry thinks they are going to do a ruling that is contrary to what they want, then they are not as willing to support their activity. We eliminate that in this bill because we have a mandatory fee. . . . So that, in itself, is a very important and significant step in establishing the independence of the accounting standards board.”).

²⁶² See, e.g., 148 CONG. REC. S7362 (Jul. 25, 2002) (statement of Sen. Dodd) (“Having FASB now be compensated for and paid for from public money and not relying on the largess and generosity of the accounting industry to receive compensation will make a significant difference in establishing accounting rules and procedures”). See also, 148 CONG. REC. S6696-S6697 (Jul. 22, 2002) (statement of Sen. Levin) (“The

[Footnote continued on next page]

appropriation could present potential and perceived risks to independence.²⁶³ Section 109 of the Sarbanes-Oxley Act provides that all of the budget of a standard-setting body that satisfies the criteria under Section 108 of the Sarbanes-Oxley Act must be payable from an annual accounting support fee assessed and collected against issuers, as may be necessary or appropriate to pay for the budget and provide for the expenses of the standard-setting body, and to provide for an independent, stable source of funding, subject to review by the Commission.²⁶⁴

To fulfill its mandate under the Sarbanes-Oxley Act, the Commission undertakes a review every year of the FASB's proposed accounting support fee. In connection with that review, the Commission also reviews the budget for the FAF and the FASB as to the proposed uses of the fee and the reasonableness of the amounts requested. The Staff reviews and analyzes these materials and engages in discussions with FAF personnel, including reviewing supporting documentation. The Commission reviews any additional sources of revenue, and the FAF represents that neither the FAF nor the FASB accept contributions from the accounting industry. At the conclusion of the review, the Commission determines whether the proposed annual accounting support fee is consistent with Section 109 of the Sarbanes-Oxley Act.

3. Monitoring Board Role in Funding

The MB Final Report maintains that the Trustees remain primarily responsible for funding the IFRS Foundation and the IASB.²⁶⁵ However, the Monitoring Board intends to take an oversight role with respect to the Trustees' performance regarding funding; it also "decided to refrain from recommending certain [funding] models, and to encourage respective jurisdictions using IFRSs to make their utmost efforts for the collection of funds, while leaving the specifics of the actual mechanisms for them to decide."²⁶⁶

[FASB] issued an exposure draft called, 'Accounting for Stock-Based Compensation,' and they decided that stock option values should be expensed. . . . Then in paragraph 60 of their findings, the FASB board said the following, that 'the debate on accounting for stock-based compensation unfortunately became so divisive that it threatened the board's future working relationship with some of its constituents. The nature of the debate threatened the future of accounting standards-setting in the private sector.' This is an extraordinary document and everybody should read it so people understand the kind of pressure that not only that board was under—hopefully, the newly independently funded board will not be under—but the kind of pressure which exists in this Congress. We have, in essence, a new board, because it has an independent source of funding.”)

²⁶³ See 148 CONG. REC. S7355 (Jul. 25, 2002) (statement of Sen. Enzi) (“We did something marvelous for the FASB. We made sure of its independence. One way we made sure of its independence, besides citing in the law, was to make sure FASB has independent funding. They will not have to come to Congress with a budget. And they will not have to go to corporate America for funding. They will get independent funding to be able to do the job they need to do. That will inhibit us from trying to change what they are doing in setting accounting standards.”)

²⁶⁴ See 15 U.S.C. § 7219. Section 109 of the Sarbanes-Oxley Act does allow for additional sources of revenue, such as from publication sales, provided that such source of revenue shall not jeopardize, in the judgment of the Commission, the entity's actual and perceived independence.

²⁶⁵ See MB Final Report.

²⁶⁶ Id.

In updating its membership criteria, the Monitoring Board elected to include a criterion based on “financial contributions by the jurisdiction to the setting of IFRSs.”²⁶⁷ Therefore, continued membership of the SEC on the Monitoring Board would be in part based on the Trustees’ success in fundraising from U.S. constituents. In the United States, this results in an interesting dynamic. Neither the Commission nor the Staff could act as a fundraiser for a private organization, and it is questionable under existing law whether the Commission could use its own funds to contribute to a private organization. In addition, the Commission may be limited from directly funding the IFRS Foundation without an appropriation request of Congress.²⁶⁸ As a result, the Commission’s membership on the Monitoring Board is dependent in part on the efforts of others in the United States to fund the IFRS Foundation.

4. Approaches in Other Jurisdictions to Contribute to the IFRS Foundation

The Trustees noted in their 2011 Public Consultation that since 2006, they have sought to establish national financing regimes, proportionate to a country’s relative GDP, that establish a levy on companies or provide an element of publicly supported financing.²⁶⁹ The Trustees believe further progress on financing is essential to safeguard the IFRS Foundation’s position as the world’s independent accounting standard setter.²⁷⁰ The Staff’s review 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 to listed companies and make their contribution from this assessment. In some jurisdictions, these levies are required to be paid by law or regulation, whereas in other jurisdictions, amounts suggested by the “levies” are voluntary (effectively resulting in a voluntary contribution model in such jurisdictions). Alternatively, contributions in some countries, such as the United States, come directly from voluntary contributions by the private sector without any suggested levy.²⁷¹ Further, a significant amount of intellectual capital and staffing is provided to the IASB by national standard setters and others, but the IASB does not pay a market rate for such support.

²⁶⁷ Id.

²⁶⁸ See 31 U.S.C. § 1341(a)(1)(B) (Antideficiency Act).

²⁶⁹ See 2011 Public Consultation.

²⁷⁰ See id.

²⁷¹ See IFRS Foundation, Annual Report 2011: 100+ countries, 46 translations, one financial reporting language (2012) (“2011 Annual Report”) (available at: <http://www.ifrs.org/The+organisation/Governance+and+accountability/Annual+reports/2011AnnualReport.htm>); see also IASB Foundation, Annual Report 2009: Financial Reporting for the world’s interconnected markets (2010) (“2009 Annual Report”) (available at: <http://www.ifrs.org/The+organisation/Governance+and+accountability/Annual+reports/2009+Annual+Report.htm>).

In its 2009 Annual Report, the IFRS Foundation cited contributions from organizations in 31 jurisdictions, spread over the Americas, Europe, Asia-Oceania, and Africa.²⁷² Not all jurisdictions that have incorporated IFRS in some form as part of their financial reporting system contribute to the IFRS Foundation. In fact, based on the Staff's initial research, it appears that less than 25% of these countries contribute; in other words, three out of four countries reported by the IFRS Foundation as permitting or requiring some form of IFRS provide no monetary funding. In the 2011 Annual Report, the number of jurisdictions from which organizations made contributions dropped from 31 to 25.²⁷³

In prior years, funding of the IFRS Foundation from countries in the EU occurred on a per-country basis. The EU passed a regulation in 2009 establishing an EC program that would support the IFRS Foundation in addition to individual country contributions. Decision No. 716/2009/EC ("Decision") creates a program through which the EC supports the IFRS Foundation through grants of up to €12.75 million from 2010–2013.²⁷⁴ The Decision cites the goal of ensuring that the IFRS Foundation benefits from clear, stable, diversified, sound, and adequate funding, enabling it to accomplish its mission in an independent and efficient manner.²⁷⁵ The Decision also states, however, that beneficiaries of funds shall not continue to benefit from contributions unless they make significant progress towards securing a majority of their total funding arrangements from neutral funding agreements, including third-country participants, within two years.²⁷⁶

5. Contributions by the Large Accounting Firms

In its 2012 budget, the IFRS Foundation continues to rely significantly on voluntary contributions from the large accounting firms.²⁷⁷ Contributions from the largest accounting firms were expected to be approximately 25% of the 2012 collections.²⁷⁸ As discussed previously, before enactment of the Sarbanes-Oxley Act, the FASB and its predecessors relied on contributions from, among other sources, the largest accounting firms. It is understandable that the IFRS Foundation, as an international organization, has encountered challenges in achieving a consistent funding mechanism for each jurisdiction. The achievement of an independent funding source for the FASB was a significant benefit from the passage of the Sarbanes-Oxley Act. However, the continued reliance by the IFRS Foundation on funding from

²⁷² See 2009 Annual Report.

²⁷³ See 2011 Annual Report.

²⁷⁴ See Decision No 716/2009/EC of the European Parliament and of the Council, establishing a Community programme to support specific activities in the field of financial services, financial reporting and auditing (Sept. 16, 2009), Article 9.

²⁷⁵ See Decision No 716/2009/EC, Recital 15.

²⁷⁶ See Decision No 716/2009/EC, Article 4.

²⁷⁷ See 2011 Annual Report. The accounting firms are Deloitte & Touche, Ernst & Young, KPMG, PricewaterhouseCoopers, BDO, Grant Thornton, and Mazars.

²⁷⁸ Calculated based on data in the 2011 Annual Report.

the largest accounting firms will continue to cause concerns as to the adequacy and independence of the IASB's funding model.²⁷⁹

6. Funding from the United States

Since the founding of the IASB, the United States has consistently been one of the largest contributors to the IASB in both monetary and in-kind funding. For example, in addition to monetary contributions, the United States has contributed significant resources to support the joint standard-setting efforts of the IASB and the FASB under their MoU. However, recently, the Trustees have not been successful in meeting their funding objectives for the United States. In the FAF's comment letter in response to the 2011 May Staff Paper, the FAF noted the importance of finding an appropriate means of funding the U.S. portion of the IFRS Foundation's operating budget.²⁸⁰ In addition, the FAF offered to "lend its support to efforts to develop a suitable funding mechanism for an appropriate share of the IASB's operating budget."²⁸¹

G. IASB Standard-Setting Process

1. Focus of the Staff's Review

When the Commission, in accordance with the Sarbanes-Oxley Act, reaffirmed its recognition of the financial accounting and reporting standards of the FASB as "generally accepted" for purposes of the federal securities laws,²⁸² the Commission stressed, among other things, the importance of three components in the standard-setting process, as follows:

- Consideration of international convergence on high-quality accounting standards for the public interest and for the protection of investors;
- Timeliness in completing projects, while satisfying appropriate public notice and comment requirements; and
- Objectivity in decision-making and careful consideration of the views of constituents and the expected benefits and perceived costs of each standard.²⁸³

²⁷⁹ See Cf. CII Study (noting, in criterion #3, that the voluntary contribution model gives rise to concerns about the IASB's independence, noting that international accounting firms contributed 26% of the 2011 budget, and reflecting Trustees' concerns that the funding is not sufficient to keep pace with demand); see also comment letter of TCHA on the 2011 May Staff Paper.

²⁸⁰ See comment letter of the FAF on the 2011 May Staff Paper.

²⁸¹ Id.

²⁸² See 2003 Policy Statement.

²⁸³ See id.

When formulating the Work Plan, the Staff decided that the three components emphasized by the Commission in evaluating the FASB's standard-setting process are also critical to an evaluation of the IASB's standard-setting process. Accordingly, in executing the Work Plan, the Staff focused on three components of the IASB's standard-setting process: (1) pre-eminence of investors; (2) timeliness; and (3) objectivity.²⁸⁴

In accordance with the Work Plan, in evaluating each of the three components, the Staff reviewed the IASB's policies and procedures as detailed in the IFRS Constitution, DP Handbook, and other relevant IFRS Foundation and IASB documents, and as supplemented by the results of the MB Governance Review and the Trustees' Strategy Review, in an effort to determine the IASB's compliance with those policies. In addition, the Staff analyzed stakeholder perspectives in each area. Further, the Staff formed views regarding the extent to which the IASB promotes the pre-eminence of investors, resolves emerging issues in a timely and effective manner without compromising due process, and fosters independence and objectivity through the Staff's monitoring of the development of IASB standards. The Staff considers the interpretations process an integral part of the standard-setting process and, as such, has reviewed the functioning of the IFRS IC as part of these procedures. The following subsections consider pre-eminence of investors, timeliness, and objectivity in the context of the IASB's standard-setting process.

2. IASB's Standard-Setting Process

a. Overview of the Process

Under the IFRS Foundation's Constitution, the IASB has complete responsibility for all IASB technical matters including the preparation and issuance of IFRSs and exposure drafts, each of which shall include any dissenting opinions, and the approval and issuance of Interpretations developed by the IFRS IC.²⁸⁵ The IASB is required to publish an exposure draft on all projects and typically will publish a discussion document for public comment on major projects in accordance with procedures approved by the Trustees.²⁸⁶ The IASB has full discretion in developing and pursuing its technical agenda, subject to consulting with the Trustees and the IFRS Advisory Council, and subject to carrying out a public consultation every three years, the first of which was started in 2011.²⁸⁷ The IASB also has full discretion over project assignments on technical matters.²⁸⁸ In organizing the conduct of its work, the IASB may outsource detailed research or other work to national standard setters or other organizations.²⁸⁹

²⁸⁴ See Work Plan.

²⁸⁵ See IFRS Foundation Constitution.

²⁸⁶ See *id.*

²⁸⁷ See *id.* See also the IASB's 2011 Agenda Consultation.

²⁸⁸ See IFRS Foundation Constitution.

²⁸⁹ See *id.*

The IFRS Foundation’s Constitution specifies certain steps for the IASB to take in gathering input on standards under development. Specifically, the IASB shall normally form working groups or other types of specialist advisory groups to give advice on major projects.²⁹⁰ It shall consult the IFRS Advisory Council on major projects, agenda decisions, and work priorities.²⁹¹ Although not a requirement for each project, the IASB shall consider holding public hearings to discuss proposed standards and consider undertaking field tests (both in developed countries and in emerging markets) to ensure that proposed standards are practical and workable in all environments.²⁹² The IASB also shall establish procedures for reviewing comments made within a reasonable period on documents published for comment.²⁹³ Further, the IASB shall explain to the Trustees its reasons for not following any of the non-mandatory procedures specified by the Trustees.²⁹⁴

In addition to the responsibilities outlined in the IFRS Foundation’s Constitution, and as noted in the Work Plan, the IASB relies on a number of practices and other factors to ensure that it considers a diversity of views from the public. First, its meetings are open to public observers and are broadcast over the Internet. Additionally, meeting materials, comment letters received, and staff summaries of comment letters on discussion papers and exposure drafts, among other materials, are publicly available on the IASB website.²⁹⁵ Further, the IASB consults with national accounting standard setters and other official bodies concerned with standard setting in order to understand better global financial reporting issues in a regional and national context.²⁹⁶

b. Commission Staff Monitoring of the IASB’s Process

The Staff monitors all of the IASB’s standard-setting projects, other than efforts related to IFRS for small and medium-sized entities (“SMEs”).²⁹⁷ For projects that are conducted jointly by the Boards, the Staff listens to all public meetings and education sessions. The Staff also listens to public IASB meetings and education sessions on certain IASB-only projects. The Staff reviews all IASB discussion papers and exposure drafts and participates in IOSCO’s Committee 1 to provide comment letters to the IASB. The Staff also periodically discusses IASB and joint

²⁹⁰ See *id.*

²⁹¹ See *id.*

²⁹² See *id.*

²⁹³ See *id.*

²⁹⁴ See *id.*

²⁹⁵ For more information, see IFRS, Standard-setting process—How we develop IFRSs (available at: <http://www.ifrs.org/How+we+develop+standards/How+we+develop+standards.htm>).

²⁹⁶ See IASB, How we consult: Encouraging broad participation in the development of IFRSs (Dec. 10, 2010) (“IASB’s How We Consult”) (available at: <http://www.ifrs.org/NR/rdonlyres/A9708702-32FA-49A9-B469-FC6BAF6136E9/0/HOWWECONSULTFINALvb.PDF>).

²⁹⁷ *IFRS for SMEs* is a self-contained standard of 230 pages, designed to meet the needs and capabilities of small and medium-sized entities. The Commission does not accept use of IFRS for SMEs by foreign private issuers without reconciliation to U.S. GAAP. See 2007 FPI Adopting Release.

IASB-FASB standard-setting projects with IASB staff on conference calls to ask questions or explain Staff comments.

The Staff attends meetings of the IFRS Advisory Council and the IFRS IC as an observer (on behalf of IOSCO) and occasionally also attends IASB project-specific advisory group meetings as an observer. The Staff reviews various other materials that are available to the public, such as comment letters received by the IASB on its documents, IASB staff comment letter summaries and summaries of IASB outreach to investors and other constituents, remarks by IASB members about the Board’s activities, and IASB educational webcasts, among other materials.

The Staff approaches its review of IASB standard-setting documents in much the same way as it conducts its review of FASB standard-setting documents. The Staff considers whether each standard under development clearly expresses its objective and proposed requirements and is understandable. The Staff considers whether the proposed requirements will result in more accurate, transparent, and useful information for investors and other users. The Staff also considers whether the standard setter has given appropriate consideration to comments by constituents about operational concerns or costs of implementing new standards, in light of the expected benefits. The Staff also considers whether there is any impact or overlap with existing Staff guidance or Commission rules or requirements and how that impact or overlap can best be addressed. Overall, the Staff considers whether the standard setter is operating in the public interest, that the results are credible and the product of an independent and unbiased process, and that each standard adopted is within an acceptable range of alternatives that serve the public interest and protect investors.

3. Pre-eminence of Investors — IASB’s Interaction with Investors

For the IFRS Foundation and the IASB, the purpose of financial reporting is to communicate financial information to investors and other users of financial statements. In the 2010 Public Consultation, the Trustees noted that the IFRS Foundation’s Constitution specifies that IFRSs should “help investors, other participants in the world’s capital markets and other users of financial information make economic decisions” and questioned whether that objective should be changed. The Trustees also noted that the financial crisis had raised questions about the intersection of financial reporting standards and “other public policy concerns, particularly financial stability requirements” and questioned whether the two perspectives can or should be reconciled.²⁹⁸ In the 2011 Public Consultation, the Trustees proposed that “the IASB should develop financial reporting standards that provide a faithful presentation of an entity’s financial position and performance” and that “[t]hose standards should serve investors and other market participants in their economic and resource allocation decisions.”²⁹⁹ A majority of respondents to both the 2010 Public Consultation and the 2011 Public Consultation generally supported the

²⁹⁸ 2010 Public Consultation.

²⁹⁹ 2011 Public Consultation.

purpose of financial reporting as outlined by the Trustees.³⁰⁰ Some commenters have, however, expressed doubts that these principles are consistently observed in practice.³⁰¹

The Trustees note that they are reaffirming, as a result of their Strategy Review, the current constitutional focus on the development of financial reporting standards aimed at making informed resource allocation decisions.³⁰² Additionally, in their Strategy Review Final Report, the Trustees recognize that general purpose financial reporting cannot, by itself, fulfill all public policy objectives and that the IASB should emphasize the needs of investors and other financial market participants in their resource allocation decisions.³⁰³

Although the Trustees and the IASB recognize that investors and other users of financial statements have an important stake in the development of IFRSs, they also recognize that many investors and other users may not have time to read and respond to detailed technical proposals or to participate in IASB working groups.³⁰⁴ In an effort to meet the needs of this stakeholder group, the IASB created a dedicated investor outreach program.³⁰⁵ The IASB regards as a core element of the outreach program its “Investor Perspectives” blog, which is primarily written by IASB members who were formerly analysts.³⁰⁶ The IASB describes the objective of the blog as offering investment professionals regular updates on items that are likely to be of interest.³⁰⁷ Additionally, the IASB has dedicated a section of its website to investor resources.³⁰⁸

The IASB has assigned IASB outreach managers to each of its major projects to lead the engagement with stakeholders.³⁰⁹ Outreach activities include: providing project specific e-mail alerts; organizing individual meetings with organizations or representative bodies; conducting

³⁰⁰ See the IFRS Foundation Staff Response Analysis and the IFRS Foundation Staff Comment Summary.

³⁰¹ See comments of ABA (“The IASB’s process must be transparent and independent, with an investor focus rather than one heavily influenced by public policy. This is an area where the IASB has a challenge, whether it is in fact or in appearance.”); CFA (citing as problematic “the lack of sufficient investor focus and representation; and differences in views regarding the primary purpose of financial reporting”); and IMA (“Quality financial reporting standards serve the public interest exclusively through transparent reporting to investors and creditors. A broad interpretation of ‘public policy’ could invite government interference in standard setting, particularly in times of crisis.”) on the 2011 May Staff Paper. Cf. CII Study (indicating, in relation to criterion #5, improvements to the IASB’s focus on investors, but indicating a desire that investors have greater representation in the IFRS Foundation, the IASB, and the IFRS Council).

³⁰² See Strategy Review Final Report.

³⁰³ See id.

³⁰⁴ See IASB’s How We Consult.

³⁰⁵ See id.

³⁰⁶ See id. As of May 2012, the IASB includes three members with a background as financial analysts: Patrick Finnegan; Stephen Cooper; and Patricia McConnell.

³⁰⁷ See id.

³⁰⁸ See IFRS, Investor Resources—Investors: the IASB needs your input on accounting (available at: <http://www.ifrs.org/Investor+resources/Investors+and+IFRS.htm>).

³⁰⁹ See IFRS, Outreach Activities—Project-related outreach and stakeholder communication Activities (available at: <http://www.ifrs.org/Outreach+activities/Outreach+Stakeholder+Communication+Activities.htm>).

live webcasts with interactive question and answer sessions; providing podcast summaries of Board meetings; and conducting online surveys targeted at the investor and analyst community.³¹⁰ The IASB's outreach activities are designed to achieve a two-way dialogue about the IASB's projects and activities.³¹¹

4. Timeliness

a. Overview of Timeliness

The Staff believes that the standard-setting process requires a careful balance between timely resolution of emerging issues and sufficient due process. The Staff observes that the IASB's responsibilities, under the IFRS Foundation's Constitution, are focused to a greater extent on due process than on timeliness. As discussed previously, the IFRS Foundation's Constitution specifies a number of steps for the IASB to take in gathering input on standards under development.³¹² However, the IASB is not explicitly required to address emerging issues in a timely manner. The IFRS IC, as discussed below, has a responsibility to provide timely guidance.³¹³

The IASB typically allows a period of 120 days separately for comment on discussion papers and exposure drafts.³¹⁴ For major projects (which are those projects involving pervasive or difficult conceptual or practical issues), the IASB may allow a period of more than 120 days for comments.³¹⁵ The DP Handbook allows for the IASB to have a shorter period of consultation, if required, of 30 days.³¹⁶ The due process periods can be reduced but never dispensed with completely.³¹⁷

³¹⁰ See id.

