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THE SEC’S CONSIDERATION OF THE CONVERGENCE OF GLOBAL ACCOUNTING STANDARDS AND POTENTIAL ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS IN THE UNITED STATES

Thomas W. White1
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For many years now, the Securities and Exchange Commission has been considering issues relating to the convergence of U.S. and international accounting standards, including possibly adopting International Financial Reporting Standards as the governing body of accounting standards for U.S. public companies. In November 2008, the SEC published a proposed Roadmap for the adoption of IFRS as early as 2014. The SEC received substantial comments on the Roadmap in early 2009. However, in light of the financial crisis and the change in leadership at the SEC, the issue remained relatively dormant until early 2010.

On February 24, 2010, the SEC published a “Commission Statement in Support of Convergence and Global Accounting Standards”3 to reaffirm its commitment to convergence of U.S. Generally Accepted Accounting Principles (“U.S. GAAP”) and IFRS and to outline its plan for further consideration of adoption of IFRS for U.S. reporting companies. The Commissioners directed the SEC Staff to execute a work plan (the “Work Plan”) in order to position the Commission to make a determination in 2011 regarding the adoption of IFRS. The SEC indicated that, should it vote to adopt IFRS, the earliest U.S. issuers would be required to report using IFRS would be approximately 2015 or 2016; however, the Commissioners have tasked the Staff to further analyze this timeline.

This outline summarizes the background of the SEC’s consideration of potential IFRS conversion and discusses the SEC’s recent Statement and the Work Plan.

I. Background

A. The Convergence Process

The SEC issued its Statement against the backdrop of an ongoing “convergence” project for U.S. and international accounting standards—i.e., for the standard setters for each system to seek to

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develop and implement common standards. In 2002, the Financial Accounting Standards Board ("FASB") and the International Accounting Standards Board ("IASB") began to work towards the goal of converging U.S. GAAP and IFRS. A 2002 memorandum of understanding issued by the two organizations set forth the goal of developing a single set of high-quality global accounting standards. In 2006, the two organizations updated the 2002 memorandum to improve the convergence process. The 2006 memorandum was updated again in 2008 to pinpoint certain convergence projects that the FASB and IASB believed were essential to the convergence process.

A G-20 meeting in 2009 requested that the FASB and IASB continue with the convergence process with a goal completion date of 2011. To this end, in November 2009, the FASB and the IASB reaffirmed their commitment to improve IFRS and U.S. GAAP and bring about their convergence by intensifying efforts to complete the projects described in the 2006 memorandum by June 2011. In addition, the FASB and the IASB stated their desire to improve efficiency and effectiveness in the convergence process by agreeing to monthly meetings and quarterly progress reports on convergence projects.

On June 2, 2010, the IASB and the FASB issued a Joint Statement about the status of their project to converge U.S. GAAP and IFRS. As noted in the Joint Statement, stakeholders expressed concerns about their ability to provide input on the large number of exposure drafts of standards that are planned for publication in the second quarter of this year in order to meet the June 2011 deadline. The standard setters therefore indicated that they were developing a modified strategy to prioritize projects and stagger the publication of exposure drafts. The result is that completion of some projects will be extended past June 2011.

Shortly afterward, SEC Chairman Schapiro issued a "Statement on FASB-IASB Decision to Modify Timing of Certain Convergence Projects." Chairman Schapiro indicated that she did not believe these modifications to the timetable for the convergence project will impact the SEC staff’s ability to execute the Work Plan. She also stated that these developments should not affect the SEC’s ability to make a determination in 2011 about whether to incorporate IFRS into the financial reporting system for U.S. issuers.

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The FASB and IASB issued their modified strategy and work plan on June 24, 2010, in anticipation of the G-20 meeting in Toronto.\textsuperscript{6}

\textbf{B. Roadmap for Adoption of IFRS by IASB for U.S. Companies}

The Statement also builds upon the SEC’s Roadmap for the adoption by all U.S. issuers of IFRS as published by the IASB, which was adopted by the Commission at a meeting on August 27, 2008.\textsuperscript{7} At the meeting and in its November 14, 2008 Roadmap release, both Commissioners and the SEC staff emphasized the importance of developing high quality global accounting standards. The SEC stated that it believed IFRS has the potential to become the global accounting standard, which will benefit investors, issuers and markets alike, by providing comparability between companies across the globe. In addition, the SEC said, during the coming years, as IFRS becomes the dominant accounting regime, U.S. GAAP will be marginalized if the U.S. does not move towards the implementation of IFRS. This could make foreign investors less likely to consider investments in U.S. companies. On the other hand, according to the SEC, the implementation of IFRS would assist companies by reducing the cost of capital and better facilitate cross-border investment.\textsuperscript{8}

The Roadmap proposed a timeline by which the SEC would decide in 2011, based on whether certain milestones are met, whether to mandate filing by U.S. companies in IFRS beginning with their 2014 fiscal year financial statements. The Roadmap release also discussed specific milestones which the SEC would review in deciding whether to mandate conversion to IFRS. It also considered permitting certain companies to “early adopt” IFRS before 2014.

The SEC received over 200 comment letters regarding the Roadmap during a comment period that ended in April 2009. Partly in response to concerns raised in the comment letters, the Commissioners voted to release the Statement and implement the Work Plan.

\textbf{II. The Statement and Work Plan}

The Statement affirms the SEC’s belief in the importance of a single set of high-quality globally accepted accounting standards, that such standards will benefit U.S. investors, and that such standards are consistent with the mission of the SEC of “protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation.”\textsuperscript{9} The SEC noted that it had

\begin{itemize}
  \item \textsuperscript{6} See Letter from Sir David Tweedie and Robert Herz to Hon. Stephen Harper and accompanying status report (June 24, 2010), http://www.iasb.org/News/Announcements+and+Speeches/update+to+G20+on+modified+convergence+strategy.htm
  \item \textsuperscript{8} Roadmap Release at 9.
  \item \textsuperscript{9} Statement at 1.
\end{itemize}
 released the Roadmap to provide a possible path for IFRS to become that set of accounting standards; however, the response to the Roadmap identified factors that the SEC should consider in moving forward in its evaluation of whether and how to adopt IFRS. To that end, the SEC released the Work Plan along with the Statement in order to “enhance both understanding of the Commission’s purpose and public transparency in this area.”\textsuperscript{10} The SEC believes that execution of the Work Plan, in conjunction with the completion of the convergence projects of FASB and IASB, will allow the SEC to make a decision regarding adoption of IFRS in 2011.

The Work Plan provides that the Staff will analyze six different areas, the first two of which are considered the most relevant for the purposes of a future determination by the SEC to adopt IFRS, and the remaining four of which are considered transitional issues that will allow the Staff “to better evaluate the scope of, timing of, and approach to changes that would be necessary to effectively incorporate IFRS into the financial reporting system for U.S. issuers, should the SEC determine in the future to do so.”\textsuperscript{11} The six key areas are:

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

  The SEC observes that “IFRS has the greatest potential of providing a common platform for capital markets regulators.”\textsuperscript{12} However, the SEC notes that there are areas where IFRS may need further improvement. In addition, as stated in the Roadmap the SEC is to consider whether the standards as established are “of high quality and sufficiently comprehensive.”\textsuperscript{13} Under the Work Plan, the Staff will look at the development of IFRS in the following areas:
  - Comprehensiveness of IFRS;
  - Auditability and enforceability of financial statements prepared under IFRS; and
  - Consistent and high-quality implementation of IFRS on a global basis.

- **The Independence of Standard Setting for the Benefit of Investors.**

  Of significant concern is the question of whether the “accounting standard setter’s funding and governance structure support the independent development of accounting

\textsuperscript{10} Id. at 2.

\textsuperscript{11} Id. at 15.

\textsuperscript{12} Id. at 16.

\textsuperscript{13} Id. at 17, quoting Roadmap release.
standards for the ultimate benefit of investors.”\textsuperscript{14} The Staff will conduct an ongoing review of the governance structure of the IASB, including oversight by the IFRS foundation and the composition of both the IFRS foundation and the IASB, and the IASB’s efforts to secure a stable funding source.

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  \item \textbf{Investor Understanding and Education Regarding IFRS.}
  
  The SEC states that in order for IFRS to provide for improved comparability of financial information, investors must understand and have confidence in the financial reporting system. Through the Work Plan, the Staff will seek to gain insight into investors’ understanding of IFRS and actions that need to be taken to increase investors’ understanding.
  
  \item \textbf{Examination of the U.S. Regulatory Environment that Would be Affected by a Change in Accounting Standards.}
  
  The SEC understands that the adoption of IFRS would have significant effects on financial reporting by U.S. issuers for other purposes. The Staff will study and consider the regulatory effect of adoption of IFRS in the following areas:
  
  \begin{itemize}
    \item The manner in which the SEC fulfills its mission, in particular how to incorporate IFRS into its rules, regulations and staff guidance, and also the potential shift from private sector standard setting bodies (such as FASB) to the IASB.
    \item The effect on other U.S. regulators and issuers subject to those regulators’ compliance requirements, where regulators rely on SEC reported financial information.
    \item The impact on application of federal and tax regulations and on issuer compliance with those regulations.
    \item How changing SEC accounting standards to IFRS would affect the application of statutory dividend and stock repurchase restrictions.
    \item The effect of a change in accounting standards on auditing standard-setting and auditor requirements, in particular on the Public Company Accounting Oversight Board. In this regard, the Staff highlighted the potential impact of adoption of IFRS on auditors’ ability to audit litigation contingencies.
    \item Whether IFRS should be adopted for broker-dealer and investment company reporting and the effects of including, or excluding, these entities from IFRS.
  \end{itemize}
\end{itemize}

\textsuperscript{14} \textit{Id.} at 19.
The impact of adoption of IFRS for public companies on private companies that would remain subject to U.S. GAAP.

The Impact on Issuers, Both Large and Small, Including Changes to Accounting Systems, Changes to Contractual Arrangements, Corporate Governance Considerations, and Litigation Contingencies.