³¹¹ See IASB's How We Consult.

³¹² See subsection III.G.2.a., above.

³¹³ See subsection III.G.4.b., below.

³¹⁴ See DP Handbook; see also IFRS, *Standard-setting Process—Comment Letters* (available at: <http://www.ifrs.org/How+we+develop+standards/Comment+letters.htm>).

³¹⁵ See id.

³¹⁶ For exposure drafts, if the matter is exceptionally urgent, the document is short, and the IASB believes that there is likely to be broad consensus on the topic, the IASB may consider a comment period of no less than 30 days, but it will set such a short period only after formally requesting and obtaining prior approval from 75% of the Trustees. See DP Handbook.

³¹⁷ There has been one instance in which the IASB issued amendments to standards without a comment period. In October 2008, the IASB issued, *Reclassification of Financial Assets - Amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures*, without previously issuing the amendments for comment. In its Basis for Conclusions, the IASB noted that "The Board normally publishes an exposure draft of any proposed amendments to standards to invite comments from interested parties. However, given the requests to address this issue urgently in the light of market conditions, and after consultation with the Trustees of the IASC Foundation, the Board decided to proceed directly to issuing the amendments." The Staff noted that several commenters noted the avoidance of due process as an area of concern. See, e.g., comment letters of IMA ("[T]he IASB should be prevented from overriding

[Footnote continued on next page]

b. IFRS IC

The IASB is assisted on IFRS interpretive matters by the IFRS IC.³¹⁸ Members of the IFRS IC are selected by the Trustees such that, as a group, they represent what the Trustees believe to be the best available combination of technical expertise and diversity of international business and market experience in the practical application of IFRSs and analysis of financial statements prepared in accordance with IFRSs.³¹⁹ Under the IFRS Foundation's Constitution, the IFRS IC is responsible for interpreting the application of IFRSs and providing timely guidance on financial reporting issues not specifically addressed in IFRSs, in the context of the IASB's conceptual framework, and undertaking other tasks at the request of the IASB.³²⁰ The IFRS IC is responsible for publishing, after clearance by the IASB, draft Interpretations for public comment and for considering comments made within a reasonable period before finalizing an Interpretation.³²¹ Final Interpretations also require approval by the IASB before publication.³²²

As part of the Trustees' Strategy Review, the Trustees considered ways to make refinements to the IFRS IC's activities.³²³ The focus of the refinements was on ways to support better the IFRS Foundation's interest in consistent application of IFRSs, in light of comments from constituents.³²⁴ Many respondents to the 2011 Public Consultation expressed the view that the IFRS Foundation needs to strengthen the IFRS IC and amend its current operations so as to ensure that more interpretations are issued.³²⁵ Some respondents asserted that the output (or lack thereof) from the IFRS IC has been such that it is not meeting the needs of stakeholders, sometimes resulting in local authorities and standard setters issuing their own interpretations or allowing for diversity in practice to persist, or both.³²⁶ Some respondents noted that in October 2010, the Trustees launched a separate review of the effectiveness and efficiency of the IFRS IC,

necessary steps in the due process as they did with the amendment to IAS 39."); Pfizer ("Our concerns around governance of the IASB relate to [among other things] instances where they have attempted to circumvent prescribed due process in an effort to expedite matters. . . .") on the 2011 May Staff Paper. Cf. CII Study. The Staff further notes that the IFRS Foundation's Constitution was amended subsequent to the single occurrence of due-process avoidance such that due process can no longer be eliminated, and reduced public comment periods require the approval of at least 75% of the Trustees.

³¹⁸ See IFRS Foundation Constitution. The IFRS IC is comprised of 14 voting members, appointed by the Trustees for renewable terms of three years, and two non-voting observers (IOSCO and the EC).

³¹⁹ See *id.*

³²⁰ See *id.*

³²¹ See *id.*

³²² See *id.*

³²³ See 2011 Public Consultation.

³²⁴ See *id.*

³²⁵ See IFRS Foundation Staff Comment Summary.

³²⁶ See *id.*

but commented that the review should be more aligned with the overall strategy of the IFRS Foundation.³²⁷

The Staff has received feedback from investors in the United States that is similar to that received by the Trustees in response to their review. The feedback received included comments that the IASB has the appropriate infrastructure to have a robust interpretive mechanism, but it is not staffed as it should be nor is it sufficiently productive, and the IASB's interpretive function needs to be much more active than it has been.³²⁸ The Staff has also heard from commenters that the United States has a more active interpretive mechanism, including through the FASB's EITF, and that a robust interpretive mechanism is necessary to ensure that users can undertake and have access to comparable financial analysis.³²⁹

In the Trustees' Strategy Review Final Report, the Trustees stated that the IFRS IC should help to ensure consistency in interpretations, without undermining the commitment to a principle-based approach to standard setting.³³⁰ The Trustees also noted that they expect the IFRS IC to play a more active role in its second decade.³³¹ The Trustees outlined several ways for the IFRS IC to carry out its role.³³² Some of the suggestions speak to timeliness: by calling on the IFRS IC to identify emerging areas of divergence before they become entrenched practice; by consulting auditors, audit regulators, and securities regulators; and by having timely public discussions and resolution of requests for interpretation or improvement.³³³ In addition, updates to IFRSs could potentially be completed more quickly by having the IFRS IC correct and clarify the wording of IFRSs for matters that are relatively minor and do not justify a separate IASB project.³³⁴ Other suggestions address the feedback aspects of the IFRS IC's activities, such as having the IFRS IC communicate persuasive explanations and reasons for not issuing further authoritative guidance than that which is already contained in the standards, and reaching out to all stakeholders to explain the interpretation and implementation processes.³³⁵ In addition, the Trustees recommended regularly reassessing the operational efficiency and effectiveness of the IFRS IC in conjunction with the Trustees' DPOC.³³⁶

³²⁷ See *id.*

³²⁸ See SEC IFRS Roundtable transcript (comments of Tricia O'Malley, former Chairman, Canadian Accounting Standards Board and David Grubb, Partner, Plante & Moran). See also comment letters of IMA ("We perceive that the IASB has been reluctant to interpret its standards and we encourage the IFRS Interpretations Committee to become more active."); Exxon; FIRCA; KPMG; IBM; and PwC on the 2011 May Staff Paper.

³²⁹ See, e.g., SEC IFRS Roundtable transcript (comments of Grubb). See also, e.g., comment letter of CNA on the 2011 May Staff Paper.

³³⁰ See Strategy Review Final Report.

³³¹ See *id.*

³³² See *id.*

³³³ See *id.*

³³⁴ See *id.*

³³⁵ See *id.*

³³⁶ See *id.*

5. Objectivity

a. Overview of Objectivity

As stated above, under the IFRS Foundation's Constitution, all IASB members are required to meet appropriate guidelines of independence established by the Trustees.³³⁷ Full-time members are required to sever all employment relationships and positions that may give rise to economic incentives that might call into question a member's independence of judgment in setting financial reporting standards.³³⁸ Although the IFRS Foundation's Constitution allows for up to three IASB members to be part-time members,³³⁹ who are not required to sever all other employment arrangements, there are currently no part-time IASB members. Under the IFRS Foundation's Constitution, each IASB member must agree contractually to act in the public interest and to give regard to the IASB's conceptual framework in deciding on and revising standards.³⁴⁰

As stated above, the DP Handbook details procedures to be followed by the IASB when setting standards, with an emphasis on how each stage of the process must address transparency and accessibility, extensive consultation and responsiveness, and accountability.³⁴¹ To fulfill its transparency and accessibility requirements under the DP Handbook, the IASB gathers input from constituents, through various means, and consults with various groups and organizations.³⁴² Additionally, the IASB makes a variety of materials available to the public.³⁴³ To fulfill its requirements for extensive consultation and responsiveness, the DP Handbook notes that the IASB solicits views and suggestions from a wide range of interested parties.³⁴⁴ The IASB may also arrange public hearings and field visits and set up working groups to promote discussions.³⁴⁵ The IASB debates different views on technical matters in public meetings and considers alternatives to its proposals.³⁴⁶ As part of its feedback process, the IASB staff summarizes and analyzes comments received from the public, and the IASB provides project summaries and feedback statements to inform the public of its positions on major points raised in the comment letters.³⁴⁷ With respect to accountability, the DP Handbook notes that the IASB explains to the Trustees its reasons for omitting any non-mandatory steps in its consultative process.³⁴⁸ As

³³⁷ See subsection III.E.4., above.

³³⁸ See IFRS Foundation Constitution.

³³⁹ See *id.*

³⁴⁰ See *id.*

³⁴¹ See subsection III.B., above.

³⁴² See DP Handbook.

³⁴³ See *id.*

³⁴⁴ See *id.*

³⁴⁵ See *id.*

³⁴⁶ See *id.*

³⁴⁷ See *id.*

³⁴⁸ See *id.*

explained earlier, the Trustees review and ensure compliance with the IASB's procedures and mandate, primarily through the DPOC.³⁴⁹

b. Enhancements to the IASB's Process

In the Strategy Review Final Report, the Trustees stated that:

A thorough and transparent due process is essential to developing high quality, globally accepted accounting standards. The IASB's due process should continue to be reviewed and regularly enhanced, benefiting from regular benchmarking against other organizations and from stakeholder advice.³⁵⁰

The Trustees noted that a benchmarking exercise is currently under way.³⁵¹ Respondents to the 2011 Public Consultation agreed that the IASB's process should be benchmarked against other similar organizations to ensure the IASB's due process is in accordance with best practice.³⁵²

Additional feedback about due process was gathered during the MB Governance Review. Most respondents to the MB Consultative Report expressed the view that the IASB's processes allow for appropriate stakeholder involvement.³⁵³ Some respondents made suggestions for improving stakeholder engagement in the standard-setting process, including allowing for more time in projects for stakeholder input and for the IASB to assess input received, and managing the pace of standard setting to correspond to what stakeholders can reasonably absorb.³⁵⁴ Other suggestions included more regular agenda consultation, increased outreach activities, increased use of field testing, and increased participation of investors.³⁵⁵ Additionally, some respondents suggested that the IASB undertake impact assessments at an earlier stage in projects.³⁵⁶

In the Strategy Review Final Report, the Trustees acknowledged that critics of the IASB have argued that the IASB does not account adequately for the views expressed by stakeholders, nor does it sufficiently explain how it reconciles differing viewpoints.³⁵⁷ The Trustees noted that they and the IASB have taken steps to address these concerns, including the IASB making greater use of working groups, publishing feedback statements and effect analyses, and greatly expanding its outreach efforts.³⁵⁸ Additionally, the Trustees noted that they have expanded their

³⁴⁹ See subsection III.E.3.a., above.

³⁵⁰ Strategy Review Final Report.

³⁵¹ See id.

³⁵² See IFRS Foundation Staff Comment Summary.

³⁵³ See MB Comment Summary.

³⁵⁴ See id.

³⁵⁵ See id.

³⁵⁶ See id.

³⁵⁷ See Strategy Review Final Report.

³⁵⁸ See id.

oversight function and have changed the composition of the IFRS Advisory Council to reflect better the views of stakeholder groups.³⁵⁹ The Strategy Review Final Report also outlines efforts to build on and make improvements to the IASB's existing due process framework, including in the areas of agenda setting, methodology for field visits and tests and effect analyses, and formal cooperation agreements with securities regulators, audit regulators, and national standard setters to receive feedback on IFRS implementation.³⁶⁰

Through various channels, the Staff received feedback from commenters that have expressed concerns that the IASB's objectivity could be undermined via outside political influence.³⁶¹ The Staff notes that, as discussed above, the MB Governance Review seeks to strike a balance between public accountability and the potential loss of standard-setter independence through too robust an involvement by external or political forces, and that the proposed enhancements to the funding, also as discussed above, can help the IASB's independence. The Staff notes that this tension is not unique to the IASB; constant vigilance is needed to protect the FASB against political interference in its standard-setting process. Broadening the scope of countries that use IFRS in addition to the United States using an endorsement mechanism to ensure a strong U.S. voice in the standard-setting process may act as a useful counterweight to ensure that no one country would be able to impose its political will on the IASB.³⁶²

6. Observations on IASB's Standard-Setting Process

a. Pre-eminence of Investors

The Staff believes that the IASB has made improvements over time in its efforts to obtain feedback from investors on its standard-setting agenda and on individual projects. Because there are often relatively few formal comment letters submitted by investors or investor groups on IASB exposure documents, it is critical for the IASB to find other ways to reach those stakeholders, and the IASB has put forth the effort to do so.³⁶³ Through its monitoring of IASB

³⁵⁹ See *id.* But cf. comment letter of the Chamber on the 2011 May Staff Paper (noting that the change to invite regional standard-setting bodies “would result in the FASB not even having a seat at the [IFRS] Advisory Council table”).

³⁶⁰ See Strategy Review Final Report.

³⁶¹ See CII Study (noting, with respect to criterion #7, that “[t]he IASB’s technical decisions and judgments have been subject to significant pressures from governmental officials and bodies, particularly those representing the EU”). See also comments of CFA Institute (noting a need to “recogniz[e] that global politics can diminish high-quality standards, and address how political pressures can be counterbalanced”); Chamber; and IMA (noting that, “The Foundation should take great care to avoid the possibility that public accountability becomes governmental or regulatory interference in, and control over, the standard setting process. The IASB’s independence needs to be protected from political interference, and pressure from regulators, at all costs.”) on the 2011 May Staff Paper. Cf. SEC IFRS Roundtable transcript (O’Malley).

³⁶² See SEC IFRS Roundtable transcript (comments of O’Malley and Mark LaMonte, Managing Director, Moody’s Investors Service).

³⁶³ Cf. CII Study (noting, with respect to criterion #6, a 2007 study from One World Trust that “assessed the IASB as possessing the best developed external stakeholder engagement capabilities among 30 of the world’s most powerful global organizations and a high performer in both transparency and evaluation”).

projects, the Staff has noted that when the IASB staff presents its analysis of feedback on IASB exposure documents, the IASB staff frequently provides a summary of the results of outreach to investors as well as a summary of public comment letters.

It is more difficult for the Staff to evaluate whether the views of investors as a single constituency are appropriately considered by IASB members when they deliberate or re-deliberate standards under development. It is similarly difficult for the Staff to evaluate whether the views of investors are appropriately considered by FASB members in their deliberations on standards. In the Staff's experience, investors typically do not have a single view on an issue and, therefore, it is difficult to evaluate how Board members weigh differing views of investors. Through its monitoring process, the Staff is aware that in public Board discussions, individual IASB members, as well as individual FASB members, will include references to the results of outreach to investors and will discuss ways in which information could be presented to meet investors' requests. However, the Staff is aware that the IASB members, as well as the FASB members, have other factors to weigh in their considerations, including, among others, the consistency of their decisions with their conceptual framework and across projects, and the amount of time and cost involved for preparers to implement new requirements. Overall, the Staff believes that, as a group, IASB members recognize the purpose of financial reporting and the standards they are developing and are making good faith efforts to understand and meet investor requests for improvements to financial statements.

b. Timeliness

The Staff notes that the Trustees' separate review of the IFRS IC's effectiveness and efficiency has not yet concluded and, therefore, the Staff cannot yet evaluate proposed changes to the IFRS IC that may result from that review.³⁶⁴ However, based on constituent input and the Staff's experience in monitoring the IASB's and IFRS IC's activities, the Staff believes enhancements are needed to the IASB's timeliness and willingness to address emerging issues. The Staff will continue to monitor the IASB's timeliness as changes resulting both from the Trustees' Strategy Review and the IFRS IC's effectiveness review are implemented.

c. Objectivity

The Staff observes that the IASB's process is heavily based on consultation and gathering of facts and views and explaining its decisions to the public. IASB members are required to act in the public interest and exercise independence of judgment in setting IFRSs but often must weigh competing views and information when deciding how to vote on an issue in a project. The Staff observes, through its monitoring of the IASB's process, that IASB member deliberations and re-deliberations on technical projects involve extensive debate and analysis of ways to recognize, measure, present, and disclose financial information. The Staff notes that IASB members, in their public discussions, consider consistency with their conceptual framework and

³⁶⁴ The Trustees made two questionnaires, one for members of the IFRS IC and one for others, publicly available on the IASB website for all interested parties to complete. The results of the outreach were discussed with the IFRS IC at several of its regular meetings. Topics of discussion included possible changes to the scope of the IFRS IC's activities, its agenda criteria, and the form of its output.

linkages across projects, and often ask the IASB staff for further research. The Staff believes, based on its monitoring, that IASB members appropriately seem to decide on the resolution of issues in projects based on the technical merits and overall usefulness for investors and other users of financial statements. Although, consistent with any standard-setting body, views on individual projects and technical decisions may vary by Board member, the Staff is not aware of instances where IASB members have failed to exercise independence of judgment in setting IFRSs.

d. Consideration of Impact of IFRS Incorporation

The Staff considered whether any concerns derived from the various observations on the IASB standard-setting process, particularly regarding the pre-eminence of investors and timeliness, could be significantly impacted by the method of incorporation. For instance, the FASB, to the degree that it acts as an endorser of IFRS for the U.S. financial reporting system, may be able to mitigate many of these concerns. The FASB, as a national standard setter, may be able to assist in mitigating concerns regarding the timeliness of standard setting in one or more ways by assisting with individual projects for which it has expertise, performing outreach to U.S. investors for individual projects, identifying areas in which there is a need to narrow diversity in practice or issue interpretive guidance, and assisting with post-implementation reviews. Further, the FASB's experience as a standard setter in the United States can be used to maintain focus on the needs of U.S. investors and help in identifying and addressing emerging issues in a timelier manner.

IV. Investor Understanding and Education Regarding IFRS

The 2010 Statement noted that the consideration of incorporation of IFRS into the financial reporting system for U.S. issuers requires, among other things, consideration of the impact on U.S. investors.³⁶⁵ This consideration requires an assessment of investor understanding and education regarding IFRS because the main benefits to investors of a single set of high-quality, globally accepted accounting standards would be realized only if investors understand and have confidence in the basis for reported financial results.

In accordance with the Work Plan, the Staff analyzed how investor understanding of IFRS could be promoted, and the robustness of existing mechanisms for educating investors about changes in the accounting standards. Specifically, the Staff:

- Conducted research aimed at understanding U.S. investors' current knowledge of IFRS and preparedness for incorporation of IFRS into the financial reporting system for U.S. issuers.
- Gathered input from various investor groups to understand how investors educate themselves on changes in accounting standards and the timeliness of such education.
- Considered the extent of, logistics for, and estimated time necessary to undertake changes to improve investor understanding of IFRS and the related education process to ensure investors have a sufficient understanding of IFRS prior to potential incorporation.³⁶⁶

To obtain information relating to these three topics, the Staff undertook three principal projects. First, the Staff issued the Investor Comment Request to solicit broad public input.³⁶⁷ Second, the Staff reached out directly to a number of investors to gain a more detailed understanding of their perspectives. Third, the Staff hosted the SEC IFRS Roundtable in July 2011, the first panel of which focused on investor understanding and knowledge of IFRS. Further, the Staff obtained additional perspectives from investors based on their responses to the 2011 May Staff Paper.

In August 2010, the Staff issued the Investor Comment Request to solicit feedback from investors on the three Work Plan topics stated above. The request for comment asked investors a series of questions, which included, but were not limited to: (1) the extent to which and how the set of accounting standards applied by a current or potential investee affects the investor's capital allocation decisions; (2) the level of confidence investors have in their current understanding of IFRS; (3) the education methods currently in use, both during and subsequent to the standard-setting process, by investors and the effectiveness of those methods in obtaining a timely and

³⁶⁵ See 2010 Statement.

³⁶⁶ See Work Plan.

³⁶⁷ See Investor Comment Request, *supra* note 6.

thorough understanding of newly-issued accounting guidance; and (4) the estimated time for investors to obtain what they would consider to be a sufficient understanding of IFRS and ways to improve mechanisms for their education of IFRS.

The Staff followed that effort by hosting the SEC IFRS Roundtable in July 2011. The SEC IFRS Roundtable was moderated by the SEC's Chief Accountant and included seven participants on the investor panel.³⁶⁸ The Staff hosted the SEC IFRS Roundtable, in part, to further its understanding of investors' views on the three Work Plan topics addressed above and to obtain investors' views on concepts contained in the 2011 May Staff Paper. Discussion topics for the participants included, but were not limited to: (1) whether a change from U.S. GAAP to IFRS would impact investment decisions; (2) whether investors have concerns about the application of IFRS; (3) whether the United States should incorporate IFRS into the U.S. financial reporting system and, if so, whether there are strategic approaches that the SEC should take before incorporation; and (4) the role of the FASB if any decision is made to incorporate IFRS into the U.S. financial reporting system.³⁶⁹

The Staff supplemented its outreach efforts with informal discussions with investors from investment bank and asset management companies. The topics in these discussions were consistent with the topics in the Investor Comment Request and the SEC IFRS Roundtable.

A. Summary Observations

Investors that responded to the 2011 May Staff Paper³⁷⁰ and investor panelists that participated on the SEC IFRS Roundtable³⁷¹ generally supported the idea of transitioning the United States to a single set of high-quality, globally accepted accounting standards. However, U.S. investors' support for IFRS is generally conditional. For example, investors have generally

³⁶⁸ See SEC Staff, List of Participants for Roundtable on International Financial Reporting Standards (Jul. 7, 2011) (available at: <http://www.sec.gov/spotlight/ifrsroadmap/ifrsroundtable070711-parts.htm>). Panelists included Managing Directors from an investment bank, a valuation firm, and two credit rating agencies; a Senior Vice President from an insurance company; an Investment Officer from CalPERS; and the Chair of Corporate Disclosure Policy Council from the CFA Institute.