The SEC acknowledges that adoption of IFRS will result in significant costs to many U.S. issuers and that smaller companies without international operations will bear these costs differently than large, international companies. The Staff will evaluate the impact of logistical changes that issuers would need to implement IFRS in the following areas:

- Changes in accounting systems and procedures to identify, collect, analyze and report financial information and the corresponding controls.
- Effects on contractual arrangements entered into by U.S. issuers that require use of U.S. GAAP or are based off of current U.S. GAAP reporting.
- Corporate governance challenges, such as the need to identify audit committee financial experts with IFRS expertise, as well as to satisfy general financial literacy requirements.

The Work Plan will also consider the effect of adopting IFRS on the following:

- The effects of adoption of IFRS on accounting and disclosure requirements in the U.S. legal environment, in light of concerns about IFRS’ potential use of a lower recognition threshold than U.S. GAAP and its requirements to make additional disclosures in the treatment of litigation loss contingencies.¹⁵
- Potential disproportionate impact on smaller public company issuers versus larger issuers.

Human Capital Readiness.

The adoption of IFRS would require the numerous parties involved in the financial reporting process, such as investors, preparers, auditors, regulators, and academics, to attain greater familiarity with IFRS. The Staff will review the effect of adoption of IFRS on the education and training of professionals involved in the financial reporting process.

¹⁵ The IASB has had pending since 2005 a proposed modification to IAS 37, Provisions, Contingent Liabilities and Contingent Assets, which would effect changes in the standards for recognition and disclosure of litigation contingencies and would depart substantially from applicable U.S. GAAP. Recently, the IASB reexposed certain aspects of the proposal and announced that it expected to complete the standard in 2010. See IASB News Release (Jan. 6, 2010), available at http://www.iasb.org/News/Press+Releases/IASB+re-exposes+proposals+on+measuring+liabilities.htm.
It will also consider issues relating to the capacity of auditors to audit IFRS financial statements.

The Statement also addresses the possibility raised in the Roadmap of early adoption of IFRS. While the SEC does not rule out early adoption as a possibility, it is not currently pursuing rulemaking that would allow for early adoption of IFRS.

In the Statement, the SEC also addresses questions about the future role of the FASB. The SEC believes that, as in other countries that have maintained a national standard setter after incorporation of IFRS, FASB will continue to play a critical and substantive role in achieving the goal of global accounting standards. The Staff will continue to analyze the FASB’s role should IFRS be adopted.

The SEC intends that public progress reports regarding the findings of the Staff in conjunction with its carrying out of the Work Plan will be released no later than October 2010 and frequently thereafter.

III. Conclusion

There has been some uncertainty about the current SEC’s views about adoption of IFRS, due to the change in leadership at the SEC and the passage of time since release of the Roadmap. The SEC’s Statement has addressed some of these questions and may be a significant step towards the eventual adoption of IFRS for use by U.S. issuers for financial reporting. The Statement affirms the SEC’s belief in the desirability of a single set of high-quality globally accepted accounting standards, and its view that IFRS can provide those standards. However, the Work Plan released in conjunction with the Statement identifies many areas that require a great deal of work in order to move forward on the adoption process. The October 2010 report should provide the next window into the SEC Staff’s views regarding the progress of the Roadmap towards adopting IFRS. It remains to be seen whether the SEC will meet its objective of deciding by 2011 whether to adopt IFRS for U.S. public reporting companies.
SECURITIES AND EXCHANGE COMMISSION

RELEASE NOS. 33-9109; 34-61578

Commission Statement in Support of Convergence and Global Accounting Standards

AGENCY: Securities and Exchange Commission.

ACTION: Commission statement.

SUMMARY: The Securities and Exchange Commission (the “Commission”) is publishing this statement to provide an update regarding its consideration of global accounting standards, including its continued support for the convergence of U.S. Generally Accepted Accounting Principles (“U.S. GAAP”) and International Financial Reporting Standards (“IFRS”) and the implications of convergence with respect to the Commission’s ongoing consideration of incorporating IFRS into the financial reporting system for U.S. issuers.

FOR FURTHER INFORMATION CONTACT: Eloise Quarles Bavaria, Special Counsel, Office of International Corporate Finance, Division of Corporation Finance, at (202) 551-3450, Jeffrey S. Cohan, Senior Special Counsel, Office of the Chief Accountant, at (202) 551-5300, or Nili Shah, Associate Chief Accountant, Office of the Chief Accountant, at (202) 551-5300, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

The Commission continues to believe that a single set of high-quality globally accepted accounting standards will benefit U.S. investors and that this goal is consistent with our mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation. As a step toward this goal, we continue to encourage
the convergence of U.S. GAAP and IFRS and expect that the differences will become fewer and narrower, over time, as a result of the convergence project.

The Commission last addressed this topic in November 2008 when it issued a proposed “Roadmap” for a possible path to a single set of globally accepted accounting standards. The Proposed Roadmap generated significant interest and thoughtful comment from investors, issuers, accounting firms, regulators, and others regarding factors that the Commission should consider as it moves forward in its evaluation of whether and how to incorporate IFRS into the financial reporting system for U.S. issuers. In addition to reaffirming the Commission’s strong commitment to a single set of global standards, the recognition that IFRS is best-positioned to be able to serve the role as that set of standards for the U.S. market, and the convergence process ongoing between the Financial Accounting Standards Board (“FASB”) and the International Accounting Standards Board (“IASB”), this statement outlines certain of these factors that are of particular importance to the Commission as it continues to evaluate IFRS through 2011.

The Commission has directed its staff to develop and execute a work plan (the “Work Plan”) to enhance both understanding of the Commission’s purpose and public transparency in this area. Execution of the Work Plan, combined with the completion of the convergence projects of the FASB and the IASB according to their current work plan, will position the Commission in 2011 to make a determination regarding incorporating IFRS into the financial reporting system for U.S. issuers.

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2 The Work Plan is included as an appendix to this statement. A summary of the key areas of the Work Plan is provided in section IV of this statement.
I. Overview

A. History of the Commission’s Steps to Foster a Single Set of High-Quality Globally Accepted Accounting Standards

The Commission has long promoted a single set of high-quality globally accepted accounting standards.\(^3\) This position advances the dual goals of improving financial reporting within the United States and reducing country-by-country disparity in financial reporting. This, in turn, would facilitate cross-border capital formation while also helping to provide investors with the comparable and material information they need to make informed decisions about investment opportunities. In 1988, the Commission issued a policy statement supporting the establishment of mutually acceptable international accounting standards, provided that investor protections were not compromised.\(^4\) The Commission cited the establishment of such standards as a critical goal to reduce regulatory impediments to cross-border capital transactions that result from disparate national accounting standards.\(^5\)

In a 1997 report to Congress, the Commission encouraged the efforts of the International Accounting Standards Committee to develop a core set of accounting standards that could serve as a framework for financial reporting in cross-border offerings. In that report, the Commission also expressed its intent to remain active in the development of those standards.\(^6\) These standards are now known as IFRS, and the

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\(^5\) Id.

International Accounting Standards Committee was succeeded by the IASB. In 2000, the Commission issued a concept release on international accounting standards, seeking comment on the requisite elements to encourage convergence toward a global financial reporting framework that would not diminish the quality of domestic financial reporting. The 2000 Concept Release discussed generally the circumstances under which the Commission would consider accepting financial statements from foreign private issuers that are prepared using IFRS without a reconciliation to U.S. GAAP.

In the 2000 Concept Release, the Commission set out some fundamental attributes for a high-quality set of accounting standards that continue to be important today. These attributes require that the standards (a) be of sufficiently high quality to support the Commission’s mission of protecting investors and facilitating capital formation, and (b) be supported by an infrastructure that ensures that the standards are established by independent standard setters, and are rigorously and consistently interpreted and applied.

After enactment of the Sarbanes-Oxley Act of 2002 (the “Act”), the Commission reaffirmed its recognition of the financial accounting and reporting standards of the

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8 The term “foreign private issuer” is defined in Exchange Act Rule 3b-4(c) [17 CFR 240.3b-4(c)]. A foreign private issuer means any foreign issuer other than a foreign government, except an issuer that meets the following conditions: (1) more than 50 percent of the issuer’s outstanding voting securities are directly or indirectly held of record by residents of the United States; and (2) any of the following: (i) the majority of the executive officers or directors are United States citizens or residents; (ii) more than 50 percent of the assets of the issuer are located in the United States; or (iii) the business of the issuer is administered principally in the United States.

FASB as “generally accepted” for purposes of the federal securities laws. One of the criteria that Congress required the Commission to consider, when recognizing an accounting standard setter, was whether that standard setter considers “international convergence on high-quality accounting standards as necessary or appropriate in the public interest and for the protection of investors.”

Also as required by Congress in the Act, in 2003, our staff issued a study on the adoption in the United States of a principles-based accounting system. That study stated that global accounting standardization through convergence would lead to the following benefits:

- greater comparability for investors across firms and industries on a global basis;
- reduced listing costs for companies with multiple listings;
- increased competition among exchanges;
- better global resource allocation and capital formation;
- lowered cost of capital; and
- a higher global economic growth rate.

Beginning in 2002, the FASB and the IASB began a formal process to converge U.S. GAAP and IFRS. In 2002, the FASB and the IASB announced the issuance of a memorandum of understanding to collaborate on the development of common, high-quality standards with the ultimate goal of a single set of high-quality global accounting

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standards. In 2006, the FASB and the IASB issued an updated memorandum of understanding that set forth the scope of their joint work program to improve and promote convergence of their accounting standards. The 2006 memorandum of understanding was updated in September 2008 to identify targets for completion of convergence projects that the FASB and the IASB believed were most critical. Throughout this process the Commission has monitored, and will continue to monitor, the activities of the FASB and the IASB and the progress in their efforts.

In 2007, the Commission took two additional actions. First, it issued a concept release on whether U.S. issuers should be allowed to prepare financial statements in accordance with IFRS. Second, the Commission adopted rules that allow foreign private issuers to make filings with the Commission using financial statements prepared in accordance with IFRS, as issued by the IASB, and without reconciliation to U.S. GAAP.

Recently, the leaders of the Group of Twenty nations (“G-20”) requested that international accounting bodies redouble their efforts to achieve a single set of high-

13 Id.
15 See “Memorandum of Understanding between the FASB and the IASB” (February 27, 2006). (available at: http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176156245558)
quality, global accounting standards through their independent standard-setting processes and complete their convergence project in June 2011.\textsuperscript{19} The FASB and IASB recently reaffirmed their commitment to improving and converging their respective accounting standards, and further committed to intensify their efforts to meet a 2011 timeline.\textsuperscript{20} Chairman Mary L. Schapiro also recently noted the Commission’s commitment “to the goal of a global set of high-quality accounting standards.”\textsuperscript{21}

\textbf{B. The Proposed Roadmap}

In November 2008, the Commission proposed a path to evaluating the further role of IFRS in the U.S. capital markets.\textsuperscript{22} The Proposed Roadmap sought comment on a number of suggested “milestones” that the Commission might consider.

The Proposed Roadmap contemplated that, subject to an assessment of the milestones and other considerations, and after consideration of public comment, the Commission could be in a position in 2011 to decide whether to require the use of IFRS by U.S. issuers beginning in 2014, potentially allowing earlier use by certain U.S. issuers beginning with filings for fiscal years ending on or after December 15, 2009.\textsuperscript{23}

\textbf{II. Public Feedback on the Commission’s Proposed Roadmap}

We received over 200 comment letters on the Proposed Roadmap from a wide

\begin{footnotesize}
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\item \textsuperscript{19} See “Leaders’ Statement from the Pittsburgh Summit” (September 24-25, 2009). (available at: https://www.g20.org/Documents/pittsburgh_summit_leaders_statement_250909.pdf)
\item \textsuperscript{21} See Speech by SEC Chairman Mary L. Schapiro: Remarks at IOSCO Technical Committee Conference (October 8, 2009).
\item \textsuperscript{22} See Proposed Roadmap. Unless otherwise noted, the phrase “IFRS” refers to “IFRS as issued by the IASB.”
\item \textsuperscript{23} The Proposed Roadmap did not address the method the Commission might use to mandate IFRS for U.S.
\end{itemize}
\end{footnotesize}
variety of market participants, including those representing investors, regulators, issuers, accounting, legal, and other professions, academia, standard setters, and international organizations. Commenters generally expressed widespread support for the ultimate goal of having a single set of high-quality globally accepted accounting standards. However, commenters differed in their views about the approach in the Proposed Roadmap to achieve further use of IFRS in the U.S. capital markets. Several commenters asserted that there are many transition questions and issues arising from the proposed approach that the Commission should consider further.

A. Potential for High-Quality Globally Accepted Accounting Standards

There was widespread support across all commenters for a single set of high-quality globally accepted accounting standards. While commenters offered differing perspectives, some commenters identified the following potential benefits from a single set of global accounting standards:

- improved financial statement comparability among companies worldwide;
- streamlined accounting processes for multinational companies; and

24 Comment letters in response to the Proposed Roadmap are available on the Commission’s Web site (at http://www.sec.gov/comments/s7-27-08/s72708.shtml). Comments are also available for Web site viewing and printing in the Commission’s Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m.


26 See, e.g., AT&T Services, Inc., The Boeing Company (“Boeing”), and Chevron Corporation.

27 See, e.g., Accretive Solutions, Alcoa Inc (“Alcoa”), CalPERS, Center for Audit Quality, Cleary Gottlieb Steen & Hamilton LLP, General Mills, Inc., Institute of Management Accountants, State of New York Banking Department, PricewaterhouseCoopers LLP (“PwC”), and RiskMetrics,
The potential benefits identified by commenters generally are consistent with the perceived benefits discussed in the staff’s 2003 Study. Improved comparability was the most frequently cited potential benefit from the use of a single set of global accounting standards. However, some commenters, while expressing support for the concept of a single set of global accounting standards, expressed reservations regarding whether the adoption of global accounting standards is a feasible objective. Some of these concerns are discussed below.

**B. The Proposed Roadmap**

Opinions regarding the approach outlined in the Proposed Roadmap diverged. The key areas of concern expressed by the commenters include the readiness of IFRS to serve as the set of accounting standards for U.S. issuers, the need for continued convergence of IFRS and U.S. GAAP, and the timeframe set for, and potential costs of, transitioning U.S. GAAP to IFRS.

Opinions regarding the potential of IFRS, in its current state, to serve as the single set of global accounting standards varied broadly across and within categories of commenters. While larger, multinational firms and commenters from the accounting profession generally saw IFRS as best positioned for the role of the single set of global standards.

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28 See, e.g., Liberty Global and Graybar Electric Company, Inc. (“Graybar”) comment letters for lists of potential benefits from the use of a single set of global standards.

29 See, e.g., American Institute of Certified Public Accountants (“AICPA”), Federation of European Accountants (“FEE”), and Institute of Chartered Accountants of Scotland.

30 See, e.g., Liberty Global, The Lubrizol Corporation (“Lubrizol”), National Association of State Boards of Accountancy (“NASBA”), and Reznick Group, P.C.
accounting standards, a number of other commenters expressed concerns regarding the capability of these standards, in their current state, to serve that role.

Many investors and investor groups that addressed this issue expressed the view that it was too early to judge the potential of IFRS to serve as the single set of global accounting standards. Commenters who expressed this view noted that:

- IFRS is not sufficiently developed or applied in practice to be adopted as a single set of global standards (e.g., either IFRS lacks guidance in certain significant areas, or the guidance it does contain appears to or may allow too much latitude to achieve more comparable financial reporting than U.S. GAAP);
- jurisdictional variants in the application of IFRS pose a significant challenge to the adoption of IFRS as a truly global reporting model; and
- the achievement of a genuine common global financial reporting model would require consistent application, auditing, and enforcement across countries.

In addition, some commenters expressed concern that a “business case” has not been sufficiently demonstrated to support moving from existing U.S. GAAP directly to IFRS. These commenters contend that existing U.S. GAAP is already widely accepted worldwide and is seen as high-quality, and that not all U.S. companies compete for capital globally or issue securities outside the U.S. market, so the primary effect of the

31 See, e.g., Boeing, FPL Group, Inc., and Kohl’s Corporation.
32 See, e.g., AICPA, Alcoa, Association of Chartered Certified Accountants, California Society of Certified Public Accountants, Center for Audit Quality, IBM Corporation, and The Ohio Society of CPAs.
33 See, e.g., Aerospace Industries Association and Committee of Annuity Insurers (“CAI”).
34 See, e.g., CalPERS, CII, ICGN, ITAC, and S&P.
35 See, e.g., American Insurance Association, CAI, Center for Capital Markets Competitiveness, Dominion Resources Services, Hot Topic Inc., McDonald’s Corporation (“McDonald’s”), and National Association of Real Estate Investment Trusts.
Proposed Roadmap would be increased costs in return for minimal and largely conceptual benefits.36 Others noted that significant challenges likely would arise in having an international organization as the ultimate body that would set standards for U.S. issuers.37 Commenters in this area questioned whether this would be a wise policy, given the Commission’s long-standing statutory role of setting and overseeing financial reporting standards for the United States.38

In contrast to the varying perspectives on the potential use of IFRS to serve as the common set of global accounting standards, commenters were more consistent with respect to their concerns on the approach and schedule outlined in the Proposed Roadmap. Many commenters, particularly investors, believed that the Commission should articulate how it intended to mandate the use of IFRS in the United States before they would be willing to support such a move.39 Also, many commenters believed the proposal either underestimated or did not adequately address the many critical issues and costs (both quantitative and qualitative) that would be involved in meeting the transition timing suggested in the Proposed Roadmap. For example, while many commenters believed the proposal identified in concept many of the factors to be considered in choosing a particular path forward for the U.S. capital markets, they also believed that it did not sufficiently articulate a plan for identifying and addressing the specific issues and the criteria against which they would be judged.40 As a result, several commenters

36 See, e.g., Darden Restaurant, Inc. (“Darden”), McDonald’s, and PPL Corporation (“PPL”).
37 See, e.g., CMS Energy Corporation and Consumers Energy Company, Darden, Lubrizol, and McDonald’s.
38 See, e.g., Darden, Intel Corporation (“Intel”), and MetLife, Inc.
39 See, e.g., CalPERS and S&P.
40 See, e.g., CFA, CII, JPMorgan Chase, and The New York State Society of Certified Public Accountants.
recommended that the Commission further develop a plan to determine the appropriate path forward, including the affirmative actions and specific steps that need to be taken.41

III. Approach Forward for the U.S. Capital Markets

We continue to support the objective of financial reporting in the global markets pursuant to a single set of high-quality globally accepted accounting standards. As evidenced by the recent economic crisis, the activities and interests of investors, companies, and markets are increasingly global. This continued globalization of our markets reinforces the idea that the pursuit of this goal is consistent with our mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation.

Since the second half of 2007, the world economy has experienced economic conditions not seen since the Great Depression. What at one time was viewed by some as an isolated crisis in the subprime mortgage sector spread to the global economy as a whole. The current environment has highlighted certain of the existing differences in the accounting standards used in the major capital markets. Some believe that these differences in accounting standards contributed to difficulty in the ability of investors and other stakeholders to assess the financial results of companies operating and competing in the global markets in determining how to allocate capital.42 As part of the G-20’s efforts to address the economic crisis, it specifically requested that accounting bodies redouble their efforts to achieve a single set of high-quality, global accounting standards through

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41 See, e.g., CalPERS, ICGN, Intel, ITAC, Northrop Grumman Corporation (“Northrop Grumman”), and S&P.

their independent standard-setting processes and complete their convergence project by 2011.43

The Commission’s statutory mandate with respect to determining the accounting standards to be used in the United States requires it to promote full, fair, and reliable disclosure for the protection of U.S. investors.44 The U.S. capital markets are among the largest and most liquid in the world. We believe that the acceptance, comprehensiveness, reliability, and enforceability of U.S. GAAP are important reasons for the pre-eminence of our capital markets. U.S. GAAP is a well-established basis for financial reporting that is applied by all U.S. issuers, many foreign companies and many U.S. private companies. Preparers and users of financial statements, such as investors and analysts, are familiar with U.S. GAAP. Thus, we acknowledge the magnitude of the task that would be involved to incorporate IFRS into our financial reporting environment for U.S. issuers. It is therefore important that, before we mandate any such change, careful consideration and deliberation, as well as a sufficient transition time for users and preparers of financial statements, occur to assure that such a change is in the best interest of U.S. investors and markets.