³⁶⁹ See SEC Staff, Agenda for Roundtable on International Financial Reporting Standards (Jul. 7, 2011) ("SEC IFRS Roundtable Agenda") (available at: <http://www.sec.gov/spotlight/ifrsroadmap/ifrsroundtable070711-agenda.htm>).

³⁷⁰ See comment letters of Allstate; Ameriprise; CalPERS; CFA; S&P; and WSIB on the 2011 May Staff Paper. In response to the 2011 May Staff Paper, CRMC and Sandler were less supportive. For example, CRMC stated: "[w]hile we support the idea of a consistent set of high quality accounting standards for companies worldwide, unfortunately we do not believe [the] IASB has been effective in achieving this objective."

³⁷¹ See SEC IFRS Roundtable transcript (comments of Neri Bukspan, Executive Managing Director, Standard and Poor's; Jonas; LaMonte; David Larsen, Managing Director, Duff & Phelps; Mary Morris, Investment Officer, California Public Employees' Retirement System; and Kevin Spataro, Senior Vice President, The Allstate Corporation). In addition, see comments of Gerry White, Chair of Corporate Disclosure Policy Council, CFA Institute from the SEC IFRS Roundtable transcript, stating: "[s]urveys of our membership show overwhelming support for the idea of a single set of financial statements worldwide. Surveys also show overwhelming support for high-quality accounting standards to be used. And the question is, how can those two goals be accomplished?"

emphasized that they are not willing to sacrifice quality in order to achieve international convergence of accounting standards, and some have expressed concerns about the IASB and its standards.³⁷² Some investors have emphasized that quality of IFRS and independence of the IASB should be addressed by the SEC prior to making any decision about the incorporation of IFRS.³⁷³

One of the primary concerns expressed by investors relates to the approach and timeliness of the IFRS IC, which is similar to concerns raised by other constituents as further discussed above.³⁷⁴ Specifically, investors at the SEC IFRS Roundtable stated that the IFRS IC should be more active in interpreting IFRS standards to narrow diversity in the application of IFRS.³⁷⁵ In addition, investors raised concerns about aspects of the IASB's current infrastructure, which included: (1) lack of independence of the IASB's funding; (2) lack of investor participation on the IASB and IFRS Foundation; and (3) potential for political interference in the standard-setting process.³⁷⁶ Investors expressed that accounting standards should be developed by a board that recognizes that its primary mission is to provide investors with decision-useful information.³⁷⁷ An endorsement approach to incorporation of IFRS into the U.S. financial reporting system, coupled with a significant and active role of the FASB in the standard-setting process, could potentially address or mitigate to varying degrees many of the concerns expressed by investors.

The Staff found there appears to be a wide spectrum of investor knowledge of IFRS; however, the majority of investors that the Staff has contacted or that have commented directly to the Staff do not have much familiarity with IFRS. Further, the Staff was informed through its outreach that many investors are not directly active participants in the standard-setting process, but rather rely on policy groups within their companies or other associations to provide input to the FASB and the IASB. Investors learn about changes in accounting methods through various methods, including through company disclosures and printed materials and through webcasts from the largest accounting firms. However, the quality and thoroughness of the training varies.

A significant amount of investor feedback related to the possible incorporation of IFRS focused on the method of any incorporation and the related transition issues. Specifically, the feedback addressed the positive and negative aspects of a staged incorporation approach versus a "big bang" approach in which incorporation would be considered in a single transition. In addition, the feedback indicated that investors believe that sufficient time should be provided for any transition and that additional clarity through disclosures should be provided as part of any transition plan.

³⁷² See, e.g., comment letters of Allstate; Ameriprise; CFA; and CRMC on the 2011 May Staff Paper. See also SEC IFRS Roundtable transcript (comments of White; Spataro; and Jonas). Cf. CII Study.

³⁷³ See comment letters of CFA and CRMC on the 2011 May Staff Paper.

³⁷⁴ See subsection II.C.2., above.

³⁷⁵ See, e.g., SEC IFRS Roundtable transcript (comments of Jonas and Larsen).

³⁷⁶ See comment letter of CFA on the 2011 May Staff Paper. Cf. CII Study.

³⁷⁷ See *id.*

B. Current Awareness and Knowledge of IFRS

U.S. investors' current awareness and knowledge of IFRS varies. Institutional and other professional investors are generally aware of the ongoing consideration of IFRS in the United States. Some of these investors stated that they have already obtained sufficient IFRS education to facilitate their global investing.³⁷⁸ These investors appear to understand the implications of the current differences between U.S. GAAP and IFRS, especially as it relates to the industries that they analyze. Many of these investors are already familiar with and actively use financial information prepared in accordance with IFRS from foreign private issuers registered with the SEC and foreign companies that are registered with foreign exchanges.³⁷⁹

The Staff understands that some investors have received education on IFRS standards through studying the Chartered Financial Analyst ("CFA") curriculum, taking the CFA exams, or both. The CFA curriculum began incorporating International Accounting Standards (the predecessor standards to IFRSs) in the mid-1990s. One of the current learning objectives in the CFA curriculum is to distinguish between U.S. GAAP and IFRS accounting standards. For example, the curriculum focuses on differences in the classification, measurement, and disclosure of financial assets, investments in associates and joint ventures, business combinations, and consolidation accounting. Further, the CFA Institute stated:

IFRS education for investors and others is available in multiple ways. There are numerous training organizations such as IASeminars offering programs on various aspects of IFRS application and differences from U.S. GAAP. There are extensive online resources related to IFRS education for investors as well as extensive in-house training programs at many accounting firms that can be shared with the investment community. We expect many of the large, buy-side organizations to undertake training and educational activities as well. The CFA Institute itself has incorporated specific IFRS educational material on all major accounting topics into its curriculum for many years and has published a text for practitioners on analyzing international financial statements. Several of our local member societies (chapters) such as the New York Society of Security Analysts provide IFRS educational opportunities.³⁸⁰

At the other end of the spectrum, there are U.S. investors that, either primarily or exclusively, focus on domestic companies and, therefore, are much more familiar with U.S. GAAP than IFRS. These investors seem to be understandably reluctant to commit extensive resources to develop a better understanding of IFRS until (1) it becomes clear whether and, if so, how, the United States might incorporate IFRS and (2) the Major Joint Projects are completed.

Between these two extremes are the many investors who may have some knowledge of IFRS and the accounting implications and differences between IFRS and U.S. GAAP but who

³⁷⁸ See comment letter of The Allstate Corporation on the Investor Comment Request.

³⁷⁹ See, e.g., SEC IFRS Roundtable transcript (comments of Jonas and LaMonte).

³⁸⁰ Comment letter of CFA Institute on the Investor Comment Request.

are not proactive in the accounting standard-setting process or in assessing the impact of potential accounting changes on their investment decisions. For example, many financial analysts use financial information to assess past trends and anticipate future performance of a company. These analysts may have some understanding of the accounting standards used in the preparation of the financial statements and related disclosures, but they are not accounting specialists and do not necessarily develop and maintain a detailed understanding of accounting standards in general or potential changes thereto, including the differences between U.S. GAAP and IFRS and the potential impact on financial analysis.

C. Investor Education Regarding Accounting Standards and Changes in Accounting Standards

In executing the Work Plan, the Staff communicated with investors to understand the manner in which they educate themselves on changes to accounting standards. If the Commission determines that it is advisable to incorporate IFRS into the U.S. financial reporting system in some manner, the method and timing of incorporation may depend in some part on the amount of time that investors would need to assimilate the new standards.

The Staff learned that investors and other users obtain education about and training in accounting standards in many different forms and from many different sources. Many investors obtain information about a new accounting standard primarily through company disclosures about pending or new standards and the effect of such standards on their financial statements. Secondary sources of information for investors include:

- Continuing professional education programs, either developed in-house or produced by professional associations (e.g., CFA Institute, AICPA, or the New York Society of Securities Analysts);
- Publications, such as sell-side analyst research, brokerage firm research for retail investors, accounting firm summaries targeted to users, investment club newsletters and research, and articles in publications read by users; and
- Presentations and speeches.

In addition, some investors obtain education about accounting standards during the standard-setting process. As one commenter noted:

The investment managers are educated about accounting standards during the standard development phase. They also participate in the comment letter process, through [the company's] technical accounting area as well as through trade associations.³⁸¹

³⁸¹ Comment letter of The Allstate Corporation on the Investor Comment Request.

D. Investor Preparedness for Incorporation of IFRS

1. Current Preparedness

Because many U.S. investors have not yet committed extensive resources to developing knowledge about IFRS, they do not appear to be prepared for a short-term, wholesale transition to IFRS. However, many investors stated they do not believe that investor preparedness issues would be a significant impediment to incorporating IFRS in the financial reporting system for U.S. issuers.³⁸² This is in part due to the fact that U.S. GAAP is not static, and investors are accustomed to adjusting to required changes in accounting standards. That said, however, the scope of the potential change and the pace of that change are important considerations.

Investors' preparedness exists on a spectrum. For example, panelists at the SEC IFRS Roundtable representing large institutional investors or other global users of financial statements suggested that investors will be prepared if the Commission decides to incorporate IFRS. One panelist noted that investors are heavily exposed to IFRS today, and investor preparedness for incorporation of IFRS would not be a significant impediment to incorporating IFRS.³⁸³ Another panelist stated:

I think I will agree that investors are going to be ready. IFRS is already here for many other companies, so we ought to be ready, if we cover companies globally.³⁸⁴

Other investors represented by the CFA Institute stated that they do not see the issue of investor preparedness as a major hurdle to incorporating IFRS.³⁸⁵ In addition, one large asset management firm stated that it does not believe the changes required to its business would be very significant if the Commission decides to incorporate IFRS.³⁸⁶

By contrast, the Staff understands that certain individual or retail investors that focus primarily on domestic companies may not have the same resources as large institutional investors and, therefore, may not be as prepared for any change. A move to incorporate IFRS would require small investors to make a fairly substantial, up-front investment of time in learning about IFRS, which would likely be a disproportionate investment of resources as compared to such investor's larger counterparts. The up-front investment would vary significantly depending upon the method of incorporation and the method employed to address resolution and transition of existing differences. During the Staff's outreach, these investors suggested that they would require some time to transition to IFRS and would prefer a gradual transition approach to incorporation.

³⁸² See, e.g., comment letter of CFA Institute on Investor Comment Request and SEC IFRS Roundtable transcript (comments of Jonas).

³⁸³ See, e.g., SEC IFRS Roundtable transcript (comments of Jonas).

³⁸⁴ SEC IFRS Roundtable transcript (comments of Bukspan).

³⁸⁵ See comment letter of CFA Institute on Investor Comment Request.

³⁸⁶ See comment letter of BNY Mellon on Investor Comment Request.

Investors communicated that the Boards' issuance of fully-converged standards under the MoU before any incorporation of IFRS in the United States would positively impact both investors' readiness for IFRS and the usefulness of IFRS financial statements.³⁸⁷ Any further actions by the Boards to harmonize other significant differences would also benefit investors' preparedness.³⁸⁸ This assessment reflects both the notion of not delaying any efforts on the convergence agenda as well as concerns about a double transition. With regard to the latter, if the FASB and IASB issue final standards that are not completely converged, and IFRS is subsequently incorporated into the U.S. financial reporting system, investors' efforts to learn the interim FASB standards would prove to be at least partially duplicative upon incorporation of IFRS.

2. Necessary Time and Activities Needed by Investors in Order to Transition Successfully to IFRS

Investors stated that a transition period would be necessary before any large scale incorporation of IFRS to enable analysts to adjust their models and to incorporate changes in trend analysis. Commenters had varying views on the amount of time necessary to complete their internal readiness efforts, from as little as a few quarters³⁸⁹ to several years.³⁹⁰ The Staff understands, based on its outreach, that the time period necessary to transition could be significantly reduced if the Boards complete the MoU convergence projects and narrow other significant existing differences between U.S. GAAP and IFRS before any incorporation of IFRS.

In addition, during the Staff's outreach, investors asserted that companies' disclosures during the transition period will be critical for investors to appreciate fully the impact of the change in the reporting basis. The Staff received feedback regarding a suggested timeline of disclosures, which was similar to transition disclosures suggested to the FASB in connection with its research project³⁹¹ on effective dates and transition methods for the priority Major Joint Projects, as follows:

- Three years before effective date: provide a narrative description of the likely impact.
- Two years before effective date: provide a more granular narrative description, accompanied by a broad quantification of the likely impact (e.g., the expected

³⁸⁷ See comment letter of CFA Institute on Investor Comment Request.

³⁸⁸ See id.

³⁸⁹ See comment letter of BNY Mellon on Investor Comment Request.

³⁹⁰ See, e.g., comment letter of The Allstate Corporation (suggesting that investors would need no less than four years to educate themselves on IFRS) on Investor Comment Request.

³⁹¹ In October 2010, the FASB and IASB published a Discussion Paper and Request for Views, respectively, to gather information about appropriate effective dates and transition methods for the Boards' priority Major Joint Projects. Additional information about the FASB's project is available at: http://www.fasb.org/cs/ContentServer?site=FASB&c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=1176157848456.

directional change on key balance sheet, income statement, and cash flow statement line items, along with a description of factors that might cause the company's assessment to change before the effective date).

- One year before effective date: provide further narrative analysis, accompanied by a detailed quantification of the likely impact (e.g., the expected impact on each respective balance sheet, income statement, and cash flow statement line item; and factors that might cause changes before the final effective date), together with a quantification of the actual impact on the current and prior period, for those companies that have sufficiently progressed in their implementation schedule.³⁹²

Similarly, one commenter stated that enhanced disclosures through a robust disclosure framework would help users analyze the full impact of the change if IFRS were incorporated:

We believe it is important that a robust disclosure framework accompany the conversion to IFRS in the United States. We reiterate our views on the need to develop a comprehensive, principle-based disclosure framework as part of the conversion process. The disclosure framework should require that companies provide comprehensive information about accounting policies and their applications, significant assumptions, composition of account balances, and forward-looking analysis. Beyond its obvious long-term benefits in meaningfully enhancing the utility of financial statements, we believe the adoption of a disclosure framework prior to conversion will greatly facilitate users' understanding of the effects of the changes.³⁹³

3. Investor Preferences with Regard to Transition

Investors fairly consistently stated that a retrospective transition method is preferable because it will generate more comparable financial information.³⁹⁴ Investors expressed a preference for retrospective application to assist in receiving comparable financial information, both period-over-period and between companies, in order to base their investment decisions on an informed analysis. Investors acknowledged that preparers may prefer prospective application because it is less complex and reduces costs but noted that prospective application can hinder users' abilities to analyze financial trend information.

While not unanimous, investors were also generally in agreement that companies should not be permitted the option to adopt IFRS early, as it would compromise comparability between similarly-situated U.S. companies.³⁹⁵ Permitting early "adoption," in many users' views, would

³⁹² See comment letter from The Corporate Reporting Users' Forum ("CRUF") dated February 17, 2011 in response to the FASB's Effective Dates and Transition Methods research project (available at: http://www.fasb.org/jsp/FASB/CommentLetter_C/CommentLetterPage&cid=1218220137090&project_id=1890-100&page_number=2).

³⁹³ Comment letter of Standard & Poor's on the Investor Comment Request.

³⁹⁴ See, e.g., comment letters of CalPERS; CFA; CII; and S&P on the 2011 May Staff Paper.

³⁹⁵ See, e.g., comment letters of CalPERS and CFA on the 2011 May Staff Paper.

undermine the objective of convergence and could potentially create a system for accounting arbitrage, where companies choose the accounting guidance that produces the most favorable financial results rather than the best disclosure to investors.

E. Other Investor Views

1. Global Accounting Standards

The foregoing discussion on investor preparedness is largely provided in the context of those investors who supported an approach to foster the development and incorporation of a single set of high-quality, globally accepted accounting standards, and who indicated that IFRS is best-positioned to become that common approach, as communicated to the Staff at the SEC IFRS Roundtable and through comment letters. The Staff also received feedback on both of these topics through its outreach processes.

First, investors and other users of financial statements generally expressed support for the concept of a single set of high-quality, globally accepted accounting standards.³⁹⁶ Investors stated that the capital markets would benefit from the development of global accounting standards by a single board that can accommodate the increasing complexity of business.³⁹⁷ This, in turn, would facilitate greater deployment and effectiveness of capital, especially in the global capital markets. In addition, investors and other users that analyze financial statements in the global capital markets articulated that consistency in the preparation of financial statements is important to their ability to compare companies across two or more different jurisdictions.³⁹⁸

Second, several investors have provided support for IFRS, stating that it is the body of standards best positioned to achieve the goal of a single set of high-quality, globally accepted accounting standards. For example, one commenter stated:

[t]he results show that our membership overwhelmingly (over 90%) supports the premise of a single set of high-quality global accounting standards as a goal to be ultimately achieved by standard setters and regulators around the world. The basis for this support is their expectation that IFRS will result in a common financial reporting language that improves transparency and enables investors to make comparisons among similar entities across jurisdictions.³⁹⁹

In this respect, investors and other users of the financial statements have stated that the EU's transition from various national accounting standards to IFRS has resulted in increased uniformity in accounting standards that helped constituents in the region to streamline their

³⁹⁶ See comment letters of Allstate; Ameriprise; CalPERS; CFA; S&P; and WSIB on the 2011 May Staff Paper. See also SEC IFRS Roundtable transcript (comments of Bukspan; Jonas; Larsen; Morris; and Spataro). Cf. CII Study.

³⁹⁷ See, e.g., comment letter of Standard & Poor's on the Investor Comment Request.

³⁹⁸ See comment letter of Standard & Poor's on the Investor Comment Request and comment letters of CFA and WSIB on the 2011 May Staff Paper.

³⁹⁹ Comment letter of CFA on the 2011 May Staff Paper.

analytical comparisons of financial information across the EU and to apply their analytical adjustments more broadly.⁴⁰⁰

Some of these investors believe that international convergence and, ultimately, incorporation or use of uniform international standards would provide long-term benefits to analysts, investors, and creditors by providing a consistent framework for financial reporting disclosure, thereby promoting better information flow, peer comparison, and global capital flow.⁴⁰¹ These investors acknowledge that having uniform standards is a necessary, but not a sufficient, condition for full comparability, understanding that differences (e.g., as a result of jurisdictional guidance) may persist even after adoption of a single set of high-quality, globally accepted accounting standards. However, these investors generally support IFRS as it is viewed as a step forward in terms of greater comparability.⁴⁰² Other investors do not believe that incorporation of IFRS will result in greater comparability.⁴⁰³

2. Ongoing Role of the FASB

If IFRS is incorporated into the U.S. financial reporting system, investors generally support the FASB retaining some role in the standard-setting process through some form of endorsement framework. Most investors who commented believed that the FASB should have a significant and active role in the standard-setting process on the grounds that it would be able more narrowly to act in the interest of U.S. constituents or to ensure a U.S. voice in standard setting.⁴⁰⁴ In this role, the FASB could be responsible for endorsing the standards that the IASB has promulgated but would also retain its authority to create new standards and interpret existing standards when necessary to protect U.S. investors. Investors that support this view indicated that high-quality accounting standards should take precedence over convergence and global comparability, even if it results in regional differences. These investors believe that a single set of high-quality, globally accepted accounting standards is an important objective, but those investors do not believe that such high-quality standards should be compromised for the sake of uniformity. Further, investors noted that the FASB, in acting as an endorser, could serve an important role of ensuring that any standard incorporated into the U.S. financial reporting system is of sufficient quality so as to maintain or improve on the financial reporting system.

Other investors commented that the FASB's role should be limited to providing support, resources, and expertise to the IASB and to participating in the development and improvement of international standards.⁴⁰⁵ In this role, the FASB would endorse IASB standards for

⁴⁰⁰ See, e.g., comment letter of Standard & Poor's on the Investor Comment Request.

⁴⁰¹ See id.

⁴⁰² See, e.g., comment letter of CFA on the 2011 May Staff Paper. See also SEC IFRS Roundtable transcript (comments of Jonas).

⁴⁰³ See, e.g., comment letter of CRMC on the 2011 May Staff Paper.

⁴⁰⁴ See e.g., comment letters of Allstate; CalPERS; and CFA on the 2011 May Staff Paper. See also SEC IFRS Roundtable transcript (comments of Jonas; LaMonte; and Spataro).

⁴⁰⁵ See comment letter of S&P on the 2011 May Staff Paper.

incorporation into U.S. GAAP. However, the FASB's authority to reject or modify international standards, or add new U.S. standards, would be limited. For example, the FASB's ability to deviate from the IASB's text could be limited to requiring supplemental disclosures when such disclosures would provide users with meaningful information. These investors believed that this more restricted role for the FASB would result in the most comparable accounting standards.

V. Regulatory Environment

Any decision by the Commission to incorporate IFRS into the U.S. financial reporting system would have a potentially significant impact on the U.S. regulatory environment. Further, the impact and implications vary significantly depending on both the method of incorporation and the method of transition.

The Staff notes that the Commission is but one of many regulators⁴⁰⁶ that uses U.S. GAAP financial information in its regulatory regime. Other regulators require their regulated entities to provide them or others with financial information, and this information is often (and sometimes must be) prepared in accordance with U.S. GAAP. While a Commission decision to incorporate IFRS for financial reporting purposes would not alter these other regulators' requirements, there could be significant impacts to the other regulators and those entities that they regulate.