We have considered carefully the input contained in the comment letters we received. We believe that a more comprehensive work plan is necessary to lay out transparently the work that must be done to support our decision on the appropriate course to incorporate IFRS into the U.S. financial reporting system for U.S. issuers, including the scope, timeframe, and methodology for any such transition. Toward this

43 See “Leaders’ Statement from the Pittsburgh Summit” (September 24-25, 2009). (available at: http://www.g20.org/ Documents/pittsburgh_summit_leaders_statement_250909. pdf)

44 See 2003 Policy Statement.
end, we have directed the staff of the Office of the Chief Accountant, with appropriate consultation with other Divisions and Offices of the Commission, to develop and carry out the Work Plan. The Work Plan accompanies this statement as an appendix.

The Work Plan sets forth specific areas and factors for the staff to consider before potentially transitioning our current financial reporting system for U.S. issuers to a system incorporating IFRS. Specifically, the Work Plan addresses areas of concern that were highlighted by commenters, including:

- Sufficient development and application of IFRS for the U.S. domestic reporting system;
- The independence of standard setting for the benefit of investors;
- Investor understanding and education regarding IFRS;
- Examination of the U.S. regulatory environment that would be affected by a change in accounting standards;
- The impact on issuers, both large and small, including changes to accounting systems, changes to contractual arrangements, corporate governance considerations, and litigation contingencies; and
- Human capital readiness.

The staff will provide public progress reports on the Work Plan beginning no later than October 2010 and frequently thereafter until the work is complete. The Work Plan is designed to provide the Commission the information it needs to evaluate the implications of incorporating IFRS into the U.S. domestic reporting system. Following successful completion of the Work Plan and the FASB-IASB convergence projects
according to their current work plan, the Commission will be in a position in 2011 to
determine whether to incorporate IFRS into the U.S. domestic reporting system.

Commenters on the Proposed Roadmap expressed a view that U.S. issuers would
need approximately four to five years to successfully implement a change in their
financial reporting systems to incorporate IFRS.\textsuperscript{45} Therefore, assuming that the
Commission determines in 2011 to incorporate IFRS into the U.S. domestic reporting
system, we believe that the first time U.S. issuers would report under such a system
would be approximately 2015 or 2016. We have asked the staff as part of the Work Plan
to further evaluate this timeline.

\section*{IV. Summary of the Key Areas of the Work Plan}

The Commission staff will analyze each of the six areas identified in its Work
Plan, as discussed further below. The first two areas consider characteristics of IFRS and
its standard setting that would be the most relevant to a future determination by the
Commission regarding whether to incorporate IFRS into the financial reporting system
for U.S. issuers. The remaining four areas relate to transitional considerations that will
enable the Staff to better evaluate the scope of, timing of, and approach to changes that
would be necessary to effectively incorporate IFRS into the financial reporting system for
U.S. issuers, should the Commission determine in the future to do so.

While an ultimate determination of any specific methods (e.g., convergence,
standard-by-standard adoption, wholesale adoption) or dates for the possible
incorporation of IFRS into the financial reporting system for U.S. issuers is beyond the
scope of the Work Plan, the information obtained through the Work Plan will facilitate

\textsuperscript{45} \textit{See, e.g.,} Boeing, Northrop Grumman, PepsiCo, Inc., and tw telecom inc.
future Commission consideration of those matters. The Work Plan provides additional
detail about the analysis that the staff will perform in each of these six areas.

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

As described in the 2000 Concept Release, the Commission’s efforts to support a
globally accepted high-quality financial reporting framework have been guided by its
mission of protecting investors, maintaining fair, orderly, and efficient capital markets,
and facilitating capital formation.\footnote{See 2000 Concept Release.} A necessary element for a set of global accounting
standards to meet these objectives is that they must be high quality, consisting of a
“comprehensive set of neutral principles that require consistent, comparable, relevant and
reliable information that is useful for investors, lenders and creditors, and others who
make capital allocation decisions.”\footnote{See 2000 Concept Release, at II.A.} The Commission continues to believe that high-
quality global accounting standards “must be supported by an infrastructure that ensures
that the standards are rigorously interpreted and applied”\footnote{Id. See also 2007 Concept Release.} both within and outside the
United States.

The increasing acceptance and use of IFRS in major capital markets throughout
the world over the past several years, and its anticipated use in other countries in the near
future, demonstrate that IFRS has the greatest potential to provide a common platform for
capital markets regulators. The IASB has made significant progress in developing high-
quality accounting standards, as noted in the 2007 Adopting Release.\footnote{See 2007 Adopting Release.} However, as the
Commission noted in the Proposed Roadmap, there are areas where completion of the IASB’s standard-setting initiatives, including those included in its convergence agenda with the FASB, should improve and further develop IFRS. The successful completion of these efforts would be a significant accomplishment toward improving financial reporting for investors worldwide. In addition, the Commission in the Proposed Roadmap stated that, in further considering IFRS, it would “consider whether those accounting standards are of high quality and sufficiently comprehensive.” As part of the staff’s efforts under the Work Plan, the staff will evaluate the IASB’s efforts to improve IFRS, including through those joint IASB-FASB projects scheduled to be completed in 2011.

1. Comprehensiveness

In the Proposed Roadmap, the Commission stated that “IFRS is not as developed as U.S. GAAP in certain areas.” For example, IFRS does not provide broad guidance for certain topical areas, such as accounting for certain common control transactions, recapitalization transactions, reorganizations, and acquisitions of minority shares not resulting in a change of control and similar transactions. IFRS also lacks guidance for certain broad industries, including those the IASB is currently developing related to utilities, insurance, extractive activities, and investment companies. As part of the Work Plan, the staff will assess the overall level of comprehensiveness of IFRS.

50 See Proposed Roadmap.
51 Id.
52 Id.
53 Id.
54 Id.
2. Auditability and Enforceability

The Proposed Roadmap noted the challenges that can exist with IFRS’s less prescriptive guidance. Commenters on the Proposed Roadmap raised several concerns regarding the auditability and enforceability of IFRS, including the risk of opportunistic accounting; diminished comparability; and the potential for accounting conclusions of preparers to be unfairly criticized by auditors, regulators, and investors.

The auditability and enforceability of a set of accounting standards are essential aspects of investor protection. Under the Work Plan, the staff will analyze factors that may influence the auditability and enforceability of financial statements prepared under IFRS.

3. Consistent and High-Quality Application

The Commission has based its continued strong support for a single set of high-quality globally accepted accounting standards, including the consideration of incorporating IFRS into its financial reporting system, on the premise that U.S. investors ultimately will benefit from the comparability of financial information from issuers on a worldwide basis. Consistent and high-quality implementation is necessary for investors to benefit from a set of high-quality global accounting standards.55 To assess the consistent and faithful application of IFRS, the staff will analyze the factors that may influence the degree of comparability of financial statements prepared under IFRS on a global basis and their consequences in practice. The staff also will assess the relative effect on comparability of financial reporting in the United States, if IFRS were

incorporated into the financial reporting system for U.S. issuers.

B. The Independence of Standard Setting for the Benefit of Investors

Another 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. This is an area of significant concern to the investors and investor groups that commented on the Proposed Roadmap. The Work Plan includes an ongoing review of the functioning of the IASB’s governance structure and developments to secure a stable, broad-based source of funding. This review will help the staff assess whether these factors promote standard setting that is accountable, independent, and free from undue influence that could affect the ability of U.S. investors to receive full, fair, and reliable disclosure. Full, fair, and reliable disclosure is essential to facilitate the meaningful comparison of financial information across national borders.

C. Investor Understanding and Education Regarding IFRS

The Commission’s Proposed Roadmap reflects its belief that U.S. investors would benefit from the use of a single set of high-quality accounting standards that are used consistently in the global capital markets. In the Proposed Roadmap, the Commission

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56 See, e.g., comment letters from CalPERS and CFA.

57 The IASB, an accounting standard-setting body based in London, was established to develop global standards for financial reporting. The IASB is overseen by the IFRS Foundation (formerly called the “IASC Foundation,” this organization has been renamed as a result of recent amendments to its Constitution, effective March 1, 2010). The IFRS Foundation is responsible for the activities of the IASB. While national accounting standard setters traditionally have been accountable to a national securities regulator or other government authority, until 2009, the IFRS Foundation did not have a formal link with any national securities regulators. Recognizing that a relationship with national securities regulators would enhance the public accountability of the IFRS Foundation, its trustees agreed on amendments to its Constitution to establish a link between the IFRS Foundation and a Monitoring Board composed of public capital markets authorities, including the Commission, charged with the adoption or recognition of accounting standards used in their respective jurisdictions. For further information on the governance structure and operation of the IASB, see www.iasb.org.
stated that a single set of global accounting standards could enhance the ability of investors to compare financial information of U.S. companies with that of non-U.S. companies. Improved comparability was the most commonly cited reason commenters believed that U.S. capital markets would benefit from the use of a single set of global accounting standards.\(^58\) Because the benefits of adopting a single set of high-quality globally accepted accounting standards would be realized only if investors understood and had confidence in the financial reporting system, the Commission believes that in order to assess incorporation of IFRS into the U.S. financial reporting system, further work is necessary to assess investor understanding and education regarding IFRS. The staff’s performance of the steps in the Work Plan should provide the staff with insight into investors’ understanding of IFRS and actions that need to be taken to increase investors’ understanding.

**D. Examination of the U.S. Regulatory Environment that Would Be Affected by a Change in Accounting Standards**

The Commission acknowledges that the incorporation of IFRS into the financial reporting system for U.S. issuers could have far-reaching effects on financial reporting by U.S. issuers for other purposes. In addition to filing financial statements with the Commission, U.S. issuers commonly provide financial information to a wide variety of other parties for different purposes. While the federal securities laws provide the Commission with the authority to prescribe accounting principles and standards to be followed by public companies and other entities that provide financial information to the Commission and investors, the Commission does not directly prescribe the provision and

\(^{58}\) See, e.g., AICPA, FEE, PPL, and TransCanada Corporation.
content of information that U.S. issuers provide to parties other than it and investors.\(^{59}\) However, changes to the Commission’s accounting standards could affect issuers and the information they provide to regulatory authorities and others that rely on U.S. GAAP as a basis for their reporting regimes.\(^{60}\) In accordance with the Work Plan, the staff will study and consider other regulatory effects of mandating IFRS for U.S. issuers.

**E. The Impact on Issuers, Both Large and Small, Including Changes to Accounting Systems, Changes to Contractual Arrangements, Corporate Governance Considerations, and Litigation Contingencies**

In considering incorporation of IFRS into the U.S. financial reporting system, the Commission must assess the significant effects that such changes would have on the preparers of financial statements — the thousands of companies that file financial statements with the Commission under the federal securities laws. In addition to the significant effects that a transition would have on investors, the issuers of financial statements would incur costs, effort, and time as a result of a transition. Smaller companies and those without international operations will bear those costs and efforts differently than larger companies and those that compete globally. As part of the Work Plan, the staff will consider the impact of the logistical changes involved in incorporating IFRS into the U.S. financial reporting system. The extent of that impact may be decreased by ongoing convergence efforts between the IASB and the FASB.

**F. Human Capital Readiness**

As contemplated by the Proposed Roadmap, incorporation of IFRS would require

\(^{59}\) Id.\(^{60}\) Id. For example, U.S. issuers often provide U.S. GAAP-based financial information to various federal and state regulators, including regulators of financial institutions, insurance companies and public utilities. Another example of the effect on reporting to others relates to federal and state income taxes. Existing U.S. GAAP is the predominant set of accounting standards used in the United States, and the Internal Revenue Code has developed over time in reliance on such accounting standards.
consideration of the readiness of all parties involved in the financial reporting process, including investors, preparers, auditors, regulators, and educators. As a result, any change involving the incorporation of IFRS into the financial reporting system for U.S. issuers would require greater familiarity of IFRS for investors, preparers, auditors, regulators, academics, and many others. Under the Work Plan, the staff will review the effect of the incorporation of IFRS on the education and training of professionals involved in the financial reporting process as well as any impact on auditor capacity.

V. Potential Transition Matters

Many commenters on the Proposed Roadmap expressed concern about having appropriate transition time to plan for and implement any changes that would be needed in connection with a further move toward incorporation of IFRS in domestic financial reporting. Commenters also indicated that the Proposed Roadmap had created a significant amount of uncertainty for market participants about how any proposed changes would affect them and whether they should begin immediately to allocate resources to prepare for use of IFRS.

We acknowledge that the changes to our current financial reporting system that would be necessary to transition to a single set of global accounting standards, including the incorporation of IFRS for U.S. issuers, could represent a fundamental change that would require significant transition time and effort for issuers, investors, and others. Several steps in the Work Plan, including progress toward completion of convergence, focus on providing the Commission with additional information about the magnitude of

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61 See, e.g., AICPA, Cymer, Inc., and Graybar.

these changes and the logistics necessary for implementing them. This information will enable the Commission to consider the plans that would need to be implemented in a move to incorporate IFRS into the financial reporting system for U.S. issuers, including providing sufficient time to efficiently and effectively implement any changes in accounting standards.

The Proposed Roadmap proposed to allow certain large U.S. issuers the option of preparing their financial statements using IFRS beginning with filings for fiscal years ending on or after December 15, 2009. A significant group of commenters disagreed with an early use option, generally because of the increased complexity, lack of comparability between U.S. issuers under a dual system, and the possibility of companies opportunistically selecting which system of accounting standards to apply. Alternative strategies proposed by this group varied widely, and included the optional use of IFRS during any contemplated transition period to a single set of global accounting standards. Some commenters suggested an open option for all issuers or, at least, a significantly expanded group of issuers.

The Commission is not foreclosing the possibility in the future that issuers may be permitted to choose between IFRS and U.S. GAAP, nor is the Commission foreclosing the possibility of some manner of early use or adoption approach. The conditions for early adoption, however, would depend on the overall approach to incorporate IFRS into the U.S. financial reporting system for U.S. issuers. As that overall approach remains under evaluation, we are not actively pursuing rulemaking to provide for an early use

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63 See, e.g., CalPERS, CFA, CII, ICGN, and ITAC.

64 See, e.g., Ernst & Young LLP and PwC.

65 See, e.g., Abbott, AICPA, and S&P.
VI. Role of the FASB

The FASB is the independent, private-sector accounting standard-setting body for the United States. Since 1973, the Commission has recognized the FASB’s pronouncements establishing and amending accounting principles as “authoritative” and “generally accepted” for purposes of the federal securities laws, absent any contrary determination by the Commission. After enactment of the Act, the Commission reaffirmed the recognition of the financial accounting and reporting standards of the FASB as “generally accepted” for purposes of the federal securities laws.

Some commenters believed the lack of clarity in the Proposed Roadmap regarding the future role of the FASB has created unnecessary uncertainty. Commenters offered divergent opinions about whether the Commission should maintain a relationship with the FASB as the U.S. national accounting standard setter in lieu of directly relying on the IASB.

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.

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66 Accordingly, we are withdrawing the proposed rules for limited early use of IFRS by certain U.S. issuers.

67 See Statement of Policy on the Establishment and Improvement of Accounting Principles and Standards, Accounting Series Release No. 150 (December 20, 1973) (expressing the Commission’s intent to continue to look to the private sector for leadership in establishing and improving accounting principles and standards through the FASB) and the 2003 Policy Statement.

68 See 2003 Policy Statement.

69 NASBA and CalPERS expressed the view that the Commission should maintain a relationship with the FASB, whereas KPMG LLP expressed the view that the Commission should recognize the IASB as the single accounting standard setter.
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.\footnote{See U.K. Financial Reporting Council.} 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.\footnote{For example, the European Union ("EU"), which required the use of IFRS as the accounting standards for companies incorporated in one of its Member States and whose securities are listed on an EU-regulated market beginning with their 2005 financial year, uses the European Financial Reporting Advisory Group to provide technical advice to the European Commission in connection with the EU’s mechanism for endorsement of IFRS.}

As part of the staff’s execution of the Work Plan, it will continue to analyze the
nature of the appropriate and ongoing role of the FASB should IFRS be incorporated into
the U.S. financial reporting system for U.S. issuers.

VII. Regulatory Requirements

This statement is not an agency rule requiring notice of proposed rulemaking,
opportunities for public participation, and prior publication under the provisions of the
Administrative Procedure Act ("APA"). Similarly, the provisions of the Regulatory Flexibility Act, which apply only when notice and comment are required by the APA or another statute, are not applicable.

By the Commission.

February 24, 2010

Elizabeth M. Murphy
Secretary
Appendix

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

OFFICE OF THE CHIEF ACCOUNTANT
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

This is a report 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.
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Background

In the 2010 Statement, the U.S. Securities and Exchange Commission ("SEC" or "Commission") directs 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”). The purpose of the Work Plan is to consider specific areas and factors relevant to a Commission determination of whether, when, and how our current financial reporting system for U.S. issuers should be transitioned to a system incorporating International Financial Reporting Standards ("IFRS"). Specifically, the Work Plan addresses areas of concern that were highlighted by commenters on the Commission’s proposed Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers, including:

1. Sufficient development and application of IFRS for the U.S. domestic reporting system;
2. The independence of standard setting for the benefit of investors;
3. Investor understanding and education regarding IFRS;
4. Examination of the U.S. regulatory environment that would be affected by a change in accounting standards;
5. The impact on issuers, both large and small, including changes to accounting systems, changes to contractual arrangements, corporate governance considerations, and litigation contingencies; and
6. Human capital readiness.

The first two areas above consider characteristics of IFRS and its standard setting that would be the most relevant to a future determination by the Commission regarding whether to incorporate IFRS into the financial reporting system for U.S. issuers. The remaining four areas above relate to transitional considerations that will enable the Staff to better evaluate the scope of, timing of, and approach to changes that would be necessary to effectively incorporate IFRS into the financial reporting system for U.S. issuers, should the Commission determine in the future to do so.

In formulating this initial Work Plan, the Staff considered commenters’ views that U.S. issuers would need approximately four to five years to successfully implement a change

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2 Hereafter, the term “IFRS” refers to “IFRS as issued by the International Accounting Standards Board (‘IASB’)” unless otherwise noted.
in their financial reporting systems to incorporate IFRS.\(^4\) Therefore, assuming that the
Commission determines in 2011 to incorporate IFRS into the U.S. financial reporting
system, the first time U.S. issuers would report under such a system would be
approximately 2015 or 2016. The Staff will further evaluate this timeline as a part of the
Work Plan.

While an ultimate determination of any specific methods (e.g., convergence, standard-by-
standard adoption, wholesale adoption) or dates for the possible incorporation of IFRS
into the financial reporting system for U.S. issuers is beyond the scope of the Work Plan,
the information obtained through the Work Plan will facilitate future Commission
consideration of those matters. Further, while the Work Plan focuses on the implications
of incorporation of IFRS into the financial reporting system for U.S. issuers on U.S.
constituents, the Staff also will consider the effects of its recommendations to the
Commission on other jurisdictions that have incorporated or have committed to
incorporate IFRS into their financial reporting systems.

Each area is important to the Staff’s consideration of the most effective approach to
advance the Commission’s objective of achieving a single set of high-quality globally
accepted accounting standards. The Staff, however, did not develop the Work Plan with
the intention that any one step is individually determinative of the optimal path forward.
Further, for many of the steps, the Staff is seeking to assess the degree to which a
particular attribute or condition exists for consideration of how the topic interacts with
policy considerations. The Staff does not view the objective of its efforts as being to
determine whether an attribute “passes” or “fails” a pre-determined standard.

The Staff has developed this Work Plan based on its understanding of the current
environment. The Staff intends to continually re-assess this Work Plan and adjust it as
new information is obtained or developments occur. Further, of necessity, the Staff will
modify this Work Plan in response to constraints encountered, such as limited availability
of information, with the intention of accomplishing each section’s stated objective to the
maximum extent possible.