Similarly, many private companies use U.S. GAAP to prepare their financial statements. Private companies' use of U.S. GAAP does not result from Commission regulation, as is the case with public companies, but rather is attributable in part to state law, including the requirements of state boards of accountancy, the AICPA, requirements in private contracts, and in many cases the voluntary decision of a company to prepare financial statements in accordance with U.S. GAAP. A decision by the Commission to incorporate IFRS would not directly alter the decisions made by and requirements imposed on private companies. However, the SEC's incorporation of IFRS into the financial reporting system for U.S. issuers could have significant effects on private companies. Although many private companies in the United States apply U.S. GAAP currently (by election or requirement), absent specific preclusions, such companies may elect to apply IFRS today provided the relevant counterparties (e.g., lender, credit providers, investors, and others) are willing to accept such use.

The Commission recognized that a decision to incorporate IFRS may have far-reaching effects, including on entities and regulators (and their regulations) beyond the Commission's purview.⁴⁰⁷ It therefore directed the Staff to "study and consider other regulatory effects of mandating IFRS for U.S. issuers."⁴⁰⁸ To execute the Work Plan, the Staff examined the following regulatory matters:

- Manner in which the SEC fulfills its mission;
- Industry regulators;
- Federal and state tax impacts;

⁴⁰⁶ The terms "industry regulators," "regulators," "regulatory agencies," and any other similar terms used in this Final Staff Report are used interchangeably to refer to regulators in the general sense, and not a specific regulator or group of regulators.

⁴⁰⁷ See 2010 Statement.

⁴⁰⁸ 2010 Statement.

- Statutory dividend and stock repurchase restrictions;
- Audit regulation and standard setting;
- Broker-dealer and investment company reporting; and
- Public versus private companies.⁴⁰⁹

To assess the potential effects of IFRS incorporation on these regulatory areas, the Staff performed outreach to various potentially impacted parties. In addition, a number of regulators provided feedback to the Staff through comment letters or through participation in the SEC IFRS Roundtable, the third panel of which was dedicated to a discussion of the regulatory environment.⁴¹⁰

A. Summary Observations

The extent to which the Commission’s incorporation of IFRS would impact the regulatory environment is largely dependent on the method by which IFRS would be incorporated. Regulators other than the SEC have consistently noted the number and significance of U.S. GAAP references in federal and state laws, in regulatory requirements and guidance, and in contracts (e.g., for procurement). These regulators have expressed that incorporating IFRS into the U.S. financial reporting system through U.S. GAAP—that is, by incorporating (subject to a determination about an appropriate threshold for endorsement) the content of IFRS into U.S. GAAP—may address or mitigate a number of significant issues that could otherwise be problematic for their regulatory regimes. In addition, some regulators have expressed a concern about their ability to present directly their views and concerns on any given standard-setting project, which could be impacted depending upon the method in which such standards were incorporated. These concerns could be mitigated to some extent if the FASB were positioned with a substantive role in any incorporation and endorsement process.

Several regulators highlighted that U.S. GAAP contains industry-specific standards which, if lost, would impair their regulatory regime (in addition to providing less meaningful information to investors).⁴¹¹ For example, IFRS does not have an equivalent standard to ASC Topic 980, *Regulated Operations* (formerly known as FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*). A method of incorporating IFRS that would not permit the retention of rate-regulated assets and liabilities as permitted under ASC Topic 980 would significantly impact utility regulators.

⁴⁰⁹ See Work Plan.

⁴¹⁰ Specifically, the SEC IFRS Roundtable covered: “Current use of U.S. GAAP financial information in regulatory activities; Steps required and timing necessary to undertake changes to regulation as a result of changes in accounting standards; Benefits and challenges attendant to a potential transition to IFRS as a basis of financial reporting; [and] Factors to reduce the costs and efforts of a potential transition to IFRS.” See SEC IFRS Roundtable Agenda.

⁴¹¹ See subsection II.B.4., above for greater detail about U.S. GAAP’s industry-specific guidance.

B. Manner in which the SEC Fulfills its Mission

In executing the Work Plan, the Staff analyzed potential approaches for the ongoing role of the FASB in accounting standard setting and interpretation and the impact of the incorporation of IFRS into the financial reporting system for U.S. issuers on Commission rules and procedures by:

- Analyzing approaches to the FASB's ongoing role in accounting standards used in the United States, and the extent of, logistics for, and estimated time necessary to undertake these approaches.
- Analyzing references to accounting standards and requirements in existing Commission rules and interpretations and Staff application guidance to identify the extent of, logistics for, and estimated time necessary to implement any changes prior to such incorporation.
- Considering how, if at all, such incorporation would affect the nature, manner, or frequency in which the Commission and its Staff provide interpretative accounting guidance and enforce accounting standards, and the extent of, logistics for, and estimated time necessary to implement any changes.⁴¹²

1. Ongoing Role of the FASB

In the 2010 Statement, the Commission expressed its view that:

We believe the FASB will continue to play a critical and substantive role in achieving the goal of global accounting standards. The FASB is the accounting standard setter for the U.S. capital markets, and it should continue to work with the IASB to improve accounting standards. Moreover, that role would remain critical after adoption of global standards. In this regard, we have considered the role that other national standard setters have maintained in connection with their consideration of IFRS. In particular, one organization with national regulatory responsibilities noted in its comment letter on the Proposed Roadmap that the continued existence of a national standard setter allows for more effective working relationships with the IASB and helps the IASB have an effective dialogue with constituents in that country. We note many developed countries have maintained a national standard setter or other mechanisms in connection with the incorporation of IFRS into their capital markets.⁴¹³

In the 2011 May Staff Paper, the Staff explored, among other things, one possible approach to the FASB maintaining a substantive ongoing role in accounting standard setting following any incorporation of IFRS. There, the Staff indicated:

⁴¹² See Work Plan.

⁴¹³ 2010 Statement (internal citations omitted).

In order to fulfill the SEC’s mission of protecting investors, maintaining fair, orderly, and efficient capital markets, and facilitating capital formation in the United States, the Staff believes it will be important for the United States to continue to have an active role in the international accounting arena to assist in the development and promotion of high-quality, globally accepted accounting standards; to be proactive in identifying new and emerging financial reporting issues; and to ensure that U.S. interests are suitably addressed in the development of those standards. The Staff believes that the FASB would be the existing body best equipped to fulfill this role in support of U.S. constituents under the framework and, in many ways, is already positioned to do so. Serving in its current role as the U.S. national accounting standard setter, the FASB’s mission is “to establish and improve standards of financial accounting and reporting that foster financial reporting by nongovernmental entities that provides decision-useful information to investors and other users of financial reports.” Based on the Commission’s recognition of the continuing importance of the FASB, in the event that the Commission determines to incorporate IFRS, the Staff envisions that the FASB would remain the standard-setting body responsible for promulgating U.S. GAAP under the framework.⁴¹⁴

The vast majority of commenters on the 2011 May Staff Paper supported the concept of retaining the FASB in a substantive, standard-setting role if the Commission were to proceed with an incorporation of IFRS. One rationale was predominant—that the FASB would be able to act in the interests of U.S. investors or other constituents to ensure a strong U.S. voice is considered in the development of IFRS. Other, more specific rationales echoed this theme:

- The FASB’s role is necessary to ensure due process in incorporating IFRS;
- The FASB’s technical capabilities can benefit the IASB;
- The FASB helps ensure the preservation of U.S. regulatory authority;
- The FASB helps maintain accounting quality and rigor;
- A robust FASB hedges against IASB failure to develop high-quality standards appropriate for U.S. capital markets; and
- The FASB can issue supplemental or application guidance for the U.S. market.⁴¹⁵

For example, one commenter stated:

The FASB should have an ongoing, significant role and continue to be instrumental in global standard setting. The development of IFRS will benefit considerably from US participation through the FASB.⁴¹⁶

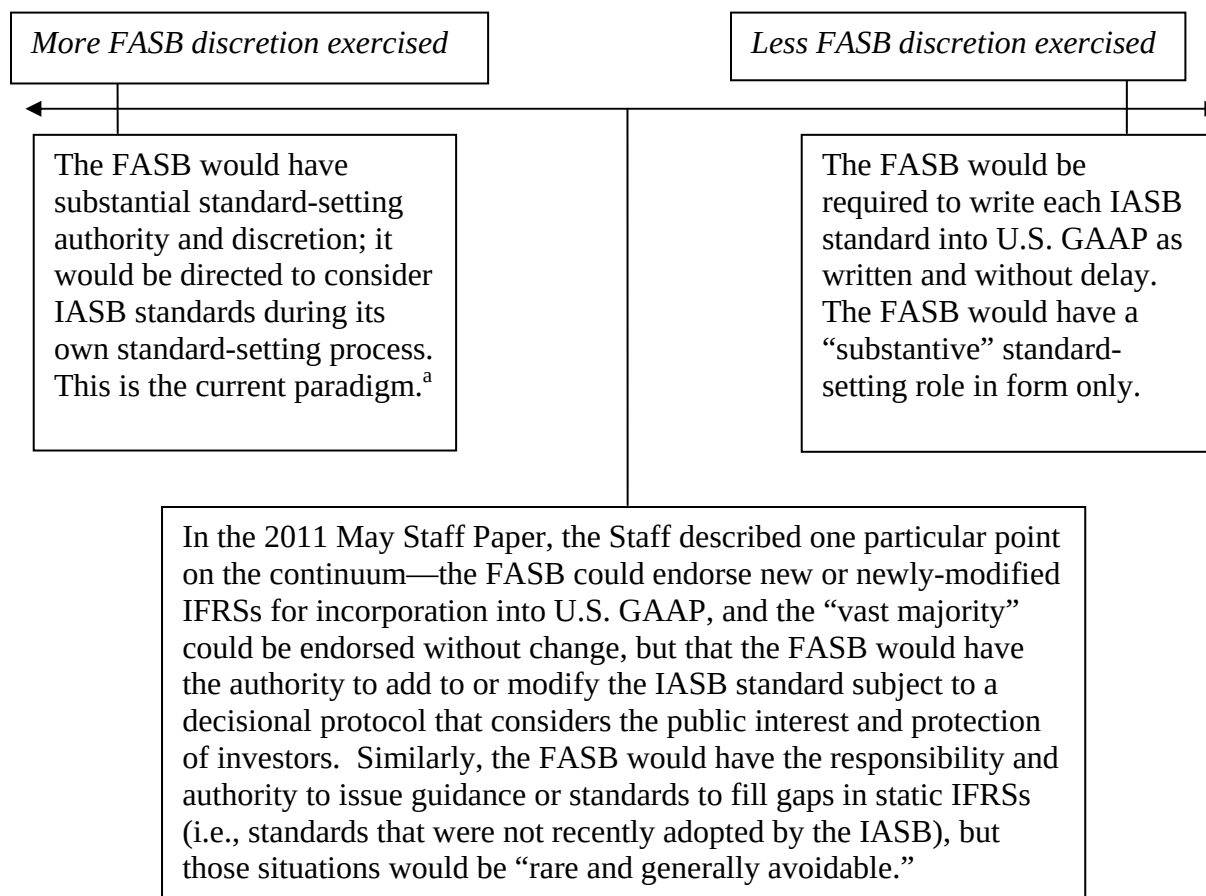
⁴¹⁴ 2011 May Staff Paper (internal citations omitted).

⁴¹⁵ See Summary of Comments on the 2011 May Staff Paper.

⁴¹⁶ See comment letter of CalPERS on the 2011 May Staff Paper.

Another commenter stated: “The FASB needs to have an elevated role to assure it has a strong voice in global standard setting.”⁴¹⁷

If a decision were made to incorporate IFRSs through an endorsement process such that the FASB would continue to play a direct role in issuing standards recognized as generally accepted for public companies in the United States, a critical question becomes how the FASB would be expected to implement such an endorsement process consistent with an overall objective of achieving IFRS incorporation. The FASB’s role during the initial transition phase of incorporation and thereafter can be considered on a continuum:



^a Section 108 of the Sarbanes-Oxley Act amended the Securities Act of 1933 to provide that the Commission may recognize accounting principles established by a standard-setting body as “generally accepted” if the body, among other requirements, considers, in adopting accounting principles, the need to keep standards current in order to reflect changes in the business environment, the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors.

⁴¹⁷ See comment letter of Chamber on the 2011 May Staff Paper.

Commenters in response to the 2011 May Staff Paper reflected this continuum when commenting on the FASB's role during and after any initial incorporation of IFRS. Some commenters believed that the role described in the 2011 May Staff Paper was correct.⁴¹⁸ Some commenters favored a role more toward the left side of the continuum such that the role of the FASB would be stronger and more involved than contemplated in the 2011 May Staff Paper. For example, commenters expressed that the FASB should be able to develop or modify standards to the extent necessary or appropriate.⁴¹⁹ Other commenters preferred a role more toward the right. For example, these commenters thought that the FASB's authority to modify standards or issue interpretative guidance should be more limited than as described in the 2011 May Staff Paper, as it could interfere with the role of the IASB or the IFRS IC.⁴²⁰ There was also a relatively consistent theme among the commenters that, whatever the point on the continuum, it would be important for the Commission to articulate clearly its expectations of the FASB and its overall role in standard setting.

If the Commission were to proceed with an incorporation approach that relies on the FASB for the endorsement and incorporation of IFRS, the Staff acknowledges both the importance of and challenges of identifying the point on the continuum that would best serve U.S. constituents and yet also advance the overall goal of a single set of high-quality, globally accepted accounting standards. The challenge exists, at least in part, because the concept of a "single set of high-quality, globally accepted accounting standards" has two components that are not necessarily congruent. To illustrate, if an endorsing body such as the FASB believes that an IASB standard is not of sufficiently high quality, any unilateral move to improve quality would be counter to the objective of maintaining a single set of standards.

In the context of an endorsement process, if a standard-setting body's discretion is limited, the resulting standards would be expected to be more uniform and aligned with IFRS as issued by the IASB (at least in the written word). However, limiting the discretion of an endorsing body (particularly one such as the FASB whose mission is to establish high-quality accounting standards) could reduce that body's ability to strengthen or otherwise modify a standard that is determined to be not sufficiently robust or to be not in the interest of the investing public in that body's jurisdiction. Affording the FASB additional discretion to diverge from the IASB's standards would likely increase differences between U.S. GAAP, as modified to incorporate IFRS, and IFRS as implemented globally. In an effort to avoid this divergence, the IASB may be incentivized to take U.S. perspectives into greater consideration during the standard-drafting process—resulting in standards that meet the needs of U.S. constituents

⁴¹⁸ See, e.g., comment letters of AGA; CalPERS (when "public interest, investor needs or local circumstances require or if the quality or application is inappropriate"); GM ("modify or supplement IFRS, when necessary, to protect the public interest and investors"); MS; and SIFMA on the 2011 May Staff Paper.

⁴¹⁹ See, e.g., comment letters of AIA (noting events that require immediate U.S. standard setting, e.g., EITF 01-10, Accounting for the Impact of the Terrorist Attacks of September 11, 2001); Citi; CMS; Duke; FEI; Lilly; NYSSCPA (expressing concern about quality of IFRS, requesting the SEC explain its conclusion as to why FASB revisions to IFRS standards would be "infrequent"); Pfizer, and Progress on the 2011 May Staff Paper.

⁴²⁰ See, e.g., comment letters of CXS; IBM; and S&P (noting as well that even the SEC should take a limited and infrequent role in issuing accounting guidance, so as to avoid a U.S. flavor of IFRS) on the 2011 May Staff Paper.

without the need for modification during an endorsement process, thus decreasing the likelihood of differences. At this stage, it is difficult for the Staff to determine which dynamic, if any of the above discussed possibilities or other options, would prevail for the FASB upon any incorporation of IFRS.

The degree to which the FASB is given greater or lesser discretion with respect to endorsing IASB standards directly affects the extent to which a U.S. variation or “flavor” of IFRS could develop. Commenters on the 2011 May Staff Paper had varied opinions on this topic. For example, several commenters that were generally supportive of the framework articulated in the 2011 May Staff Paper questioned whether that approach will inevitably lead to a U.S. flavor of IFRS, which would diminish comparability and lessen progress toward the goal of a single set of high-quality, globally accepted accounting standards.⁴²¹ The existence of deviations from IFRS as issued by the IASB that are accepted in the United States may encourage other jurisdictions to follow suit and introduce their own local deviations to IFRS. Other commenters were less concerned, noting that widespread adoption of IFRS with some variation in multiple jurisdictions is preferable to the current state of accounting standards, and may be inevitable in any event to reflect differences in circumstances and jurisdictions.⁴²² Further, allowing additional FASB discretion would help ensure that the FASB would have a strong voice in international standard setting such that deviations could be unnecessary.

The Staff also considered the FASB’s interaction with the IASB in an environment in which IFRS was incorporated into the U.S. financial reporting system. A number of commenters on the 2011 May Staff Paper called for increased formality in the relationship of the FASB and the IASB. Methods for achieving a more formal role for FASB ranged from formalizing an agreement with the IASB to allow the FASB to influence the IASB’s standard-setting process more than that of an “ordinary” commenter,⁴²³ to interlocking the Boards (i.e., reserving one seat on the IASB for a member of the FASB).⁴²⁴ In support of this view, commenters noted that more formal connections between the Boards could provide better technical support for the IASB’s standard setting, could enhance mutual understanding (for the IASB, better understanding of U.S. views; and for the FASB, better understanding of the IASB’s basis for conclusions), and could generally decrease the likelihood of a U.S. flavor of IFRS.

2. Analysis of Changes to the Commission’s Rules and Guidance

The Staff performed an initial survey of the references to U.S. GAAP in Commission rules, regulations, and other guidance. Although there is a substantial volume of material,⁴²⁵ the

⁴²¹ See, e.g., comment letters of Chevron; CP; IIF; Mazars; MS; S&P; and UBS on the 2011 May Staff Paper.

⁴²² See, e.g., comment letters of AGA; Alcoa (“even if the result is a slight US flavor of IFRS, we believe that very closely aligned global accounting standards is still a considerable improvement from existing circumstances, both for preparers and users”); Chamber; Dell; and FHLB on the 2011 May Staff Paper.

⁴²³ See comment letter of the FAF on the 2011 May Staff Paper.

⁴²⁴ See, e.g., comment letters of FEI and GE on the 2011 May Staff Paper.

⁴²⁵ As two examples, the Commission recently updated several rules and forms, and the Staff updated the Codification of Staff Accounting Bulletins, to reflect the new references in the FASB’s Codification. See

[Footnote continued on next page]

method of incorporation would significantly impact the level of effort required for any changes to this material. If IFRS were to be incorporated into the U.S. financial reporting system directly, rather than through an endorsement method, a comprehensive effort would need to be undertaken before the effective date of such incorporation in order to modify each reference to be compatible with IFRS. If an endorsement method were used, however, no such effort would be needed, as the Staff already has processes in place to update Commission rules and regulations for changes to U.S. GAAP when issued by the FASB. Those processes may need to be supplemented with additional resources to address any increased volume of changes that may result from any incorporation of IFRS into U.S. GAAP, but incremental processes would not need to be developed.

3. Analysis of Changes to Commission's Ability to Issue, Interpret, or Enforce Accounting Standards

The Commission has statutory authority to establish accounting standards for use by issuers in their filings with the Commission. The Commission has historically recognized the standards set by private-sector entities, such as the FASB, as generally accepted for purposes of the federal securities laws. In addition, the Commission has, from time to time, issued specific accounting requirements (e.g., related to oil and gas accounting)⁴²⁶ and published accounting and financial reporting guidance to address specific practices to narrow practice, where appropriate, and to provide practical implementation guidance. In addition, the Commission has the authority to enforce against non-compliance with accounting standards.

If the Commission were to incorporate IFRS, the Commission's authority to do any of the actions outlined above would not change. As the Commission has frequently expressed, a significant benefit of a single set of standards would be that it could help promote global comparability of financial statements. That benefit could be diminished if multiple bodies were to set their own standards or issue their own interpretations. However, as is also the case described above regarding the point on the continuum that would be appropriate for the FASB as endorser, similar considerations also may be warranted for the exercise of the Commission in issuing its own standards or guidance.

C. Industry Regulators

In executing the Work Plan, the Staff analyzed, among other items, the effects of any incorporation of IFRS into the financial reporting system for U.S. issuers by:

- Analyzing the effects on issuer compliance with industry regulatory requirements.
- Considering the impact of a change in SEC reporting on industry regulators.

Release No. 33-9250 (Aug. 8, 2011) [70 FR 5017 (Aug. 12, 2011)]; and Staff Accounting Bulletin No. 114 (Mar. 7, 2011), respectively.

⁴²⁶ See ASR Nos. 253 (Aug. 31, 1978); 257 (Dec. 19, 1978); and 258 (Dec. 19, 1978).

- Analyzing constituent concerns associated with any potential changes, or lack thereof, to regulatory regimes.⁴²⁷

The Staff reached out to various industry regulators in order to obtain their perspectives on the expected impact on their respective regulatory regimes should the Commission decide to incorporate IFRS. The Staff did not survey every regulator that could potentially be impacted by a Commission decision, but rather gathered information from regulators representing a number of different regulatory regimes, including regulators of financial institutions, insurance companies, employee benefits, public utilities, and government procurement. The Staff notes that several of the issues raised by regulators that were surveyed would also be relevant to other types of SEC-regulated entities where U.S. GAAP financial reporting is used (e.g., requirements for broker-dealers) or may be proposed to be used (e.g., capital requirements for securities-based swap entities) for regulatory purposes. Based on the information obtained, the Staff identified some common themes, the more significant of which are discussed below.

1. Regulators Currently Tend to Use U.S. GAAP

The U.S. regulators surveyed are responsible for a wide variety of regulatory functions, including establishing utility rates, assessing the safety and soundness of financial institutions and approving financial institutions' transactions or activities, and determining the permissibility of costs for federal procurement contracts. These regulators rely heavily on regulated entities' financial information—currently prepared in accordance with U.S. GAAP—in carrying out these activities. Some regulators use amounts established under U.S. GAAP directly. Other regulators have their own regulatory accounting standards, which may rely on U.S. GAAP-based inputs. For example, certain regulatory capital requirements for financial institutions are determined by adjusting a U.S. GAAP-based input for specific regulatory requirements (e.g., equity calculated under U.S. GAAP adjusted for specific requirements within a regulation), resulting in the number submitted to prudential regulators. Changing U.S. GAAP could result in changes to the numbers relied on by regulators (either directly or as inputs), which could have significant implications for the regulatory regime.