In executing this Work Plan, the Staff will gather information using a variety of methods,
including, but not limited to, performing its own research; seeking comment from,
holding discussions with, and analyzing information from constituents, including
investors, issuers, auditors, attorneys, other regulators, standard setters, and academics;
considering academic research; and researching the experiences of other jurisdictions that
have incorporated or have committed to incorporate IFRS into their financial reporting
systems and foreign private issuers who currently report under IFRS. The Staff will

\(^4\) See, e.g., The Boeing Company (“Boeing”), Northrop Grumman Corporation (“Northrop Grumman”),
PepsiCo, Inc. (“Pepsi”), and tw telecom inc (“tw telecom”). Comment letters in response to the Proposed
Comments are also available for Web site viewing and printing in the Commission’s
Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the
hours of 10:00 a.m. and 3:00 p.m. Unless otherwise noted, comment letters referenced in this Work Plan
were submitted in response to the Proposed Roadmap and are cited by author.
provide public progress reports beginning no later than October 2010 and frequently thereafter until the work is complete.
I. Sufficient Development and Application of IFRS for the U.S. Domestic Reporting System

A. Introduction

The 2010 Statement notes that “[a] necessary element for a set of global accounting standards to meet [the agency’s mission] is that they must be high-quality….” The Commission previously has described high-quality standards as consisting of a “comprehensive set of neutral principles that require consistent, comparable, relevant and reliable information that is useful for investors, lenders and creditors, and others who make capital allocation decisions.”\(^5\) The Commission also has expressed its belief that high-quality accounting standards “must be supported by an infrastructure that ensures that the standards are rigorously interpreted and applied.”\(^6\)

In the Proposed Roadmap, the Commission stated that, in further considering IFRS, it would “consider whether those accounting standards are of high-quality and sufficiently comprehensive.” Accordingly, the Staff believes that an evaluation of whether IFRS is sufficiently developed and applied to be the single set of globally accepted accounting standards for U.S. issuers requires consideration of the following areas:

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

As the Commission noted in the Proposed Roadmap, there are areas where completion of the IASB’s standard-setting initiatives, including those included in its convergence agenda with the Financial Accounting Standards Board (“FASB”), as discussed in the 2010 Statement, should improve and further develop IFRS. The Commission further notes in the 2010 Statement, “[t]he successful completion of these efforts would be a significant accomplishment toward improving financial reporting for investors worldwide.” As such, the Staff’s efforts in the above areas will include consideration of the IASB’s efforts to improve IFRS.

B. Comprehensiveness of IFRS

The Commission stated in the Proposed Roadmap that “IFRS is not as developed as [U.S. generally accepted accounting principles (‘U.S. GAAP’)] in certain areas.” This is due, in part, to IFRS’s relative youth, as articulated by one commenter:

[W]e are concerned about quality and maturity of IFRS in comparison to…[U.S.


\(^6\) 2000 Concept Release.
U.S. GAAP has a long history and has been tested and refined through multiple and complex economic events and developments. Many of the standards in U.S. GAAP have emerged as a direct result of circumstances and events that demonstrated the need for better and more transparent financial reporting (for example, the rise of derivative instruments and recent financial scandals such as the collapse of Enron).…

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 (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. Commenters’ views were mixed as to whether the lesser degree of detailed guidance under IFRS, as compared to U.S. GAAP, is indicative of a higher quality set of accounting standards. Commenters who preferred IFRS’s approach asserted that it is less complex than U.S. GAAP and allows companies to capture the substance of transactions. On the other hand, commenters who preferred U.S. GAAP’s approach expressed that IFRS relies too much on management discretion, thereby increasing the potential for opportunistic accounting; creating challenges for auditors, as discussed in section I.C below; and reducing comparability, as discussed in section I.D below.

Other commenters have argued, however, that this debate may not be relevant in the U.S.

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8 See, e.g., Proposed Roadmap. See also, e.g., Financial Accounting Foundation (“FAF”), Investors Technical Advisory Committee (“ITAC”), Liberty Global, and Standard & Poor’s Ratings Services. The Staff acknowledges that in certain of these specified areas, these concerns are equally applicable to U.S. GAAP.
9 See, e.g., Proposed Roadmap. See also, e.g., Accretive Solutions, First Commonwealth Financial Corporation (“First Commonwealth”), and ITAC.
For example, as the FASB staff discussed in “Board Meeting Handout: Joint Revenue Recognition Project” (April 9, 2008) (available at: http://www.fasb.org/04-09-08_rev.pdf)), revenue recognition guidance under U.S. GAAP (prior to the FASB Codification) consisted of over 200 pieces of literature from various sources, whereas revenue recognition guidance under IFRS “lacks explicit measurement guidance. Although such measurement guidance exists in abundance in U.S. GAAP, IFRS suffers from the opposite extreme.”
environment. For example, the FAF asserted in its comment letter that:

> [W]hile it is perceived that IFRS provides financial statement preparers more discretion in application than U.S. GAAP, such additional discretion may not result in major differences in the application of IFRS by U.S. companies because the U.S. institutional framework plays a major role in shaping how companies would apply the discretion.

The Staff will analyze for the Commission’s benefit the extent to which IFRS is comprehensive so as to support a Commission decision regarding whether to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Inventory areas in which IFRS does not provide guidance or where it provides less guidance than U.S. GAAP.
- Analyze how issuers, auditors, and investors currently manage these situations in practice.
- Identify areas in which issuers, auditors, and investors would most benefit from additional IFRS guidance.

C. Auditability and Enforceability

IFRS’s less detailed and prescriptive guidance may or may not create challenges in its auditability and enforceability. If it were to do so, IFRS may “[make] litigation or enforcement outcomes more difficult to predict.” This outcome may be true not only within jurisdictions, but also across jurisdictions, as the existence of differing regulatory regimes and legal environments across jurisdictions may exacerbate the inconsistent interpretation and enforcement of IFRS. For example, the CFA Institute stated the following in its comment letter:

> Investors need greater assurance regarding the divergence of application within the principles-based standards of IFRS prior to adoption. Conversion to more principles-based standards that are applied inconsistently in different regulatory environments, auditing regimes and cultures may not be beneficial to investors.

Commenters raised several concerns regarding the audibility and enforceability of IFRS, including the risk of opportunistic accounting; the potential for accounting conclusions of preparers to be unfairly criticized by auditors, regulators, and investors; and diminished comparability.

First, regarding the risk of opportunistic accounting, some commenters expressed that IFRS allows for increased flexibility, as compared to U.S. GAAP, and may result in standards being less auditable and enforceable, which would not be in the public

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12 Proposed Roadmap.
interest.\textsuperscript{13} 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.\textsuperscript{14}

Second, regarding the potential for accounting conclusions of preparers to be unfairly criticized by auditors, regulators, and investors, some commenters have expressed concerns that IFRS’s less detailed and prescriptive guidance could expose companies to increased claims by shareholders and others seeking to challenge its application, given the perceived litigious environment in the United States.\textsuperscript{15} The Staff has acknowledged similar concerns in the context of an objectives-oriented system, noting:

We believe that the existence of a strong and consistently applied enforcement mechanism is a necessary component to the success of an objectives-oriented system. Preparers and auditors have expressed concern that those charged with enforcement in a principles-based environment will question reasonable judgments made in good faith (footnote omitted). In fact, some have asked whether the Commission staff would be willing to accept reasonable views and interpretations by preparers and auditors in the application of accounting principles (citation omitted).\textsuperscript{16}

However, the Staff also stated:

We believe…that the concern over litigation uncertainty is sometimes overstated….If preparers and auditors maintain contemporaneous documentation that demonstrates that they properly determined the substance of a covered transaction or event, applied the proper body of literature to it, had a sound basis for their conclusions-particularly those involving the exercise of judgment-and ensured through disclosure that their method was transparent, their exposure to litigation may be reduced.\textsuperscript{17}

Some commenters stated that the U.S. legal system, which relies, to a larger extent, on guidance, rules, and bright lines, ultimately will drive IFRS to evolve, similar to U.S.

\textsuperscript{13} See, e.g., Fund Stockowners Rights, National Association of State Boards of Accountancy (“NASBA”), and Psoras.

\textsuperscript{14} American Accounting Association, Financial Accounting Standards Committee (“AAA-FASC”).

\textsuperscript{15} See, e.g., FPL Group, Inc. (“FPL”) and tw telecom.


\textsuperscript{17} Principles-Based Accounting System Study.
GAAP, into a rules-based set of standards. Accordingly, commenters advocated addressing the causes of rules-based standards, such as through changes to the U.S. legal and regulatory environment, and development of an accounting and auditing judgment framework to reassure issuers that they will not be penalized for the use of reasonable judgment in the application of IFRS.

The Staff also observed that the exercise of professional judgment in an objectives-oriented regime would require certain cultural changes, including: (1) a reduction in the tendency to ask questions like “where does the literature say I cannot do this,” (2) a reduction in an audit checklist mentality, (3) an improvement in accounting professionals’ understanding of the economic substance of a transaction, and (4) an improvement in the transparency of disclosures.

Finally, IFRS’s less detailed and prescriptive guidance, coupled with any diversity of perspectives amongst issuers, auditors, and regulators on a global basis may affect the comparability of financial statements prepared under IFRS. For example, in the auditing context, commenters raised concerns regarding the possibility that each audit firm will develop its own interpretations of IFRS, resulting in reduced comparability across companies using different auditors. Some commenters went further by echoing concerns raised in the 2007 Concept Release that IFRS also may contribute to reduced comparability within audit firms, due to the lack of internationally integrated accounting firms with a single global accounting perspective.

Similarly, commenters expressed concern that differing regulation and enforcement structures and practice on a global basis may undermine the comparability of financial statements prepared under IFRS. The Commission has noted that securities regulators have developed and continue to improve infrastructure to foster the consistent and

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19 See, e.g., American Institute of Certified Public Accountants (“AICPA”), California Society of Certified Public Accountants (“CA CPAs”), Center for Audit Quality (“CAQ”), Deloitte & Touche LLP (“Deloitte”), McGladrey & Pullen LLP (“McGladrey”), Morgan Stanley, NYBD, and The Ohio Society of CPAs (“Ohio CPAs”).