The Staff found, through its outreach, that regulators use U.S. GAAP for different reasons. Regulators' use of U.S. GAAP may be a question of expediency: the consideration of financial information is necessary for regulatory purposes, and it is easier to use financial information prepared in accordance with U.S. GAAP—which is both uniform and already required by the Commission—than it is to develop new requirements. In addition, the Staff identified many situations in which statutes or regulations specifically require the use of U.S. GAAP, either directly or by interpretation of the regulator.

2. Commission Incorporation of IFRS Would Impact Regulators

The regulators surveyed expressed uncertainty about the impact of a Commission decision to incorporate IFRS, in part, because the impact would depend greatly on the method and timing of incorporation.

⁴²⁷ See Work Plan.

a. Direct Incorporation

If the Commission determined to incorporate IFRS directly—i.e., to require U.S. issuers to use IFRS as issued by the IASB—regulators indicated that several challenges would result. First, the Commission’s determination would apply only to U.S. issuers and not to private companies—but other regulators typically regulate both types of companies. Unless private companies also transitioned to IFRS (a topic discussed further below), a regulator would be supervising some companies that prepare financial information in accordance with IFRS, and other companies that prepare financial information in accordance with U.S. GAAP. Regulatory responses to this situation could include: (1) continuing to require regulatory reporting based on U.S. GAAP (forcing issuers to maintain dual accounting records); (2) shifting regulatory reporting for all companies to IFRS (forcing private companies to change their basis of accounting to IFRS or maintain dual accounting records); or (3) adjusting the regulatory regime to accept both sets of standards. Regulators have expressed that in some cases there is legal uncertainty regarding their authority to accept IFRS in any respect under their governing statutes. Therefore, it is possible that federal and state legislation may be required before some regulators could even consider the second or third options outlined above. Moreover, it is not clear what would happen to U.S. GAAP over the long term if the Commission were to require directly the use of IFRS, thereby adding uncertainty to options one and three above. In addition, some companies have more than one regulator. Different regulators may take different approaches, based on their regulatory needs, resulting in complexity and increased expense for regulated entities.

If a regulator were to determine that it had the authority to accept IFRS and elect an option that involved accepting IFRS information (either exclusively or as an alternative in addition to U.S. GAAP), regulators expressed that they would need to engage in a process to evaluate the IFRS standards to determine areas of alignment with their regulatory regime and areas of disconnect and, accordingly, determine how to adjust their regulatory requirements. For example, if regulators that accepted only U.S. GAAP as an input into a regulatory accounting system then decide to accept either set of standards going forward, they may need to develop a parallel regulatory accounting system that takes into account the differences between U.S. GAAP and IFRS. The regulator likely would need to undertake a substantial amount of up-front work to create the separate system, and likely would need to put forth incremental effort going forward to maintain the systems, provide training, and incorporate any future changes to IFRS or U.S. GAAP. To the extent that IFRS and U.S. GAAP are converged and remain converged before any incorporation, these potential burdens on the regulators may decrease. For regulators that accept either basis of accounting and that use financial statement inputs to make regulatory calculations, any differences in the set of standards used to provide those inputs may complicate comparability across regulated entities.

Some regulatory agencies have significant amounts of regulation, policy, and other material (e.g., internal manuals and training materials) based on U.S. GAAP, which likely would require update to reflect the adoption of IFRS in the United States. Additionally, some agencies have large examination or inspection functions and few of their personnel have had significant exposure to IFRS to date. To this point, some regulators expressed concerns about whether current staff levels would be sufficient to effectively handle a conversion to IFRS or a potential two-GAAP accounting regime in which, for example, U.S. issuers report under IFRS and private

companies report under U.S. GAAP. Finally, regulators raised concerns about the cost of the general IFRS requirement to apply IFRS retrospectively upon adoption. For example, energy regulators at state and federal levels expressed concerns about the retrospective application of IFRS to fixed asset accounting and the impact it would have on their regulatory activities.

b. Incorporation through an Endorsement Mechanism

A decision that would involve the FASB's incorporation of IFRS into U.S. GAAP would most likely alleviate many of the regulators' issues associated with direct incorporation of IFRS, but it would not resolve all issues or concerns. Regulators could continue to require regulatory reporting based on financial statements prepared in accordance with "U.S. GAAP," which, in this scenario, would incorporate IFRS. In theory, rule-making would not necessarily be required, and regulators would not have to develop dual systems. However, regulators would need to review each standard written by the FASB to incorporate IFRS and determine whether and, if so, how, to modify their regulatory systems to take into consideration the changes. In general, regulatory agencies expressed that they have processes in place to respond to accounting changes. The sophistication and effectiveness of the processes vary significantly among the regulatory agencies, and the Staff understands that the process for responding to change can be at times lengthy. Therefore, if the Commission determines to incorporate IFRS in some form into the financial reporting system for U.S. issuers, a transition approach that incorporates existing IFRSs into U.S. GAAP over time may be needed to facilitate the required changes.

3. Regulators' Impressions of IFRS

a. Regulators Generally Support a Single Set of Standards

Regulators generally agreed that they would benefit from a single set of high-quality, globally accepted accounting standards that fosters transparent and consistent reporting. A single set of standards likely would provide regulators and their counterparts in other jurisdictions with a common accounting language, thereby potentially simplifying cross-border interactions and allowing for a greater exchange of more comparable information. Regulators' support for a single set of high-quality, globally accepted accounting standards is tempered by concerns in several areas: (1) the extent of resources likely needed to address a transition (e.g., changing regulations, training of examiner work force, etc.); (2) whether their ability to express their views and provide input to a global accounting standard-setting body would be more limited than it is currently; and (3) whether jurisdictional variations (either in the text of the written standards or in application) will prevent the full benefit of consistency from being achieved after expending significant costs in trying to achieve that benefit.

b. Regulators Have Some Concerns about IFRS

Regulators expressed three primary concerns about the potential for IFRS to be used as the single set of high-quality, globally accepted accounting standards.

First, both IFRS and U.S. GAAP are in a state of change. The Boards are working on two MoU projects—financial instruments and insurance—that will have a significant impact on regulators of financial institutions and insurance companies, respectively. The conclusions reached in these and other joint projects of the Boards, and the extent to which the final standards

are converged, will inform regulators' views on the sufficiency of IFRS for their respective purposes.

Second, some broad concerns were raised about the perception that IFRS is more principles-based than U.S. GAAP and lacks interpretive guidance, which could impact the sufficiency of IFRS for regulatory purposes. Certain industry regulators felt that they may be compelled to issue more detailed guidance and interpretations about the acceptable application of IFRS to enable them to limit diversity in practice and achieve more effectively their regulatory objectives (e.g., safety and soundness for a bank or policyholder protection for an insurer). This dynamic exists with any accounting regime, including U.S. GAAP, and is a reasonable way to address differing information needs. However, regulatory interpretations may in turn impact the underlying financial reporting. To the extent that multiple regulators issue interpretations, and do so in different ways, regulated entities could be faced with conflicting interpretations from multiple authoritative sources.

Third, IFRS lacks industry-specific guidance in certain areas. Under U.S. GAAP, industry-specific standards and practices have developed over time to respond to the unique nature of different industries. The absence of such standards or practices under IFRS causes concern for some regulators. For example, as discussed above, there is no equivalent in IFRS to ASC Topic 980, *Regulated Operations*, which permits incurred costs that are expected to be recovered in the future to be recognized as a rate-regulated asset.⁴²⁸ Further, commenters expressed concerns about losing industry-specific guidance for investment companies and oil and gas companies.⁴²⁹

D. Federal and State Tax Impacts

Incorporation of IFRS into the financial reporting system for U.S. issuers also could affect federal and state tax regulations (e.g., U.S. Internal Revenue Code). As explained in the 2008 Roadmap:

As the Internal Revenue Code has developed over an extended period of time with existing U.S. GAAP as the predominant set of accounting standards used in the United States, certain interactions exist between certain provision of U.S. GAAP and income tax requirements. For example, the Internal Revenue Code has conformity provisions related to the method of accounting for inventory for tax reporting purposes and the method used for reporting to shareholders (and other owners or beneficiaries) or for credit purposes. IFRS does not allow for the use of last-in, first-out, or LIFO, method of accounting for inventory. As a result, a company that reports in accordance with IFRS would be required to use a method of accounting for inventory that is acceptable under IFRS, for example

⁴²⁸ The Federal Energy Regulatory Commission ("FERC") has expressed concern about this issue. See SEC IFRS Roundtable transcript (comments of Bryan Craig, Chief Accountant and Director of Audits, FERC). See also comment letter of the FERC on the 2011 May Staff Paper.

⁴²⁹ See comment letter of SIFMA (regarding investment companies) on the 2011 May Staff Paper. See also comment letters of API and Exxon (regarding oil and gas companies) on the 2011 May Staff Paper.

the first-in, first-out, or FIFO, method. U.S. issuers changing to FIFO for financial reporting purposes may experience a change in taxable income based on the difference between inventory valued on a LIFO basis and on a FIFO basis.⁴³⁰

If federal and state tax regulators maintained their current tax codes, companies may experience a significant increase in the number of book-tax differences they would be required to track upon incorporation of IFRS. Further, because of the high cost that otherwise would be incurred in maintaining two sets of records, the U.S. Internal Revenue Code, as well as state and local tax codes and related regulations, may need to be modified. Alternatively, if federal and state tax regulators continued to align their tax codes with reporting for SEC purposes, companies may experience significant changes to the amount of tax that they are required to pay.

In executing the Work Plan, the Staff analyzed the effects of any incorporation of IFRS into the financial reporting system for U.S. issuers on federal and state tax regulations, as well as issuers subject to such regulations by:

- Analyzing the effects on federal and state tax regulations, as well as issuers subject to such regulations.
- Considering the impact of a change in SEC reporting on federal and state tax regulators.
- Analyzing constituent concerns associated with any potential changes, or lack thereof, to federal and state tax regulation.⁴³¹

The Staff coordinated with staff of the IRS and the U.S. Department of the Treasury (“Treasury”) to understand the potential effects of incorporating IFRS on federal tax regulations. The tax-related areas that may be most significantly affected from any IFRS incorporation include: (1) taxpayers’ ability to use the LIFO inventory method for tax purposes;⁴³² (2) changes in U.S. tax accounting methods, to the extent changes in accounting policies made in the transition to IFRS are considered changes in accounting methods under the U.S. tax code; (3) changes in the computations of U.S. earnings and profits for U.S. tax purposes; and (4) the impact on organizations’ existing transfer pricing policies and documentation. Consistent with the responses of other regulatory agencies, the manner of any incorporation and transition to IFRS would have important implications. Commenters stated that incorporation of IFRS through U.S. GAAP would reduce the level of effort that tax regulators would be required to expend and would reduce the complexity of the transition.⁴³³

With respect to state taxation, tax professionals identified two areas that would be most significantly impacted by any incorporation of IFRS: (1) the apportionment of income, should

⁴³⁰ 2008 Roadmap (internal citations omitted).

⁴³¹ See Work Plan.

⁴³² See comment letter of TLIFOC (the LIFO Coalition) on the 2011 May Staff Paper.

⁴³³ See comment letter of Tax Executives Institute, Inc. on the 2008 Roadmap.

the transition change underlying apportionment factors; and (2) taxes based on an entity's equity or net worth (in those states that have them), should the transition impact either of those calculations.⁴³⁴

E. Statutory Dividend and Stock Repurchase Restrictions

The Work Plan described how the legality of certain corporate actions—e.g., declaring a dividend or repurchasing stock—may be based on amounts determined for financial reporting purposes. Pursuant to the Work Plan, the Staff:

- Analyzed the effect of such incorporation on legal standards, such as a company's ability to pay dividends or repurchase stock, on issuers and investors.
- Considered the impact of a change in SEC reporting on state statutes in this regard.
- Analyzed constituent concerns associated with any potential changes, or lack thereof, to such state statutes.⁴³⁵

The Staff executed this aspect of the Work Plan primarily by outreach to issuers using the Issuer Comment Request, which solicited comment on several issues related to the potential impact of any incorporation of IFRS on statutory dividend and stock repurchase restrictions. Specifically, the Issuer Comment Request inquired about the extent to and manner in which any incorporation of IFRS would impact the ability of issuers to make distributions to security holders; how such impacts would be addressed; and how potential effects of incorporation could be avoided or minimized.

In response to the Issuer Comment Request, some commenters indicated concern that corporate activities tied to state law requirements, including distribution, stock repurchase, and asset sale requirements, could be impacted by a transition to IFRS if the size and/or volatility of assets and/or liabilities as measured under U.S. GAAP was increased or decreased because of transition to IFRS.⁴³⁶ Other commenters discounted these concerns, suggesting that incorporating IFRS into the financial reporting system for U.S. issuers is unlikely to affect materially the ability of issuers to pay dividends and make distributions.⁴³⁷ One commenter

⁴³⁴ See *id.*

⁴³⁵ See Work Plan.

⁴³⁶ See comment letters of Aerospace Industries Association; The Allstate Corporation; and FirstEnergy Corp. on the Issuer Comment Request.

⁴³⁷ See comment letters of American Institute of Certified Public Accountants; BNY Mellon; and Institute of Management Accountants on the Issuer Comment Request.

believed it was too early to determine the impact of fully incorporating IFRS, given the uncertain status of the MoU projects.⁴³⁸

The Staff noted that many state statutes governing corporate distributions are not based on specific accounting standards, so incorporation of IFRS likely would not result in a need to seek changes to state statutes relating to corporate distributions to ensure that companies are able to comply with such provisions following any incorporation of IFRS. Although statutory distribution restrictions generally include references to accounting standards and related terminology (e.g., “assets,” “liabilities,” or “net assets”) and a company’s board of directors may rely on financial statements prepared in accordance with governing accounting principles in determining whether a dividend or share repurchase is permitted under the governing statute, whether such funds are legally available for distribution under state law does not appear to depend solely on the accounting surplus (i.e., whether assets exceed liabilities as recorded on the statement of financial position) but, rather, on management’s good faith, reasonable determination of the value of the company’s assets and liabilities. A change in governing accounting standards seems unlikely to limit or expand significantly the ability of a corporation to declare a dividend or repurchase outstanding equity securities. In addition, the Staff noted that issuers currently would need to consider these same issues with regard to whether changes to accounting standards under U.S. GAAP would affect their ability to pay dividends or make distributions under state statutes. The Staff believes the consideration would be similar if IFRS is incorporated into U.S. GAAP.

There may be a variety of other state statutes that specifically reference “generally accepted accounting principles” and that may be affected by incorporation of IFRS. In such instances, the statutes may specifically refer to generally accepted accounting principles in order to achieve some degree of predictability of application or regularity of accounting, and not because of a substantive preference for U.S. GAAP as compared to IFRS or other standards. For such statutes, it would likely not be necessary to amend the statute if IFRS were incorporated into the U.S. financial reporting system by means of the FASB endorsing IFRS as U.S. GAAP.

As previously discussed, the method of and timing for transition could make a difference in this area. The Staff understands that states may be required to at least assess their corporate statutes to determine whether any changes would need to be made and that this process could take a substantial amount of time. Commenters noted that a sufficient transition period would be beneficial to provide state legislatures the necessary time (or for issuers to make internal adjustments themselves).⁴³⁹

F. Audit Regulation and Standard Setting

In executing the Work Plan, the Staff analyzed the effects of any incorporation of IFRS on PCAOB audit standard setting and auditor requirements by:

⁴³⁸ See comment letter of Intel Corporation on the Issuer Comment Request.

⁴³⁹ See comment letters of American Institute of Certified Public Accountants; Alcoa Inc.; BNY Mellon; FirstEnergy Corp.; and Lincoln Financial Group on the Issuer Comment Request.

- Considering the impact of such incorporation on PCAOB standards.
- Considering the extent of, logistics for, and estimated time necessary to undertake any changes to the auditing standards.⁴⁴⁰

Currently, there are over 350 foreign private issuers that file financial statements using IFRS that are audited by accounting firms using PCAOB standards as the basis for issuing an audit opinion. The Staff met with representatives from accounting firms to understand whether there are limitations on their ability to perform audits and issue audit opinions for foreign private issuers. These firm representatives indicated that they are able to perform audits and issue audit opinions on financial statements prepared in accordance with IFRS using PCAOB auditing standards currently, so any incorporation of IFRS should not affect the firms' ability to continue to issue audit opinions in the future.

The Staff met with staff of the PCAOB to discuss the PCAOB's auditing standards and whether any incorporation of IFRS would necessitate changes to such standards. Under any of the alternatives likely to be considered with respect to an incorporation of IFRS, the PCAOB staff did not think initially that there appears to be a need to make significant modifications to existing PCAOB auditing standards solely to facilitate any particular incorporation method. However, there may be a need for the PCAOB to update certain of its interim standards with language that is neutral with respect to accounting framework applied by issuers and referred to by auditors. For example, AU Section 337, *Inquiry of a Client's Lawyer Concerning Litigation, Claims and Assessments* ("AU 337"), was written specifically in contemplation of ASC Topic 450, *Contingencies*. Therefore, AU 337 may need to be updated if there are differences in the relevant IFRS standard. In general, however, as the PCAOB has updated its interim auditing standards, it has written the standards in a manner that is neutral with respect to the accounting framework and, in the Staff's judgment, the effort required to update the interim standards related to any particular incorporation method would not be significant.

In meeting with the PCAOB staff, the Staff also sought to understand whether the PCAOB staff has identified concerns with accounting firms' abilities to audit IFRS financial statements in accordance with PCAOB audit standards. The PCAOB staff indicated that they have a limited sample of inspections of audits of financial statements prepared in accordance with IFRS; however, based on the inspections to date, the PCAOB has not identified auditing issues that are unique to IFRS. As the PCAOB's inspections of audits of financial statements prepared in accordance with IFRS increase, however, issues unique to IFRS may be identified.

G. Broker-Dealer and Investment Company Reporting

In executing the Work Plan, the Staff analyzed possible approaches for financial reporting requirements for broker-dealers and investment companies, should the Commission determine in the future to incorporate IFRS by:

⁴⁴⁰ See Work Plan.

- Assessing the effects of such incorporation on broker-dealers, investment companies, and investors, including whether IFRS includes sufficient standards, and the extent of, logistics for, and estimated time necessary to undertake any changes, should broker-dealers and investment companies be included in the scope of any potential Commission decision.
- Evaluating the effect on investors of excluding broker-dealers and investment companies from the scope of any potential Commission decision.⁴⁴¹

The Staff discussed with the ICI the implications for investment companies if the Commission were to incorporate IFRS. In addition, the ICI commented on the 2011 May Staff Paper. This outreach suggested that the benefits of a transition to IFRS may not be realized for investment companies and, in fact, could result in potentially significant costs to and issues for investors. Specifically, the ICI commented that:

The typical investor benefits associated with a transition to a single set of accounting standards, (e.g., comparable financial information for U.S. and foreign issuers) do not apply to investment companies as issuers of financial statements. This is because U.S. securities laws strongly limit or discourage investment by U.S. persons in foreign funds and U.S. tax rules discourage foreign investment in U.S. investment companies. . . . Further, even absent these impediments, the typical investor benefits would be limited because few European countries apply IFRS to open-end funds.⁴⁴²

In addition to the lack of a clear investor benefit, the Staff outreach highlighted other potential challenges. U.S. GAAP and the SEC’s regulations, when assessed in combination, represent a custom set of accounting guidance for investment companies. U.S. GAAP has specific standards for financial information to be provided by investment companies—both registered and unregistered funds (e.g., schedule of investments and financial highlights). These requirements would be eliminated or removed if IFRS were applied. In addition, shares issued by investment companies (e.g., open-end funds, such as mutual funds) are treated as equity under U.S. GAAP, which enables a calculation of the fund’s net asset value per share (“NAV/share”)—a figure which is fundamental to the regulatory environment for investment companies and which is required to be disclosed on an investment company’s statement of financial position.⁴⁴³ IFRS would require the shares issued by certain investment companies (e.g., multiple-class open-end funds) to be classified as liabilities. This classification would result in these investment companies not having any equity and therefore, no NAV/share. These changes, according to the Staff’s outreach, would result in less meaningful and less transparent reporting for investment companies at a significant cost to investors. In addition to any transition and conversion costs, ongoing costs would be attributable to a decrease in relevant information provided in the

⁴⁴¹ See Work Plan.

⁴⁴² Comment letter of ICI on the 2011 May Staff Paper.

⁴⁴³ See Article 6 of Regulation S-X.

financial statements and an increase in the amount of record keeping surrounding increased book/tax differences that would be borne by the investor.

The Staff also conducted outreach to FINRA and SIFMA regarding the potential implications of IFRS incorporation on broker-dealers. Broker-dealers apply specific industry guidance contained in U.S. GAAP that does not exist within IFRS. Similar to investment companies' concerns, concerns were raised related to the relevance of broker-dealers' financial reporting absent any industry- or activity-specific guidance. In addition, and as discussed previously, a change in the underlying accounting may necessitate a change in regulation or cause the entity to maintain two sets of accounting records (e.g., one for SEC reporting and another for industry regulatory purposes). For example, the net capital computation is an important metric for regulators of broker-dealers. This computation is based on U.S. GAAP but adjusted for certain items such as non-allowable assets deductions and "haircuts" on proprietary positions. After any incorporation of IFRS, broker-dealers would need to maintain records under U.S. GAAP in order to calculate net capital, absent a modification to the underlying calculation by regulators.

One potential solution for retaining the existing accounting standards for investment companies and broker-dealers would be to exclude both types of entities from the scope of any IFRS incorporation. While this solution would be preferred by the ICI (at least with respect to investment companies),⁴⁴⁴ some constituents outside of the investment company and broker-dealer industries have expressed that no issuer should be exempt from a transition to IFRS, and that all filings with the SEC should be based on IFRS.⁴⁴⁵

Absent a full exclusion of investment companies and broker-dealers from a potential incorporation of IFRS, a mechanism of incorporation that could preserve current accounting and disclosure requirements, at least until comparable standards exist under IFRS, would be important for the affected entities and their investors. The Staff outreach indicated that an approach such as the approach outlined in the 2011 May Staff Paper would better serve investment companies and their investors than alternative approaches (i.e., those that immediately eliminate industry-specific guidance). Such an approach would retain the industry guidance contained in U.S. GAAP until such time that affected transactions can be addressed by future IASB standard setting.

H. Public versus Private Companies

In executing the Work Plan, the Staff analyzed the effects of any incorporation of IFRS into the U.S. financial reporting system on U.S. private companies by:

- Analyzing the effects of such incorporation for U.S. issuers on private companies, auditors, and investors.

⁴⁴⁴ See comment letter of ICI on the 2011 May Staff Paper.

⁴⁴⁵ See, e.g., comment letters of BDO Seidman, LLP and The Center for Audit Quality on the 2008 Roadmap.

- Assessing the extent of, logistics for, and estimated time necessary to undertake changes to accommodate any resulting implications on private companies.⁴⁴⁶

Private companies generally are not subject to a Commission requirement that financial statements be prepared in accordance with U.S. GAAP. Generally, private companies can prepare financial statements on whatever basis best suits the needs of their investors. In fact, since 2008, U.S. CPAs that are members of the AICPA have been permitted to audit financial statements for private companies in accordance with IFRS, or even IFRS for SMEs.⁴⁴⁷ However, in practice, most private companies continue to use U.S. GAAP for a number of reasons, including that investors are accustomed to seeing financial statements prepared in accordance with U.S. GAAP, and should the private company decide to register with the SEC in the future, it would be required to convert retroactively years of financial data to U.S. GAAP prior to its initial registration with the Commission.

The impact of any Commission decision to incorporate IFRS on private company reporting may depend, at least to some extent, on the method of incorporation. If IFRS is incorporated directly (i.e., full adoption is required by U.S. issuers), private companies may retain the option to apply U.S. GAAP, but the current structural and other forces identified above that encourage alignment with public company accounting today will continue to exist in the future and may force at least certain private companies to apply IFRS following the transition. If a decision were made to incorporate IFRS into U.S. GAAP, private companies continuing to apply U.S. GAAP for their own purposes would, in effect, transition at the same pace as public companies, absent delayed transition provisions for private companies. Thus, the Staff acknowledges that financial reporting of private companies may be impacted by any Commission decision on the incorporation of IFRS into the U.S. financial reporting system.

Commenters differed on the extent to which the Commission should consider private company financial reporting in conjunction with its decision of whether to incorporate IFRS for public companies. One commenter suggested that any timeline established for an incorporation of IFRS for public companies should also take into consideration private companies because it will be a *de facto* transition for private companies as well.⁴⁴⁸ Some constituents also indicated that the Staff should consider whether IFRS for SMEs should be incorporated into the U.S. financial reporting system as part of the transition to IFRS.⁴⁴⁹

Other jurisdictions that have transitioned to IFRS encountered similar challenges regarding private versus public companies. The Canadian Accounting Standards Board

⁴⁴⁶ See Work Plan.

⁴⁴⁷ See Appendix A of AICPA's Code of Professional Conduct and Bylaws (Reprinted from the AICPA Professional Standards) (available at: <http://www.aicpa.org/research/standards/codeofconduct/downloadabledocuments/2011june1codeofprofessionalconduct.pdf>).

⁴⁴⁸ See comment letter of MSCPA on the 2011 May Staff Paper.

⁴⁴⁹ See comment letters of AFP and ILCPA on the 2011 May Staff Paper.

incorporated IFRS into its reporting system for public companies as of January 1, 2011 for the vast majority of publically accountable enterprises and provided an alternative for private companies to apply IFRS or a separate set of accounting standards.⁴⁵⁰ The Canadian Bankers Association made the following statement with respect to private company accounting subsequent to any U.S. incorporation of IFRS:

We acknowledge that to many smaller regional U.S. entities who may not be SEC registrants, and participate solely within the U.S. market, IFRS adoption (in whatever form) is less likely to yield similar benefits of comparability. From our experience in Canada, a potential solution to this issue is to maintain a separate set of accounting standards for private enterprises (ASPE) and allow entities the option of applying either these standards or IFRS. We have many clients who prepare ASPE financial statements and have found this approach to be practical and beneficial to all parties. It allows smaller private entities a reprieve from a potentially burdensome transition from which they may not significantly benefit. It also acknowledges that in an increasingly global financial marketplace, large multi-national organizations often have more in common with global competitors than their smaller regional counterparts.⁴⁵¹

The FAF is similarly pursuing the consideration of accounting standard needs for private companies and their investors. In 2010, the FAF jointly sponsored a Blue Ribbon Panel on Standard Setting for Private Companies with the AICPA and the National Association of State Boards of Accountancy (“NASBA”) to examine comprehensively the standard-setting process for private companies and how U.S. accounting standards can best meet the needs of private company financial statement users. The panel concluded its work and published a report⁴⁵² containing its recommendations. As a next step in its consideration of the private company accounting standard setting, the FAF formed a Trustee Working Group which conducted outreach to various constituents, including auditors that focus on private companies, academia, lenders, users, regulators, and others. In May 2012, the FAF established the Private Company Council (“PCC”) to focus on improving the accounting standard-setting process for private companies.⁴⁵³ The PCC is expected to determine whether exceptions or modifications to U.S. GAAP are necessary to address the needs of private company financial statement users. The specific changes called for by the PCC would be subject to endorsement by the FASB and would

⁴⁵⁰ See Chartered Accountants of Canada, International Financial Reporting Standards (available at: <http://www.cica.ca/applying-the-standards/ifrs/index.aspx/news/canadian-developments/item13344.pdf>).

⁴⁵¹ Comment letter of CBA on the 2011 May Staff Paper.

⁴⁵² See Blue Ribbon Panel on Standard Setting for Private Companies, Report to the Board of Trustees of the Financial Accounting Foundation (Jan. 2011) (available at: http://www.accountingfoundation.org/cs/ContentServer?site=Foundation&c=Document_C&pagename=Foundation%2FDocument_C%2FFAFDocumentPage&cid=1176158181336#participating_observers).

⁴⁵³ See FAF Board of Trustees, Establishment of the Private Company Council—Final Report (May 30, 2012) (available at: http://www.accountingfoundation.org/cs/ContentServer?site=Foundation&c=Document_C&pagename=Foundation%2FDocument_C%2FFAFDocumentPage&cid=1176160066778).

be submitted for public comment before being incorporated into U.S. GAAP. If IFRS standards were to be incorporated into the U.S. financial reporting system through an endorsement mechanism, the FAF may need to determine what role the PCC or any other body that specifically considers private company reporting issues would have vis-à-vis such endorsement approach.

VI. Impact on Issuers

Incorporation of IFRS into the financial reporting system for U.S. issuers would significantly affect preparers of financial statements—including approximately 10,000 issuers that file reports with the Commission. Numerous commenters to the 2008 Roadmap expressed the view that the costs, effort, or time involved with a move to IFRS in the manner contemplated by the 2008 Roadmap would be considerable,⁴⁵⁴ with many asserting that the benefits of such a move may not justify those costs.⁴⁵⁵ Accordingly, the Work Plan explored the magnitude and logistics of changes that issuers would need to undertake to incorporate IFRS. The Work Plan examined the following areas:⁴⁵⁶

- accounting systems, controls, and procedures;
- contractual arrangements;
- corporate governance;
- accounting for litigation contingencies; and
- smaller issuers versus larger issuers.⁴⁵⁷

In executing the Work Plan, the Staff was informed by, among other sources:

- commenters on the Issuer Comment Request;
- commenters on the 2011 May Staff Paper;
- participants in the SEC IFRS Roundtable, particularly on the panel on smaller public issuers; and
- individual issuers with which the Staff held discussions.

⁴⁵⁴ See, e.g., comment letters of Chevron Corporation; Eli Lilly Corporation; Shawn S. Fahrner; Hot Topic Inc.; Intel Corporation; Kohl's Department Stores, Inc.; Molson Coors Brewing Company; National Association of Regulatory Utility Commissioners; PPL Corporation; Andrea Psoras; Mark A. Supin; Securities Industry and Financial Markets Association; U.S. Congressman Lee Terry; Tuesday Morning Corporation; and U.S. Congressman Zach Wamp on the 2008 Roadmap.

⁴⁵⁵ See, e.g., comment letters of The Davey Tree Expert Company; Exxon Mobil Corporation; Marriott International, Inc.; McDonald's Corporation; Plantronics, Inc.; Regions Financial Corp.; and tw telecom inc. on the 2008 Roadmap.

⁴⁵⁶ The human capital impact on issuers is discussed further in section VII.

⁴⁵⁷ See Work Plan.

A. Summary Observations

Issuers generally supported the objective of a single set of high-quality, globally accepted accounting standards. However, the views varied based on the size of the issuer, with larger issuers generally being more supportive as compared to smaller issuers. Issuers also generally expressed a need for the Commission to provide as much clarity as possible as to the ultimate approach for further incorporation of IFRS. Further, the manner in which the United States would incorporate and transition to IFRS, if a decision were made to do so, significantly impacted issuers' views. Changes required as a result of the implementation of different accounting standards can be both resource intensive and costly and, with the number of priority Major Joint Projects expected to be completed over the next 18 months, many users expressed a concern about how much change the financial reporting system could absorb. While not unanimous, more issuers preferred a managed transition over time effected by the FASB incorporating IFRS into U.S. GAAP.

B. Accounting Systems, Controls, and Procedures

In executing the Work Plan, the Staff analyzed the effects on U.S. issuers' accounting systems, controls, and procedures, if IFRS were to be incorporated into the financial reporting system. Specifically, the Staff sought to:

- Determine the extent of, logistics for, and estimated time necessary to undertake changes to issuer accounting systems, controls, and procedures to facilitate such incorporation.
- Consider the implications of a "stable platform," including the length of time and means of addressing emerging issues.⁴⁵⁸

The Staff acknowledges that any incorporation of IFRS would require issuers to implement changes to accounting systems, controls, and procedures that may be substantial and require significant transition time and effort. For example, issuers may be required to maintain dual accounting systems during a transition period. Further, issuers would be required to make changes to systems and related internal controls and to complete a comprehensive review and update of company policies and procedures to reflect any incorporation of IFRS.⁴⁵⁹

The impact of a change in an accounting standard can vary based on the pervasiveness of the standard and the extent of the changes to the standard. For example, the Staff compared the efforts expected to be undertaken by issuers to implement the proposed revenue standard, one of the priority Major Joint Projects expected to be finalized in the near-term, with the efforts necessary to implement the FASB's recently published standard related to accounting for goodwill impairment.⁴⁶⁰ Revenue represents a routine, recurring process which is significant to

⁴⁵⁸ See id.

⁴⁵⁹ See id.

⁴⁶⁰ See FASB, Exposure Draft, Proposed Accounting Standards Update (Revised) – Revenue from Contracts with Customers: Revision of Exposure Draft Issued June 24, 2010 (Nov. 14, 2011) (available at:

[Footnote continued on next page]

most issuers. If the Boards were to finalize their new revenue standard, issuers would need to undertake a comprehensive effort to integrate the new standard into their accounting systems. By contrast, the modifications to the goodwill impairment guidance were not substantial, and accounting for goodwill is generally much less pervasive than revenue, so the incorporation of the revised goodwill guidance and any related changes to systems and processes is not expected to be significant for issuers.

To illustrate further, in order to adopt a revised comprehensive accounting standard for revenue recognition, an issuer would likely perform the actions described below, among others:

- Review existing customer contracts or revenue-generating activities to determine the impact of the changes caused by transitioning from existing practices to the requirements of the new accounting standard and consider updates to the customer arrangements and/or contracts to address requirements in the new accounting standard.
- Evaluate outstanding customer transactions, including accounts receivable and unearned revenue, to determine the impact of the change and recognize a transition adjustment, if necessary.
- Revise the corporate accounting policy for revenue recognition and consider disclosure of the change in accounting policies, or necessary changes to critical accounting policy disclosures.
- Determine whether the company's current accounting system can capture the data elements for each customer contract necessary to account for revenue under the new standard and to provide required disclosures. Make system changes as needed.
- Establish new or modify existing internal controls over financial reporting for revenue processes impacted by the change in accounting standard. Consider whether disclosure of new or modified internal controls is required.
- Determine whether the accounting processes responsible for the original accounting before adoption of the new accounting standard must be retained in order to comply with contractual covenants or regulatory reporting.

<http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175823564392&blobheader=application%2Fpdf>). See also FASB, Accounting Standards Update ("ASU"), *Intangibles – Goodwill and Other – Testing Goodwill for Impairment*, (Sept. 15, 2011) ("ASU 2011-8—Goodwill Impairment") (available at: <http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175822937733&blobheader=application%2Fpdf>). These two standards were selected as examples of how issuers manage change to accounting standards in general. The FASB's issuance of a final standard for revenue, along with any final Major Joint Project, would impact issuers regardless of the Commission's decision to incorporate IFRS. Further, revisions resulting from ASU 2011-8—Goodwill Impairment were already adopted and are effective for annual and interim tests for fiscal years beginning after December 15, 2011.

The activities above also will require training of personnel performing these activities as well as internal testing of the new or modified internal controls over financial reporting. The issuer also will bear the costs of additional external audit procedures required to evaluate and test the new or modified processes.

By contrast, changes to other standards may not involve such a comprehensive process. For example, ASU 2011-8—Goodwill Impairment changed how goodwill is evaluated for impairment by providing a company the option first to assess qualitatively goodwill for impairment to determine if additional analysis is required. While such a change may require an issuer to perform some of the activities described above, the impact to an issuer from this change is not expected to be a significant burden because it should not involve a wholesale change in processes and procedures nor greatly impact accounting systems.

The Staff is aware that issuers already face a significant level of change as the Boards develop fundamentally revised accounting standards for the priority Major Joint Projects, including revenue recognition, leasing, and financial instruments. Even without the prospect of any incorporation of IFRS, issuers face significant change in accounting standards in the near-term, which the Staff expects will create stresses on the financial reporting system. As the Staff has considered the possible incorporation of IFRS, it also has been mindful of the overall impact that the pending changes to the aforementioned pervasive accounting standards may have on constituents. The Staff also has considered the positive effect that convergence of the accounting areas subject to the priority Major Joint Projects could have on incorporation of IFRS. To the extent that such new standards are implemented, or are in the process of being implemented, the Staff would not expect significant incremental efforts to be required in connection with such standards for any incorporation of IFRS.

1. Systems, Controls, and Procedures

Through outreach, the Staff learned that many issuers believe that it is impractical for companies to develop appropriate implementation plans until certainty is provided by the Commission with respect to the method for and timing of any transition to IFRS. As one group of commenters asserted, many companies' chief financial officers "have not even begun to prepare for [incorporation], while others indicate they are in the process of preparing but are not yet ready largely due to the difficulty of developing and executing an implementation plan without a defined transition method and set implementation date."⁴⁶¹ The Staff understands that issuers have limited resources and developing cost and impact estimates based on several different hypothetical incorporation periods and methods—without any certainty that those analyses could subsequently be used for the business purpose of effecting an actual transition to IFRS—may be impractical for many issuers.

Some commenters noted, in general, that various methods of transition could have positive or negative effects on the scope of changes to systems, controls, and procedures. For

⁴⁶¹ See joint comment letter of Archer-Daniels-Midland Company; Ford Motor Company; Ford Motor Credit Company, LLC; Bank of New York Mellon Corporation; Chrysler Group LLC; Kellogg Company; and United Continental Holdings on the Work Plan.

example, several commenters advocated prospective application of any newly-incorporated IFRS standards because of the positive cost-minimizing effects, such as on systems transition.⁴⁶² One large multinational issuer estimated the cost for full retrospective adoption of four of the Major Joint Projects—leases, revenue recognition, financial statement presentation, and financial instruments—at over \$400 million and suggested that extrapolating those costs to facilitate full IFRS adoption would “call into question the entire value proposition” of IFRS incorporation.⁴⁶³

Commenters’ opinions diverged when evaluating whether a “big bang” or phased approach would be preferable for transitioning systems, controls, and procedures. Some, but fewer, issuers supported a “big bang” approach for any incorporation of IFRS primarily because it would help them minimize costs by transitioning at a single point in time, rather than over an extended period.⁴⁶⁴ A more common theme of commenters, however, was an opposition to a “big bang” approach for incorporation, generally citing the cost savings that could be achieved through a more gradual development of the systems and processes necessary to implement IFRS.⁴⁶⁵

In addition, commenters noted the effects that the amount of time allowed for incorporation of IFRS could impact the challenges of modifying systems, controls, and procedures. The 2011 May Staff Paper introduced the possibility of a five to seven year transition timeframe. In response, some issuers supported the five to seven year timeframe because, in part, it would ease the demands on upgrading systems and controls.⁴⁶⁶ Other issuers believed that the five to seven year estimate was “aggressive”; the process would need to take much longer.⁴⁶⁷ Some commenters offered the opposite view, however, supporting a faster transition on the grounds that a slower, phased transition would result in accounting complexity (i.e., the need to keep dual accounting records) for a longer period of time.⁴⁶⁸

Finally, U.S. companies that have either parents or subsidiaries outside the United States that are already preparing financial statements in a jurisdiction that has incorporated IFRS raised

⁴⁶² See, e.g., comment letters of ADM; AGA; Chevron; Dell; McDonald’s; McKesson; NextEra; PPL; Praxair; URS; and Zimmer on the 2011 May Staff Paper. Commenters on the 2011 May Staff Paper were particularly concerned that retrospective application: (1) would require dual reporting (see, e.g., comment letter of Dell (noting that retrospective application could require dual reporting for transaction-level information, which would likely be a manual process—increasing the risk of mistakes and insufficient controls)); and (2) would require the generation of accounting information from past periods that systems had not been designed to capture, particularly with respect to asset componentization (see, e.g., comment letter of PPL).

⁴⁶³ See comment letter of Chevron on the 2011 May Staff Paper (specifying that the “majority” of the cost “stems from modifications required to the company’s financial reporting systems to incorporate the new requirements”).

⁴⁶⁴ See, e.g., comment letters of Allstate and IBM on the 2011 May Staff Paper.

⁴⁶⁵ See, e.g., comment letters of AGA; Citi; Edison; Endurance; KeyCorp; McDonald’s; TDS; URS; and Zions on the 2011 May Staff Paper.

⁴⁶⁶ See, e.g., comment letters of CNA; CP; Goodyear; and PPL on the 2011 May Staff Paper.

⁴⁶⁷ See, e.g., comment letters of CMS and Emerson on the 2011 May Staff Paper.

⁴⁶⁸ See, e.g., comment letters of ACCA; Crowe; Ford; and PICPA on the 2011 May Staff Paper.

particular concerns. These companies (or their parents or subsidiaries) may already be maintaining two (or more) sets of accounting records to accommodate their internal and external reporting requirements. Some believe a quick transition to incorporation (or an option to adopt IFRS early) would be preferable because it would allow these companies to eliminate one set of accounting records and manage the company more efficiently.⁴⁶⁹

2. Stable Platform

Some issuers expressed concerns that a transition to IFRS may be more complicated and costly if accounting standard setters continued to promulgate accounting standards during the period of transition. Several commenters expressed a preference for a moratorium on additional standard setting during the transition period—i.e., giving issuers a so-called “stable platform” from which to transition.⁴⁷⁰

The Staff believes that the relevance of a stable platform may depend, in part, on the mechanism through which IFRS would be incorporated as well as the method of transition. An endorsement-like approach that is gradual and incorporates IFRS into U.S. GAAP would enable issuers to employ current processes and procedures in place to respond to changes in U.S. GAAP and, therefore, incorporate all changes from standard-setting efforts whether resulting from an incorporation of IFRS or other FASB standard setting. However, minimizing the volume of other standard-setting projects could nonetheless be important to avoiding general fatigue with respect to accounting changes. By contrast, if a more immediate transition is used, a stable platform may be more important because the benefits of a single, comprehensively-managed incorporation effort could be lessened if standards continued to change throughout initial incorporation. Under either approach, the Staff understands that issuers desire to avoid multiple transitions (i.e., having to implement a new U.S. GAAP standard that is inconsistent with its IFRS counterpart, followed by incorporation of the IFRS standard soon thereafter).⁴⁷¹

The Staff also has concerns with a stable platform to the extent that it would limit the standard setter’s ability to respond to changes in practice or external circumstances that could require revisions to standards. This concern illustrates pragmatic difficulties in the implementation of a stable platform: the platform may be more or less stable based on the need to adjust to changing circumstances. The Staff notes that this concern would be less pronounced in an abbreviated transition to incorporate IFRS standards. However, if a longer-term incorporation approach were pursued, the need for intervening standard setting would be almost certain. If a decision were made to incorporate IFRS standards through an endorsement approach, one potential way to accommodate the need for standard-setting flexibility may be for the FASB to modify its due process framework to incorporate a requirement to solicit comments on and to consider whether an otherwise-important project is truly time-sensitive, or whether it could be deferred until after IFRS incorporation has further progressed.

⁴⁶⁹ See, e.g., comment letters of AFP; HP; HSBC; and TMCC on the 2011 May Staff Paper.

⁴⁷⁰ See, e.g., comment letters of ADM; Dell; and Southern on the 2011 May Staff Paper.

⁴⁷¹ See, e.g., comment letter of ADM on the 2011 May Staff Paper.