20 See Principles-Based Accounting System Study.

21 See, e.g., Community Health, Eli Lilly and Company (“Eli Lilly”), and Marriott International, Inc. (“Marriott”).


23 See, e.g., London Ctr Int’l Corp Gov Law.

faithful application and enforcement of IFRS around the world. For example, in January 2007, an International Organization of Securities Commissions ("IOSCO") database for cataloguing and sharing securities regulators’ experiences on IFRS application around the world became operational. Further, the Commission and the Committee of European Securities Regulators ("CESR") published a work plan in August 2006, covering information sharing in regular meetings and the confidential exchange of issuer-specific information. In addition to the coordination with organizations of securities regulators and under the CESR work plan, the Commission also has developed bilateral dialogues with particular securities regulators to discuss accounting and enforcement matters.

These recent developments were noted by the CFA Institute in its comment letter:

[T]his coordinated effort and related processes [by members of IOSCO] are still being developed and the overall effectiveness of their regulatory oversight has not been fully demonstrated (i.e., that the interpretation and enforcement of IFRS is consistent). The SEC should focus on how IFRS is being applied and ensure that studies about this are undertaken and widely circulated to all interested parties.

The Staff believes that the auditability and enforceability of financial statements prepared under IFRS is a key component in considering whether to incorporate IFRS into the financial reporting system for U.S. issuers. Accordingly, the Staff intends to gather data to inform the Commission in this regard. Specifically, the Staff will:

- Analyze factors that may influence the auditability of financial statements prepared under, and the enforceability of, IFRS.
- Evaluate factors that may influence the consistent audit of financial statements prepared under, and the enforcement of, IFRS.
- Identify potential changes to improve the auditability and enforceability of financial statements prepared under IFRS and to facilitate their consistent audit and enforcement.

D. Comparability Within and Across Jurisdictions

One of the primary benefits of a single set of global accounting standards is increased comparability of financial statements. However, as the Proposed Roadmap stated:

The advantages to U.S. investors of increased comparability across investment alternatives, as contemplated under this Roadmap, are dependent upon financial

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26 See Id.
27 See Id.
reporting under IFRS that is, in fact, consistent across companies, industries and countries.

A number of factors may undermine the comparability of IFRS financial statements. As discussed above, the lesser degree of comprehensiveness and the challenges of consistent audit and enforcement of IFRS financial statements may affect their comparability. In addition, jurisdictional variations in the application of IFRS, the optionality within IFRS, and inconsistencies arising from differences in the translation of IFRS also may reduce the benefits of IFRS as a single set of global accounting standards.28

Some sources indicate that more than 100 countries “require or allow the use” of IFRS.29 At the same time, there is the real possibility of jurisdictional variations, which could undermine comparability. Jurisdictional variations may arise from both authoritative and informal application guidance, changes made to the standards for purposes of use within a jurisdiction, and variations in the times it may take separate jurisdictions to complete their respective processes to enact into law or otherwise adopt new or amended standards. Historical approaches and cultural differences also may give rise to jurisdictional variations.

Commenters frequently cited concerns regarding the existence of and future potential for jurisdictional variations of IFRS.30 Similarly, the Commission noted that “the extent to which IFRS is adopted and applied globally, and whether IFRS is adopted and applied in foreign jurisdictions as issued by the IASB or as jurisdictional variations of IFRS” “may influence the degree to which comparability may be achieved through widespread adoption of IFRS.”31

Regarding optionality, the SEC’s Advisory Committee on Improvements to Financial Reporting (“CIFiR”) and others have asserted that IFRS’s permitted alternative accounting treatments in a number of areas “contribute to avoidable complexity by making financial reports less comparable.”32

28 See Proposed Roadmap.


31 Proposed Roadmap.

In the Proposed Roadmap, the Commission expressed that:

IFRS…in certain areas permits a greater amount of options than in U.S. GAAP…[This] greater optionality in IFRS could reduce comparability of reported financial information, as different issuers may account or provide disclosure for similar transactions or events in different ways[,] but this flexibility also allows a financial statement that may more closely reflect the economics of transactions.

To counter any diminished comparability, commenters expressed the need for greater transparency around divergence in application.33 However, as one commenter noted, extensive footnote disclosures explaining how management has applied its discretion “will place the burden upon the user of the financial statements to understand and interpret the differences between companies.”34

In light of these concerns, the Staff will analyze for the Commission’s benefit the extent to which financial statements prepared under IFRS are comparable within and across jurisdictions so as to support a Commission decision regarding whether to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Analyze factors that may influence the degree of comparability of financial statements prepared under IFRS on a global basis.
- Assess the extent to which financial statements prepared under IFRS may not be comparable in practice and how investors manage these situations.
- Identify ways to improve the comparability of financial statements prepared under IFRS on a cross-border basis to provide the most benefit for investors.

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33 See, e.g., CFA Institute (“CFA”) and ITAC.
34 tw telecom.
II. Independent Standard Setting for the Benefit of Investors

A. Introduction

The 2010 Statement notes that “[a]nother 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.” To provide the Commission with the information necessary to determine whether the IASB is sufficiently independent for IFRS to be the single set of high-quality globally accepted accounting standards for U.S. issuers, the Staff will analyze four areas in particular:

- Oversight of the IFRS Foundation (formerly called the “International Accounting Standards Committee (‘IASC’) Foundation”);\(^{35}\)

- Composition of the IFRS Foundation and the IASB;

- Funding of the IFRS Foundation; and

- IASB standard-setting process.

B. Oversight of the IFRS Foundation

The IASB was established to develop global standards for financial reporting.\(^{36}\) The IASB is overseen by the IFRS Foundation, which 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 the development of interactive data taxonomies for IFRS.\(^{37}\)

National accounting standard setters traditionally have been accountable to a national securities regulator or other government authority. In the United States, the FASB is overseen by the Commission. Until 2009, the IFRS Foundation did not have a similar link with any national securities regulators and public capital market authorities.\(^{38}\)

The Commission has long supported enhanced governance of the IFRS Foundation (and its predecessor, the IASC), which includes independent oversight representing the public

35 In January 2010, the IFRS Foundation Trustees (“Trustees”) agreed to a number of changes to their Constitution, including changes to the names of several bodies within the organization, effective March 1, 2010. This Work Plan uses the revised names, except when citing a document issued under the predecessor name. See IASC Foundation, Trustees Announce Further Governance Enhancements (February 15, 2010). (available at: http://www.iasb.org/News/Press+Releases/further+governance+enhancements.htm)

36 For more information on the structure and operation of the IASB, see www.iasb.org.

37 See Proposed Roadmap.

38 See Id.
Recognizing that a relationship with public capital market authorities would enhance the public accountability of the IFRS Foundation, the Trustees amended the IFRS Foundation’s Constitution to establish a connection between the IFRS Foundation and a Monitoring Board composed of public capital market authorities charged with the adoption or recognition of accounting standards used in their respective jurisdictions.

Commenters noted that recent events have demonstrated the significant pressure that can be exerted on a standard setter and acknowledged that the establishment of the Monitoring Board was an important step in improving the public accountability of the IFRS Foundation. However, some commenters suggested improvements to the Monitoring Board and urged that the Monitoring Board should include representatives from the investment community, analysts, auditors, and preparers, as well as national and regional regulators. A number of commenters noted that additional time is needed to determine the effect that the Monitoring Board will have on the public accountability of the IFRS Foundation and the IASB.


42 See, e.g., Council of Institutional Investors (“CII”) (suggested, for example, that the Monitoring Board duties include: (1) explicit responsibility for protecting and defending the independence of the IASB and (2) focus primarily on educating and communicating with the representatives of public authorities about the benefits of independent private-sector standard setting), Institut der Wirtschaftsprüfer in Deutschland (Institute of Public Auditors in Germany) (“IDW”) (suggested the Monitoring Board participate in the appointment process and approve the appointment of Trustees, but not assume responsibility for Trustee appointment directly, so as to avoid overstepping the fine line between oversight and control of the IFRS Foundation).

43 See, e.g., CalPERS, CII, FRC (expressed the view that in due course the IFRS Foundation Monitoring Board should be extended to encompass official global organizations with a wider range of responsibilities, notably those with financial stability, banking, and insurance mandates, provided that the primary aim of accounting standards to improve information to providers of capital is respected), ICGN, and Nicholas Véron (observed that the current Monitoring Board is badly designed as it excludes important stakeholders. This commenter suggested that the Commission should promote the transformation of the Monitoring Board into a broader body that represents all the stakeholders, especially investor groups).

44 See, e.g., AICPA, Alcoa, Deloitte, Deutsche Bank AG (“Deutsche Bank”), FAF, FEE, FRC, IBM Corporation, ICAEW, IDW, Potash, tw telecom, and XenoPort, Inc. (“XenoPort”).
The Staff believes that effective oversight is critical to any decision to incorporate IFRS into the financial reporting system for U.S. issuers. The Staff will analyze for the Commission’s benefit the extent to which the Monitoring Board is functioning as designed so as to support a Commission decision regarding whether to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will analyze the operations of the Monitoring Board and assess any areas for improvement.

C. Composition of the IFRS Foundation and the IASB

The IFRS Foundation is governed by 22 trustees with geographically diverse backgrounds. Trustees are appointed for a term of three years that is renewable once.

The IASB is currently composed of 15 full-time members who serve five-year terms subject to one re-appointment. Full-time members are required to sever all employment relationships and positions that may give rise to economic incentives that might compromise a member’s independent judgment in setting accounting standards. The IASB members come from ten countries and have a variety of backgrounds (e.g., auditors, investors, and preparers). In selecting IASB members, the Trustees must seek an appropriate mix, such that the IASB is not dominated by any particular constituency.

In response to feedback received through its current Constitution review, the IFRS Foundation has approved amendments to its Constitution, which:

- Emphasize the organization’s commitment to developing standards for investors.
- Provide for enhanced guidelines regarding the Trustees’ geographical diversity.
- Provide additional guidelines regarding geographical diversity of the IASB members to help ensure that membership of the IASB represents a broad international basis.
- Increase the maximum number of members of the IASB to 16 by July 2012, with up to three positions being permitted for part-time members (There are no part-time

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45 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 region, subject to maintaining overall geographical balance.