C. Contractual Arrangements

Companies' contracts often, either explicitly or implicitly, require the use of U.S. GAAP or are based on current U.S. GAAP reporting. If IFRS were to be incorporated into the U.S. financial reporting system, U.S. issuers would be required to determine how their contracts could be impacted and how those impacts should be addressed. Accordingly, in executing the Work Plan, the Staff:

- Assessed the types and pervasiveness of contractual arrangements that would be affected by such incorporation and the manner in which they would be affected.
- Determined the costs, ability, plans, and estimated time required to address concerns regarding affected contractual arrangements.⁴⁷²

The Staff executed this aspect of the Work Plan primarily by outreach to issuers using the Issuer Comment Request, which solicited comment on several issues related to the potential impact of any incorporation of IFRS on issuers' contracts, including:

- The extent and manner in which incorporating IFRS would be likely to affect the application, interpretation, or enforcement of contractual commercial arrangements such as financing agreements, trust indentures, merger agreements, executive employment agreements, stock incentive plans, leases, franchise agreements, royalty agreements, preferred stock designations, or other commercial arrangements;
- How parties to such arrangements would most likely address the effects and whether an incorporation of IFRS would be treated differently than a change in an existing financial reporting standard under U.S. GAAP is treated today; and
- The extent to which any potential effects of incorporation could be mitigated by phased-in transition and, if so, the length of such transition.

The Staff also received insightful feedback at the SEC IFRS Roundtable and through comments on the 2011 May Staff Paper.

1. Types and Pervasiveness

Commenters identified the following two principal terms in contracts that may be affected by any incorporation of IFRS: (1) terms requiring delivery of financial statements prepared in accordance with U.S. GAAP; and (2) terms requiring that a company achieve or

⁴⁷² See Work Plan.

maintain certain financial targets or ratios, the inputs for which are currently calculated using U.S. GAAP (and which may or may not explicitly state that U.S. GAAP is to be used).⁴⁷³

Commenters noted that these types of contractual terms could be found in the types of contracts identified in the Issuer Comment Request (and noted above) but also in sale/purchase agreements, hedging contracts, R&D collaboration agreements, employee compensation arrangements, and a significant number of additional types of contracts.⁴⁷⁴ The Staff believes that both the scope and the volume of the impacted contracts would be significant.

The Staff noted that some companies have anticipated the potential for change in accounting standards (either due to normal course changes to U.S. GAAP or due to the potential incorporation of IFRS) by using so-called “frozen GAAP.” That is, the contract will specify the use of U.S. GAAP as it exists at the time the contract was signed. These contracts may also be impacted by incorporation of IFRS, but differently, as described below.

2. Effects on Issuers

To some extent, commenters described difficulties in determining how any incorporation of IFRS would impact their contractual arrangements. Commenters emphasized that the extent of the impact would depend, in part, on the progress of current efforts to converge U.S. GAAP and IFRS: the more successful the convergence process is now, the easier the transition to incorporate IFRS would be later.⁴⁷⁵ Commenters also pointed out that the incompleteness of the convergence process makes it difficult at this time to predict comprehensively and accurately the impact of a transition to IFRS.⁴⁷⁶

That said, however, the vast majority of commenters explained that companies will need to review all of their contracts to identify explicit or implicit references to U.S. GAAP and to determine how they will address those provisions that would be affected by any incorporation of IFRS.⁴⁷⁷ However, some commenters noted that companies already have in place (or should

⁴⁷³ See comment letters of American Institute of Certified Public Accountants; The Allstate Corporation; Beckman Coulter; Financial Executives International; FirstEnergy Corp.; The Institute of Chartered Accountants in England and Wales; Lincoln Financial Group; and URS Corporation on the Issuer Comment Request.

⁴⁷⁴ See, e.g., comment letters of American Council of Life Insurers; American Institute of Certified Public Accountants; Alcoa Inc.; The Allstate Corporation; Beckman Coulter; Chevron Corporation; Constellation Energy; FirstEnergy Corp.; Ford Motor Company; The Institute of Chartered Accountants in England and Wales; Institute of Management Accountants; KPMG LLP; Eli Lilly and Company; Lincoln Financial Group; Northrop Grumman; and URS Corporation on the Issuer Comment Request.

⁴⁷⁵ See comment letters of American Council of Life Insurers; American Institute of Certified Public Accountants; Alcoa Inc.; The Center for Audit Quality; Conrad Hewitt; and KPMG LLP on the Issuer Comment Request.

⁴⁷⁶ See comment letters of American Council of Life Insurers; U.S. Chamber of Commerce; Intel Corporation; and Lincoln Financial Group on the Issuer Comment Request.

⁴⁷⁷ See comment letters of American Council of Life Insurers; Association for Financial Professionals; Alcoa Inc.; The Allstate Corporation; BNY Mellon; The Center for Audit Quality; FirstEnergy Corp.; Institute of Management Accountants; KPMG LLP; Eli Lilly and Company; Lincoln Financial Group; Northrop Grumman; and State Street Corporation on the Issuer Comment Request. See also comment letter of the American Institute of Certified Public Accountants on the Issuer Comment Request (noting that the amount of effort this would

[Footnote continued on next page]

have in place) mechanisms for assessing changes to contracts caused by changes to accounting standards, as these changes currently occur in the ordinary course.⁴⁷⁸ A transition to IFRS would involve an invocation of these same mechanisms—but the scope of the overall impact assessment would be much more extensive.⁴⁷⁹

Commenters asserted that many of the contracts affected by any incorporation of IFRS may need to be renegotiated.⁴⁸⁰ The Staff understands that a contract renegotiation could be executed with relatively little effort (e.g., the parties may agree to substitute IFRS financial reports for U.S. GAAP reports),⁴⁸¹ or renegotiations could be more complex and time-consuming. For example, counterparties may attempt to renegotiate other issues, or agreements related to debt securities or other indebtedness may require a consent solicitation or tender offer, which would involve substantial time and cost, and which could be economically disadvantageous based on market conditions.⁴⁸²

Several commenters expressed concerns regarding the possible incorporation of more principles-based accounting on the Federal Acquisition Regulation (“FAR”) system and government contractors.⁴⁸³ Specifically, the FAR’s cost accounting standards (“CAS”) reference or incorporate U.S. GAAP in several aspects, but currently, it is unclear whether, and, if so, how the CAS would be transitioned to IFRS—whether the CAS would be modified to incorporate the relevant provisions of IFRS or whether affected issuers would need to maintain dual accounting records. Thus, commenters requested that the SEC work with the Department of Defense, National Aeronautics and Space Administration, and the General Services Administration to resolve the cost accounting issue concurrently with any incorporation of IFRS.⁴⁸⁴

require varies from company to company, with leasing companies, real estate management companies, and financial services companies likely having a large volume of contracts that need to be addressed).

⁴⁷⁸ See comment letters of The Center for Audit Quality and KPMG LLP on the Issuer Comment Request.

⁴⁷⁹ See comment letters of American Institute of Certified Public Accountants; The Allstate Corporation; The Center for Audit Quality; The Institute of Chartered Accountants in England and Wales; KPMG LLP; and Lincoln Financial Group on the Issuer Comment Request.

⁴⁸⁰ See comment letters of American Institute of Certified Public Accountants; Alcoa Inc.; The Allstate Corporation; Beckman Coulter; BNY Mellon; Chevron Corporation; Constellation Energy; Financial Executives International; FirstEnergy Corp.; Institute of Management Accountants; Lincoln Financial Group; Northrop Grumman; and State Street Corporation on the Issuer Comment Request. See also comment letter of Intel Corporation on the Issuer Comment Request (noting that it could not determine how many of its own contracts would need renegotiation because of uncertainty associated with ongoing standard setting in areas such as leasing and financial instruments with characteristics of equity).

⁴⁸¹ See comment letters of FirstEnergy Corp. and Lincoln Financial Group on the Issuer Comment Request.

⁴⁸² See comment letters of Alcoa Inc.; Beckman Coulter; Constellation Energy; FirstEnergy Corp.; Institute of Management Accountants; and Lincoln Financial Group on the Issuer Comment Request.

⁴⁸³ See comment letters of Aerospace Industries Association; Northrop Grumman; and URS Corporation on Issuer Comment Request.

⁴⁸⁴ See comment letters of Aerospace Industries Association and Northrop Grumman on the Issuer Comment Request.

Commenters acknowledged that not all contracts would need to be renegotiated specifically to incorporate IFRS. For example, contracts could be updated to reflect IFRS incorporation during their normal renewal cycles. A lengthier transition period, in general, would afford issuers increased flexibility in addressing contracts through this process. Finally, it is possible that a transition to IFRS would only immaterially impact contractual arrangements, requiring no action to be taken.⁴⁸⁵

Finally, for contracts containing frozen GAAP provisions, contractual counterparties would, in theory, not need to take any action to respond to any incorporation of IFRS. One commenter noted that issuers that have agreements with frozen GAAP currently would need to have processes in place to be able to report or assess compliance with contractual terms based on U.S. GAAP as it existed when it entered into the agreement.⁴⁸⁶ Any incorporation of IFRS would involve the use of these same processes—but the scope of the changes to be managed could be much different.⁴⁸⁷ For example, to the extent that current accounting systems must be significantly modified to incorporate IFRS, the maintenance of legacy accounting systems necessary to track frozen GAAP could become more costly (as would the alternative of calculating adjustments from IFRS to the frozen GAAP). As a result, companies may have incentives to renegotiate contracts containing metrics based on frozen GAAP upon any incorporation of IFRS as a means of avoiding additional costs.

The Staff understands that the burdens of incorporating IFRS into the financial reporting system for U.S. issuers could be mitigated if any such incorporation is accomplished by amending the substance of U.S. GAAP to conform to IFRS by incorporating such standards into the Codification, while continuing to refer to the amended accounting standards as U.S. GAAP.⁴⁸⁸ In some cases, however, this approach may result in the need to renegotiate the terms of the contract, particularly when the resulting accounting treatment is not favored nor anticipated by the company or its counterparty.⁴⁸⁹ Although this approach to incorporation could be helpful, it would not be a substitute for comprehensive reviews of contracts. Commenters were nearly unanimous in noting that an appropriate transition period (comments centered on a five-year transition period) would be necessary to provide issuers sufficient time to complete their review of contracts, to determine how to respond, and to execute on those decisions (e.g., by conducting the required renegotiations).⁴⁹⁰

⁴⁸⁵ See comment letter of Intel Corporation on the Issuer Comment Request.

⁴⁸⁶ See comment letter of KPMG LLP on the Issuer Comment Request.

⁴⁸⁷ See id.

⁴⁸⁸ See comment letters of Alcoa Inc.; Conrad Hewitt; and BNY Mellon on the Issuer Comment Request.

⁴⁸⁹ See comment letter of Institute of Management Accountants on the Issuer Comment Request.

⁴⁹⁰ See comment letters of American Council of Life Insurers; Association for Financial Professionals; American Institute of Certified Public Accountants; Alcoa Inc.; Beckman Coulter; BNY Mellon; The Center for Audit Quality; U.S. Chamber of Commerce; Chevron Corporation; Constellation Energy; Financial Executives International; FirstEnergy Corp.; Institute of Management Accountants; KPMG LLP; Lincoln Financial Group; Northrop Grumman; State Street Corporation; and URS Corporation on the Issuer Comment Request.

D. Corporate Governance and Other Regulatory Compliance

Any incorporation of IFRS may affect an issuer's compliance with corporate governance requirements, including those under Commission or exchange rules. Further, similar to the potential effects on compliance with other regulatory requirements, changes in financial reporting could impact a company's compliance with certain quantitative listing standards. The Staff analyzed the impact on compliance with corporate governance standards by:

- Determining the potential effects on corporate governance and related concerns of such incorporation.
- Determining possible approaches to address corporate governance concerns and the extent of, logistics for, and estimated time necessary to undertake these approaches.⁴⁹¹

1. Corporate Governance

The Work Plan provided two examples of corporate governance issues that could be caused by an incorporation of IFRS. First, in 2003, as required by the Sarbanes-Oxley Act, the Commission adopted rules that require a registrant to disclose whether it has at least one "audit committee financial expert" (as defined) serving on its audit committee and, if so, the name of the expert and whether the expert is independent of management.⁴⁹² Those rules also indicate the education and experience through which the experts' attributes must have been acquired. Second, stock exchange listing rules have varying levels of financial literacy requirements for audit committee members.⁴⁹³ For both sets of requirements, it is unclear whether an individual who has qualified as an expert or as financially literate based on his or her experience with U.S. GAAP could retain that qualification following a transition to IFRS.

The Staff executed this aspect of the Work Plan primarily by outreach to issuers using the Issuer Comment Request, which solicited comment on several issues related to the potential impact of any incorporation of IFRS on corporate governance. Specifically, the Issuer Comment Request inquired about:

- The extent and manner in which incorporating IFRS likely would affect compliance with corporate governance and related disclosure requirements applicable to U.S. issuers, such as stock exchange listing requirements relating to the composition and function of audit committees of the boards of directors and disclosure requirements regarding audit committee financial experts;

⁴⁹¹ See Work Plan.

⁴⁹² See SEC Release No. 33-8177, Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002 (Jan. 23, 2003) [68 FR 5110 (Jan. 31, 2003)].

⁴⁹³ See Work Plan.

- The extent that current members of boards of directors likely would have the education or experience needed to meet the requirements of the definition of “audit committee financial expert” and whether there would be adverse effects if such requirements were not met;
- How issuers and individual directors most likely would address such adverse effects; and
- The extent to which any potential adverse effects could be mitigated or otherwise affected by providing for a transition or phase-in period for compliance.

Several commenters to the Issuer Comment Request expressed their belief that a transition to IFRS should not call into question the status of audit committee financial experts or audit committee financial literacy requirements under exchange listing rules.⁴⁹⁴ These commenters noted a variety of factors that would justify this conclusion:

- Expertise in U.S. GAAP is transferrable to IFRS;⁴⁹⁵
- Many audit committee members are already familiar with IFRS through board service (in multinational companies or subsidiaries of foreign companies) or specialized training;⁴⁹⁶
- Audit committee members, particularly the designated expert, will become familiar with IFRS through experience and specific training during any transition period;⁴⁹⁷
- Retraining already occurs with respect to changes to U.S. GAAP, and similar retraining for IFRS-related changes would be available (although notably, many commenters conceded that additional training programs would be necessary to

⁴⁹⁴ See comment letters of American Council of Life Insurers; American Institute of Certified Public Accountants; Beckman Coulter; BNY Mellon; Chevron Corporation; Conrad Hewitt; Frederick D. Lipman; and Lincoln Financial Group on the Issuer Comment Request.

⁴⁹⁵ See comment letters of American Council of Life Insurers; American Institute of Certified Public Accountants; BNY Mellon; and Lincoln Financial Group on the Issuer Comment Request.

⁴⁹⁶ See comment letters of Conrad Hewitt and The Center for Audit Quality on the Issuer Comment Request. Two commenters noted, however, that smaller companies may not have access to these resources. See comment letters of American Council of Life Insurers and The Center for Audit Quality on the Issuer Comment Request.

⁴⁹⁷ See comment letters of Chevron Corporation; Ford Motor Company; Institute of Management Accountants; and Lincoln Financial Group on the Issuer Comment Request. Nearly all commenters who responded in this area believed that at least some additional training programs would be necessary to provide audit committee members with IFRS-specific experience. See, e.g., comment letters of American Council of Life Insurers; Association for Financial Professionals; Aerospace Industries Association; American Institute of Certified Public Accountants; Alcoa Inc.; The Allstate Corporation; Beckman Coulter; FirstEnergy Corp.; Conrad Hewitt; The Institute of Chartered Accountants in England and Wales; Institute of Management Accountants; Intel Corporation; KPMG LLP; Lincoln Financial Group; Gregory Misiorek; and Northrop Grumman on the Issuer Comment Request.

provide IFRS-specific education, especially for the audit committee financial expert);⁴⁹⁸ and

- Technical experts are available for consultation with audit committee members to answer IFRS-specific questions.⁴⁹⁹

Several commenters requested that the Commission or the exchanges, or both, supply transitional guidance to avoid any potential disruption.⁵⁰⁰ Commenters also noted that a substantial transition period (e.g., five years) would alleviate some of the potential issues identified with respect to the financial expert and literacy requirements.⁵⁰¹

Finally, a small number of commenters raised concerns that the Work Plan viewed this issue too narrowly.⁵⁰² Specifically, a company's CEO and CFO may also need additional training in IFRS in order to make the financial statement certifications required under the Sarbanes-Oxley Act. In addition, every employee that has financial or accounting responsibilities would need training to some extent. While these considerations are perhaps outside of the specific compliance-related questions discussed in the Work Plan, the Staff acknowledges that these are also important issues that companies would need to consider with respect to any incorporation of IFRS.

2. Other Effects

Commenters also noted the following additional effects of any transition:

- Transitioning to IFRS could affect compliance with quantitative exchange listing standards, including, for example, New York Stock Exchange listed company Rule 102.01C (that establishes minimum listing requirements based on an earnings test, a valuation/revenue test, an affiliated company test, or an assets and

⁴⁹⁸ See comment letters of BNY Mellon; Lincoln Financial Group; and Frederick D. Lipman on the Issuer Comment Request. See also comment letter of The Center for Audit Quality on the Issuer Comment Request (the broad-based scope of changes resulting from any incorporation of IFRS could have a more significant effect as compared to "a discreet [sic] change in U.S. GAAP in any given year").

⁴⁹⁹ See comment letters of American Institute of Certified Public Accountants and Beckman Coulter on the Issuer Comment Request.

⁵⁰⁰ See comment letters of Association for Financial Professionals; Aerospace Industries Association; The Allstate Corporation; and Chevron Corporation on the Issuer Comment Request.

⁵⁰¹ For example, a sufficiently long transition period would provide time for audit committees and their financial experts to obtain the training necessary to keep pace with a transition to IFRS. See comment letters of Association for Financial Professionals; Aerospace Industries Association; American Institute of Certified Public Accountants; Alcoa Inc.; The Allstate Corporation; Beckman Coulter; BNY Mellon; The Center for Audit Quality; Chevron Corporation; FirstEnergy Corp.; Institute of Management Accountants; KPMG LLP; Lincoln Financial Group; and Frederick D. Lipman on the Issuer Comment Request.

⁵⁰² See, e.g., comment letters of Alcoa Inc.; Institute of Chartered Accountants in England and Wales; Intel Corporation; and Northrop Grumman on the Issuer Comment Request.

equity test, any or all of which could be affected by a transition to IFRS).⁵⁰³ Most commenters, however, asserted that maintaining listing qualifications should not be a problem.⁵⁰⁴

- Transitioning to IFRS could affect the application or interpretation of various disclosure requirements, including some that bear on corporate governance, such as executive compensation disclosure rules.⁵⁰⁵

E. Accounting for Litigation Contingencies

In accordance with the Work Plan, the Staff analyzed the effects on accounting and disclosure requirements for litigation contingencies under IFRS in the U.S. legal environment. Specifically, the Staff sought to:

- Discuss with issuers, the legal profession, and investors concerns regarding accounting and disclosure requirements for litigation contingencies under IFRS.
- Determine possible approaches to address concerns regarding accounting and disclosure requirements for litigation contingencies under IFRS and the extent of, logistics for, and estimated time necessary to undertake these approaches.⁵⁰⁶

The accounting for litigation contingencies is different under IFRS than under U.S. GAAP. Both sets of standards require that loss contingencies are recognized when a future economic outflow is probable; however, the term “probable” is defined differently under IFRS and U.S. GAAP. IFRS defines “probable” as “more likely than not to occur,”⁵⁰⁷ which the Staff understands to be greater than 50% (i.e., 51% would meet the definition). U.S. GAAP defines “probable” as “the future event or events are likely to occur,”⁵⁰⁸ which is generally interpreted to be a significantly higher percentage of likelihood than 50%.⁵⁰⁹ Further, once the recognition threshold is triggered, the two sets of standards provide different approaches for measurement of a liability.⁵¹⁰ As the Work Plan noted, commenters have expressed concerns both about the

⁵⁰³ See comment letters of The Allstate Corporation; FirstEnergy Corp.; and Lincoln Financial Group on the Issuer Comment Request.

⁵⁰⁴ See comment letters of American Council of Life Insurers; American Institute of Certified Public Accountants; Alcoa Inc.; BNY Mellon; and The Center for Audit Quality on the Issuer Comment Request.

⁵⁰⁵ See comment letters of Alcoa Inc.; FirstEnergy Corp.; and URS Corporation on the Issuer Comment Request.

⁵⁰⁶ See Work Plan.

⁵⁰⁷ See IAS 37, paragraph 23.

⁵⁰⁸ See ASC Section 450-20-20.

⁵⁰⁹ See Section III.P of the GAAP Comparison Paper.

⁵¹⁰ See *id.*

lower threshold for recognition and the different disclosures required by IFRS.⁵¹¹ One commenter noted that the current IFRS standard on contingent liabilities requires disclosures on information that, if revealed, could be detrimental to the outcome of pending litigation.⁵¹² In addition, as the Work Plan also noted, the FASB in 2008 proposed revisions to the loss contingency disclosures, which generated significant controversy.⁵¹³ The Staff observed that the IFRS provisions are similar to the FASB's rejected proposals and, thus, those provisions could be met with similar objections. In 2010, the FASB released a revised proposal that was less significant of a departure from existing standards, but it too was met with controversy.⁵¹⁴

In response to the 2011 May Staff Paper, one commenter discussed two areas of IFRS and U.S. GAAP that it believed may never be aligned: LIFO, discussed above, and litigation contingencies. With regard to litigation contingencies, the commenter stated:

The CCMC [U.S. Chamber of Commerce, Center for Capital Markets' Competitiveness] has also raised concerns with the stress of our litigation system upon IFRS. There has been a delicate balance in place regarding financial reporting concerns and legal rights in the recognition of loss contingencies. That need for balance has been underscored by the debate concerning potential changes to the FAS 5 standard, while the CCMC also strongly opposed the proposed IAS 37 standard by the IASB. Accordingly, it is the opinion of the CCMC that IAS 37 is insufficient to withstand the crucible of the American litigation system.⁵¹⁵

Another commenter noted that changes in the accounting requirements for litigation contingencies also could necessitate a change to auditing standards, particularly AU 337.⁵¹⁶ In balancing the public interest of accurate financial reporting and attorney-client confidences, the AICPA and American Bar Association, in 1975, issued a Statement of Policy regarding lawyers' responses to auditors' requests for information.⁵¹⁷ This Statement of Policy, sometimes colloquially referred to as the "Treaty," does not provide a basis for auditors' noncompliance with the relevant accounting rules.⁵¹⁸ If any incorporation of IFRS results in an increase in the

⁵¹¹ See Work Plan.

⁵¹² See comment letter of Pfizer Inc. on the 2008 Roadmap.

⁵¹³ See *id.*

⁵¹⁴ See, e.g., comment letter of New York City Bar on FASB, Exposure Draft, Proposed Accounting Standards Update – Disclosure of Certain Loss Contingencies, (Jul. 20, 2010) (available at: <http://www.nycbar.org/pdf/report/uploads/20071990-LettertoFASBReDisclosureofCertainLossContingencies.pdf>).

⁵¹⁵ Comment letter of Chamber on the 2011 May Staff Paper (internal citation omitted).

⁵¹⁶ See comment letter of Navistar on the 2011 May Staff Paper.

⁵¹⁷ See AU 337C, Exhibit II – American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (Dec. 1975) (available at: <http://pcaobus.org/Standards/Auditing/Pages/AU337C.aspx>).

⁵¹⁸ See, generally, Kim Nilsen, Renewed Focus on Loss Contingency Disclosures, J. OF ACCOUNTANCY (Apr. 2011) (available at: <http://www.journalofaccountancy.com/Issues/2011/Apr/20113854.htm>).

scope or detail of matters required to be disclosed in financial statements as compared with existing U.S. GAAP requirements, there may be external pressure to revisit the terms of the Treaty, which could result in a great deal of controversy between the accounting and legal communities, particularly considering that the current requirements are themselves continually the subject of contention between the two parties.

The method by which IFRS is incorporated into the U.S. financial reporting system could impact this issue. A phased approach would, at a minimum, permit additional time to study the issues related to litigation contingencies. Further, an approach of this nature would provide the FASB with the opportunity to explore other solutions (e.g., retaining the existing U.S. GAAP standard on this issue, or providing issuers an option to use either the legacy U.S. GAAP standard or the IFRS standard, so that companies desiring to assert dual compliance could elect to comply with the IFRS version of the standard). Despite the inconsistencies between U.S. GAAP and IFRS, the Staff observed that accounting for litigation contingencies also may be an area for which inconsistency exists in the application of IFRS. As noted in the IFRS Application Paper, it appeared that many companies omitted disclosure or provided limited disclosure of the financial exposure and the underlying uncertainties surrounding provisions and contingent liabilities.⁵¹⁹ It was unclear to the Staff whether the level of disclosures (or absence thereof) in this area was due to noncompliance, immateriality, or reliance on an accommodation within IFRS to omit certain disclosures if such disclosure is expected to seriously prejudice the position of the company.⁵²⁰

F. Smaller Issuers versus Larger Issuers

The Commission in the 2010 Statement noted that smaller companies and those without international operations will bear the costs and effects from incorporation of IFRS differently than large companies and those that compete globally.⁵²¹ Several commenters on the 2008 Roadmap asserted that adoption of IFRS would be particularly burdensome for smaller U.S. issuers. For example, one commenter included studies from two independent consultants indicating that, while recognizing potential cost savings for some large, multinational firms, a move to IFRS is likely to impose substantial transition costs, including disproportionate costs, on smaller issuers.⁵²²

In light of the above comments, the Staff analyzed the extent to which any incorporation of IFRS would affect smaller issuers differently than larger issuers and the extent of, logistics for, and estimated time necessary to undertake any changes. Specifically, the Staff sought to:

⁵¹⁹ See IFRS Application Paper (referencing IAS 37, paragraphs 84 and 86).

⁵²⁰ See *id.* (referencing IAS 37, paragraph 92).

⁵²¹ See 2010 Statement.

⁵²² See comment letters of Biotechnology Industry Organization and the FAF on the 2008 Roadmap. But, cf., comment letter of Xenoport, Inc. (“[T]he impact is expected to be very small and the majority of the impact will occur in non-routine or one-off transactions which are typically subject to significant scrutiny in any case.”) on the 2008 Roadmap.

- Determine the manner in which the impact of such incorporation varies based on issuer size.
- Determine possible approaches to mitigate concerns regarding any disproportionate effects on smaller issuers of such incorporation and the extent of, logistics for, and estimated time necessary to undertake these approaches.⁵²³

Responses from small issuers on the 2011 May Staff Paper and Issuer Comment Request were limited as compared to other classes of issuers. To supplement the Staff's outreach, the SEC IFRS Roundtable included a panel with smaller issuers focused on understanding the impact of any incorporation of IFRS on such issuers. The Staff recognizes that smaller issuers, as a matter of practice, may more closely focus on issues that could have an immediate impact on the company, and they, therefore, may not make dedicated efforts to analyze and understand the effects of a transition to IFRS because it is not viewed as a near-term event.⁵²⁴

From its research, the Staff understands that both small and large issuers would generally have to perform similar activities to transition to IFRS. However, the number of accounting and financial staff was cited as an aspect that varies based on issuer size. Smaller issuers indicated that they generally have fewer internal resources available to dedicate to nonroutine projects such as a transition to IFRS and, hence, the impact may be more burdensome to smaller issuers on a relative basis.⁵²⁵

Some commenters cited the proportionally higher costs for some smaller or primarily U.S.-based companies to incorporate IFRS as support for phased adoption (e.g., by size).⁵²⁶ One commenter noted the efficiencies that may be leveraged by smaller issuers to the extent that larger issuers first incorporate IFRS. In this regard, smaller issuers may be able to benefit from lessons learned if implementing on a delayed basis.⁵²⁷ Others argued that a permanent option to use IFRS for U.S. companies with no requirement to do so for all companies would be preferable to appropriately scale the costs such use would pose on U.S. companies with no foreign operations.⁵²⁸ If only provided an option, it was viewed that many small issuers would elect to remain on U.S. GAAP, resulting in a dual GAAP reporting system for domestic issuers.

⁵²³ See Work Plan.

⁵²⁴ See, e.g., comment letter of ICBA on the 2011 May Staff Paper. See also SEC IFRS Roundtable transcript (comments of Ron Zilkowski, CFO, Cuisine Solutions, noting that some small companies are trying to find a "proper seminar just to learn the nomenclature of IFRS").

⁵²⁵ See, e.g., SEC IFRS Roundtable transcript (comments of Shannon Greene, CFO, Tandy Leather Factory).

⁵²⁶ See comment letters of Ford and PCI on the 2011 May Staff Paper. See also comment letter of Chamber on the 2011 May Staff Paper (proposing the creation of an advisory group to assist the Commission in identifying costs of mid-sized and smaller companies).

⁵²⁷ See SEC IFRS Roundtable transcript (comments of Zilkowski, contrasting IFRS with his experience of the Sarbanes-Oxley Act Section 404 implementation).

⁵²⁸ See comment letters of FIRCA; PICPA; Praxair; SIFMA; Southern; and Zions on the 2011 May Staff Paper.

Finally, one commenter noted that the costs of applying IFRS on a go-forward basis (i.e., not just transitioning to it) are prohibitive, particularly with regard to the commenter's perception that IFRS has more extensive requirements to use fair value.⁵²⁹ Two panelists at the SEC IFRS Roundtable similarly expressed concerns that any incorporation of IFRS would only impose costs on some companies; there would be no benefit to incorporation.⁵³⁰

⁵²⁹ See comment letter of Zions on the 2011 May Staff Paper.

⁵³⁰ See SEC IFRS Roundtable transcript (comments of Rowland and Greene).

VII. Human Capital Readiness

The Commission noted in the 2010 Statement that “incorporation of IFRS would require consideration of the readiness of all parties involved in the financial reporting process, including investors, preparers, auditors, regulators, and educators.”⁵³¹ If IFRS is to be incorporated successfully into the U.S. financial reporting system (should the Commission determine to do so), individuals who produce, use, or otherwise have an interest in U.S. GAAP and financial statements issued in accordance with U.S. GAAP will need to prepare for and understand both potential changes that will be made to accounting standards, as well as changes to the process in which those standards are set, changed and interpreted.⁵³² A critical part of IFRS incorporation, therefore, would be formulating a transition strategy that provides sufficient time to plan and execute the logistics necessary to build a level of human capital that is sufficient to execute the change.

Accordingly, the Work Plan called for the Staff to evaluate the following two areas:

- Education and training; and
- Auditor capacity.⁵³³

A. Summary Observations

The level of preparedness for a transition to IFRS varies widely—some companies’ personnel are already familiar with IFRS and would require little supplementation to be fully prepared for a transition, while other companies’ personnel currently have little or no knowledge of IFRS requirements or developments and are only focused on U.S. GAAP. The amount of time and effort that would be needed for issuers to transition will be significantly impacted by the method by which IFRS is incorporated into the U.S. financial reporting system. Further, the extent to which IFRS and U.S. GAAP are more closely aligned through completion of the Major Joint Projects will directly impact this assessment.

Broadly, issuers could acquire the necessary human capital resources to incorporate IFRS by either training existing personnel or by employing outside expertise (as either new employees or consultants). Though neither approach is without flaw, training existing personnel may require significant investment, of both time and money, as well as the opportunity cost of shifting those resources away from the tasks they otherwise would have been performing for the company. External additions of human capital may be more expeditious in building needed IFRS expertise, but the pool of qualified candidates is limited and increasingly costly to the extent that demand for such individuals exceeds the available talent.

⁵³¹ 2010 Statement.

⁵³² Preparedness of users (i.e., investors) is discussed further in subsection IV.D.

⁵³³ See Work Plan.

The demands on human capital to incorporate IFRS will be influenced by the method of transition to IFRS and by the length of any transition period. For example, a “big bang” approach to incorporation coupled with a short transition period could impose a significant burden on human capital if there is too little time to develop expertise internally and if many companies are competing for the same pool of qualified external candidates. The Staff, in part, considered other approaches to incorporation with the intention of possibly reducing these pressures. A “big bang” approach with a longer transition period could provide some relief, but the rigors of managing full incorporation by a date certain would still impose additional costs on constituents. By contrast, an endorsement method that phases in changes to U.S. GAAP over time would allow individuals to develop their skills more traditionally, using the existing types of training and resources that those individuals currently use to update their knowledge of U.S. GAAP in response to ongoing standard setting. By extending any incorporation of IFRS over a sufficient period of time, the degree of change should not be significantly different from what individuals experience following the existing pace of FASB standard setting.

B. Education and Training

In executing the Work Plan, the Staff considered the education and training in IFRS by:

- Evaluating the current level of IFRS expertise and extent of IFRS education and training needs among constituents.
- Considering the extent of, logistics for, and estimated time to implement plans for future training among constituents.⁵³⁴

The Staff performed targeted outreach to various constituents, including issuers, auditors, and regulators, to assess their current understanding of IFRS and the current level of their organizations’ IFRS training efforts. Additionally, the Staff considered the existing processes constituents apply to identify and incorporate changes in accounting standards and whether such processes could be employed if the Commission were to determine to incorporate IFRS.

The Staff noted that IFRS readiness varied greatly. A few constituents have an extensive and detailed understanding of IFRS. The majority of constituents with whom the Staff consulted, however, indicated that they only have a limited or foundational understanding of IFRS. The Staff noted a wide disparity in the amount of current IFRS training, contributing to diversity in constituents’ understanding of IFRS.

Those constituents that indicated that they have an extensive understanding of IFRS generally are associated with the technical accounting groups of either of the following: (1) the U.S. practices of large international public accounting firms; or (2) large multinational companies that have foreign entities that report in jurisdictions that have or are in the process of incorporating IFRS. The large international accounting firms generally have internal IFRS training programs and training resources already in place. Likewise, large multinational companies with IFRS reporting requirements have IFRS training programs in place or have

⁵³⁴ See Work Plan.

provided IFRS training to their personnel at various stages through the IFRS-readiness and adoption processes.

In general, most constituents with whom the Staff consulted, including many smaller public accounting firms and regulators, indicated that they have limited internal IFRS training or experience. These constituents further indicated that they are awaiting a Commission determination regarding the incorporation of IFRS before they devote resources to begin to or develop further their IFRS understanding. In advance of a Commission decision, many of the smaller accounting firms indicated that they are developing or have developed a base of IFRS knowledge only out of client-service necessity (e.g., to support the audit of a subsidiary of a foreign parent that reports in a jurisdiction that incorporates IFRS).

In the absence of internal training resources, constituents have identified third-party training resources that are currently available that could supplement or provide an alternative to internal IFRS training. Third parties currently providing IFRS training and training resources include, for example, professional accounting organizations, for-profit training entities, and large international accounting firms. The training resources currently available include, for example, online training modules, conferences, and IFRS manuals, and are targeted at preparers, investors, regulators, academics, and others.

Consistent with expectations, the Staff's outreach to preparers confirmed that companies have in place processes for identifying changes in accounting standards that impact their financial reporting and for making the adjustments necessary to apply the changed standards. For the majority of preparers with whom the Staff consulted, their current processes would not be sufficiently robust to accommodate a "big bang" adoption of IFRS. Therefore, many preparers would need to employ external or additional internal resources to facilitate adoption. However, other, more measured transition methods, such as a transition over a period long enough to allow for comprehensive changes in financial reporting processes or an incorporation of IFRS through convergence or endorsement strategies, likely would reduce the extent to which existing processes would need to be supplemented by outside resources to incorporate IFRS. Preparers indicated that the processes for incorporating IFRS through an endorsement mechanism generally would be substantially similar to the processes used currently for managing accounting changes.

C. Auditor Capacity

In executing the Work Plan, the Staff analyzed auditor capacity constraints with respect to IFRS by:

- Analyzing concerns regarding auditor capacity constraints, including the effect on audit quality, cost, and audit firm concentration and competitiveness.

- Determining possible approaches to mitigate these concerns and the extent of, logistics for, and estimated time necessary to undertake these approaches.⁵³⁵

To determine the effect that incorporation of IFRS could have on auditor capacity, the Staff first assessed the population of auditors that would be impacted. Auditors of public companies would, of course, be the most directly impacted. As of January 2011, there were approximately 850 public accounting firms identified by the PCAOB that issue audit reports opining on the financial statements of public companies.⁵³⁶ Not all of these 850 firms would be impacted equally, however. For instance, this firm count includes some foreign firms that are located in jurisdictions that have already incorporated or may permit the use of IFRS. These foreign firms are more likely to be already familiar with IFRS.

To assess the implications of transition on auditor capacity, the Staff made inquiries to a number of public accounting firms, solicited views of issuers and various other constituents, and considered feedback from foreign regulators, comment letters, and the recommendations contained in the final report of the Treasury Advisory Committee on the Auditing Profession.⁵³⁷

According to some public accounting firms, the expected availability of audit services following any incorporation of IFRS would vary according to the extent to which each individual firm has incorporated IFRS into its existing auditing infrastructure. Specifically, the readiness is a product of the firm's experience with IFRS to date, the extent and manner of training developed by the firm on IFRS and provided to employees, and the extent to which a firm's quality control systems have already been designed to contemplate audits of financial statements prepared in accordance with IFRS, including hiring, staffing of audits, and professional advancement. In general, the largest international public accounting firms generally already have such quality control infrastructures in place. These infrastructures may be sufficiently suitable (with some augmentation and training) to accommodate any form of IFRS incorporation. By contrast, smaller and mid-size public accounting firms appear to have no or less-extensive IFRS infrastructures in place. These infrastructures may not be sufficient, as they currently exist, to provide support to issuers transitioning to IFRS, or to perform audits of financial statements prepared in accordance with IFRS.

Specifically:

- Large firms. The IFRS infrastructures of the largest international public accounting firms generally include certain key components that are considered

⁵³⁵ See Work Plan.

⁵³⁶ The term "public company" as used in this context refers to an issuer with securities registered under Section 12 of the Exchange Act, or that is required to file reports under Section 15(d) of the Exchange Act, or that files or has filed a registration statement under the Securities Act which has not yet become effective and has not been withdrawn. See PCAOB, Inspected Firms (available at: <http://pcaobus.org/Inspections/Pages/InspectedFirms.aspx>).

⁵³⁷ See U.S. Department of the Treasury, Advisory Committee on the Auditing Profession, Final Report (Oct. 6, 2008) (discussing IFRS in accounting curricula). See also subsections II.D. and V.F.

important for maintaining quality in the audits of financial statements prepared in accordance with IFRS.

First, these firms have some existing in-house IFRS knowledge and expertise, as well as additional IFRS resources through their global networks. However, even the largest public accounting firms would likely have to reallocate or supplement existing resources to respond appropriately to any incorporation of IFRS for U.S. issuers. The extent to which firms would need to supplement their current resources, training, and processes would greatly depend on the method of incorporation of IFRS.

Second, these firms also generally have extensive global IFRS accounting manuals, U.S. GAAP to IFRS comparison guides and tools for identifying differences, formal IFRS training, and IFRS internal consultation protocols. These existing infrastructures would help support the quality of work performed, including compliance with standards and consistent application of the standards across clients and geographies. However, the network structure of these global entities limits the extent to which resources outside of the U.S. individual member firms can be leveraged to support U.S. transition.

- Smaller and mid-size firms. Smaller and mid-size public accounting firms generally have not developed the extensive IFRS infrastructure of the largest public accounting firms. Many smaller firms do not have the resources to support dedicated in-house IFRS experts that are available to consult in a “National Office” capacity. Further, smaller firms generally have not developed internal IFRS guidance and many have no plans to develop or acquire such guidance until the Commission makes a decision regarding any incorporation of IFRS into the U.S. financial reporting system. Currently, smaller and mid-size firms generally have access to IFRS guidance either through their international network of affiliated firms or external sources, such as resources made publicly available by the largest accounting firms, professional associations, and other providers of technical accounting guidance.

Some constituents have raised concerns about auditor capacity and the impact to the availability and cost of qualified auditors in the event of a U.S. transition to IFRS, noting that the impact will likely be influenced by the method and timing of transition. For example, one preparer who participated in the SEC IFRS Roundtable expressed concerns about the costs that would be associated with incorporation of IFRS specifically as it related to the need to hire consultants to effect any change.⁵³⁸ This preparer expects the need to hire consultants to support the transition efforts and has concerns as to the availability of qualified consultants and the effect such availability may have on the cost of the consultants. In many cases, “qualified consultants” either are employed by audit firms themselves, or, if independent, could be sought after by audit firms to help manage the firm’s client demands through the transition process. To the extent that

⁵³⁸ See SEC IFRS Roundtable transcript (comments of Rowland).

the limited pool of resources available from audit firms is transitioned from audit roles into consulting functions to help preparers manage their transition, audit resources could be adversely affected. During any IFRS transition, the reverse scenario could unfold as well—to the extent that auditors consume available consulting resources, preparers will have less choice and greater expense in retaining qualified assistance for their own transitions. Although commenters did not provide quantitative data on this topic, anecdotally (based on their experiences with other large-scale transitions), commenters believed that shortages could be significant. A longer, phased-in transition could provide auditors greater opportunity to make the necessary adjustments, and to leverage in-house resources in that task, which would seem generally to promote the availability of audit services.

Finally, the Staff considered concerns related to audit firm concentration and competitiveness. Some constituents believe that a transition to IFRS would further concentrate the audit of public companies among the largest international public accounting firms and restrict competitiveness. For example, NASBA commented that:

[some] firms would determine that they were not able to maintain competence in two standards [U.S. GAAP and IFRS] and would elect to serve only clients that used standards for non-issuers, which would result in further concentration of auditing and other accounting services in the remaining firms that have expertise in IFRS.⁵³⁹

Although the analysis of auditor competition effects is outside of the Staff's area of direct expertise, it would seem that the method of transition could have an impact here as well. A more gradual transition period that conforms U.S. GAAP with IFRS—thereby retaining one set of accounting standards in the United States—would give auditors the opportunity to keep abreast with changes in U.S. GAAP related to any incorporation of IFRS, through continuing professional education and other education opportunities, and would permit auditors to focus on one set of standards, rather than two. On the other hand, in the event of a less gradual transition, some firms may choose to exit the audit market rather than make the changes and investments necessary to audit companies applying IFRS. At the same time, other firms may welcome the business opportunities created by the broader application of IFRS and may determine to expand, thereby increasing the competition with the largest international public accounting firms.

⁵³⁹ Comment letter of NASBA on the 2008 Roadmap.

Appendix A, Exhibits A – I

A	Commission Statement in Support of Convergence and Global Accounting Standards (Feb. 24, 2010) (“2010 Statement”)
B	Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers (Feb. 24, 2010) (“Work Plan”)
C	Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers—Progress Report (Oct. 29, 2010) (“2010 Progress Report”)
D	Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers—Exploring a Possible Method of Incorporation—a Securities and Exchange Commission Staff Paper (May 26, 2011) (“2011 May Staff Paper”)
E	2011 May Staff Paper—Summary of Comments (“Summary of Comments on the 2011 May Staff Paper”)
F	Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers—A Comparison of U.S. GAAP and IFRS—a Securities and Exchange Commission Staff Paper (Nov. 16, 2011) (“GAAP Comparison Paper”)
G	Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers—An Analysis of IFRS in Practice—a Securities and Exchange Commission Staff Paper (Nov. 16, 2011) (“IFRS Application Paper”)
H	IFRS Foundation Monitoring Board, Final Report on the Review of the IFRS Foundation’s Governance (Feb. 9, 2012) (“MB Governance Review”)
I	IFRS Foundation, Report of the Trustees’ Strategy Review 2011: IFRSs as the Global Standards: Setting a Strategy for the Foundation’s Second Decade (“Strategy Review Final Report”)