46 As a result of changes to the IFRS Foundation’s Constitution in January 2010, second terms will be limited to three years for IASB members not serving as the chair or vice chair. See Trustees Announce Further Governance Enhancements (February 15, 2010). (available at: http://www.iasb.org/News/Press+Releases/further+governance+enhancements.htm)

47 As of February 2010.

48 See footnote 45, above.

49 Membership of the IASB will be 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 overall geographical balance.
Some commenters argued that all IASB members should be full time – for example, in order to avoid potential conflicts of interest with their outside employers. Further, these commenters expressed the view that the IASB should include greater representation from investors, as the primary consumers of financial reports.

The Staff believes the composition of the IFRS Foundation and the IASB affects the independence of the IASB’s standard-setting process. The Staff will analyze for the Commission’s benefit the extent to which the composition of the IFRS Foundation and the IASB promotes the independent development of accounting standards for the ultimate benefit of investors so as to support a Commission decision regarding whether to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will analyze the changes to the composition of the IFRS Foundation and the IASB and their effect on the IASB’s ability to independently develop accounting standards for the ultimate benefit of investors.

D. Funding of the IFRS Foundation

Until 2008, the IFRS Foundation financed IASB operations largely through voluntary contributions from a wide range of market participants from across the 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. Since 2008, efforts to change the financing basis of the IFRS Foundation have continued. Most funds are now obtained on a national basis from national standard setters and national capital market authorities. The number of narrowly-based voluntary regimes is decreasing. Contributions from the major accounting firms also are decreasing.

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50 The Trustees concluded that the expansion of the IASB to 16 members would enable the IASB to discharge its increasing liaison functions in an improved manner, while not negatively affecting the efficiency of the IASB’s deliberative processes.

51 See, e.g., CII and ICGN.


53 See the list of long-term funding commitments on the IASB’s Web site. (available at: http://www.iasb.org/The+organisation/Governance+and+accountability/Financing/Long-term+funding+commitments.htm)
The Commission previously has expressed concern that the IASB may be subject to a perceived or, potentially, an actual connection between the availability of funding and the outcome of its standard-setting process. Similarly, the FCAG Final Report stated that in order for the IASB to protect its independence from undue influence, “the IASB must have a permanent funding structure under which sufficient funds are provided to it on an equitable and mandatory basis.” In the Proposed Roadmap, the Commission expressed the view that its “future determination regarding the required use of IFRS for all U.S. issuers should only occur after the IFRS Foundation reaches its goal of securing a stable funding mechanism that supports the independent functioning of the IASB.”

Similarly, many comment letters raised concerns about the independence and stability of the IASB’s funding. A number of commenters were concerned that the current voluntary nature of the contributions, as well as the source, might impact the apparent, or actual independence of the IASB. Commenters expressed the view that establishing a stable, transparent funding framework for the IFRS Foundation would significantly reduce the concern that financial pressure could compromise the independence of the IASB’s decision-making.

The Staff recognizes that the United States has a significant interest in the stable funding of the IFRS Foundation and is committed to exploring strategies to address this issue. Accordingly, the Staff will analyze 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. Specifically, the Staff will:

- Evaluate whether the Trustees’ four characteristics governing the establishment of a funding approach are appropriate.

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54 See Proposed Roadmap and 2007 FPI Adopting Release. See also “Report of the Financial Crisis Advisory Group” (July 28, 2009) (“FCAG Final Report”). (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 (collectively, the “Boards”) 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.


56 See, e.g., American Accounting Association, Financial Reporting Standing Committee; CalPERS; CRIFR; and Institute of Management Accountants (“IMA”).

57 See, e.g., CalPERS and IMA.

58 In 2009, 33 companies based in the United States were expected to provide voluntary contributions, ranging widely in amount. See IASC Foundation, Information for Observers: IASCF Meeting with Monitoring Board (April 1, 2009). (available at: http://www.iasb.org/NR/rdonlyres/B0B1770C-F414-4DCA-968D-505D521D1839/0/APMB2CFundingreport.pdf)
Monitor 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.

Explore alternatives for funding mechanisms in the United States.

E. IASB Standard-Setting Process

The IASB conducts projects necessary to develop high-quality standards. The *Due Process Handbook for the IASB* details procedures to be followed when setting standards, with an emphasis on how each stage of the process must address transparency and accessibility, extensive consultation and responsiveness, and accountability.\(^{59}\)

The IASB solicits views and seeks input from the public throughout the standard-setting process, starting with selecting items for its agenda and including developing and publishing a discussion paper and/or exposure draft and issuing a final standard. Input is received from discussions at its project working group and roundtable meetings as well as written submissions from constituents.\(^{60}\)

In the 2003 Policy Statement, the Commission stressed 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;\(^{61}\)
- 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.

The following discussion will consider each of these components in the context of the IASB’s standard-setting process.

1. Pre-eminence of Investors

In its final report, CIFiR asserted that:

Investor perspectives are critical to effective standards-setting, as investors are the

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\(^{60}\) See Id.

\(^{61}\) The effect of international convergence on the quality of IFRS will be evaluated in section I. Accordingly, in this section, this component of the standard-setting process will focus on accounting standards for the public interest and the protection of investors.
primary consumers of financial reports. Only when investor perspectives are properly considered by all parties does financial reporting meet the needs of those it is primarily intended to serve. Therefore, investor perspectives should be given pre-eminence by all parties involved in standards-setting.62

Several commenters, including investor groups, expressed the view that greater investor representation on the IASB (and FASB) and related oversight groups would assist in meeting the primary objective of general purpose financial reporting (i.e., providing useful information to investors in making business and economic decisions).63 One commenter expressed the view that the lack of investor representation may expose those charged with governance to pressure from special interest groups to act in a manner that may not be compatible with the best interests of investors.64

The Staff notes the IFRS Foundation’s recent efforts involving investor groups. Recently, two new members from the U.S. investor community have been appointed to the IASB.65 In addition, the IASB has an advisory council – the IFRS Advisory Council (formerly called the “Standards Advisory Council”)66 – that is composed of approximately 40 individuals67 drawn from geographically-diverse countries, some of which use IFRS and others that do not. The IFRS Advisory Council has an investor subgroup representing major investment organizations in the U.S. and internationally to allow for better engagement of the IASB and its staff with investor representatives.

The Staff intends to explore the extent to which the IASB promotes the pre-eminence of investor views. For example, the Staff will review the IASB’s practices, as compared to the requirements detailed in the Constitution, Handbook, and other relevant IFRS Foundation and IASB documents and constituent expectations, to assess the IASB’s focus on the pre-eminence of investor views.

2. Timeliness

The IASB normally allows a period of 120 days for comment on a discussion paper and exposure draft. For major projects (which are those projects involving pervasive or difficult conceptual or practical issues), the IASB normally will allow a period of more than 120 days for comments.

63 See, e.g., ICGN.
64 See CFA.
66 The IFRS Advisory Council supports the IASB and provides a forum where the IASB consults individuals and representatives of organizations affected by its work that are committed to the development of high-quality IFRS.
67 A list of members is available at: http://www.iasb.org/NR/rdonlyres/A0D53C88-8988-4B3F-8B0A-07B01DCBF975/0/MembershipSAC.pdf.
A commenter noted that the IASB’s standard-setting process could be improved through prompt consideration to keep standards current and reflect emerging accounting issues and changing business practices. The commenter also noted that in rare circumstances, the IASB may need to shorten its due process period in order to achieve a timely solution.68

The Handbook allows for the IASB to have a shorter period of consultation, if required, of 30 days. Effective March 1, 2010, the Trustees revised their Constitution to include a provision to allow them, in exceptional circumstances, to authorize a shorter due process period. Authority would be given only with the approval of 75 percent of the Trustees after the IASB had made a formal request. The due process periods could be reduced but never dispensed with completely.

Recently, the FCAG addressed situations in which it may be appropriate for the Boards to expedite due process. The FCAG Final Report urged the Boards to adequately define the circumstances under which it is appropriate to act on the basis of expedited due process and develop procedures to ensure that, in such circumstances, the maximum consultation practicable is obtained.

The Staff believes that the standard-setting process requires a careful balance between timely resolution of emerging issues and sufficient due process. The Staff will analyze for the Commission’s benefit the extent to which the IASB balances timely resolution of emerging issues and due process so as to support a Commission decision regarding whether to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will review the IASB’s practices, as compared to the requirements detailed in relevant IFRS Foundation and IASB documents and constituent expectations, to assess the IASB’s ability to resolve emerging issues in a timely and effective manner without compromising due process.

3. **Objectivity**

The Monitoring Board, of which the SEC Chairman is a member, recently stated that “confidence in the quality and integrity of the standards depends upon independence and transparency in the standard setter’s due process.”69 The Monitoring Board statement expressed the view that robust participation by all interested parties is an essential element of due process.

Commenters expressed concerns regarding whether the independence of the IASB recently has been compromised.70 A commenter further questioned whether the IFRS

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68 See FRC.


70 See, e.g., BEP, CFA, and ITAC.
Foundation and the IASB have the ability and infrastructure to confront political pressure from governments around the world.\textsuperscript{71}

Similarly, the FCAG observed that:

\[\text{(T)o develop standards that are high quality and unbiased, accounting standard setters must enjoy a high degree of independence from undue commercial and political pressures, but they must also have a high degree of accountability through appropriate due process, including wide engagement with stakeholders and oversight conducted in the public interest.}\textsuperscript{72}\]

The IASB relies on a number of practices and other factors to ensure that it considers a diversity of views, including:

- The IASB’s meetings are open to public observers and broadcast over the internet.
- Meeting materials, comment letters received, and staff summaries of comment letters on discussion papers and exposure drafts are publicly available on the IASB Web site.\textsuperscript{73}
- The IASB is assisted on IFRS interpretive matters by its IFRS Interpretations Committee (formerly called the “International Financial Reporting Interpretations Committee,” or “IFRIC”).\textsuperscript{74}
- The IASB consults with the IFRS Advisory Council on single projects with a particular emphasis on practical application and implementation issues.\textsuperscript{75}
- The IASB cooperates with national accounting standard setters and other official bodies concerned with standard setting in order to promote the convergence in accounting standards around the world.\textsuperscript{76}

\textsuperscript{71} See MetLife, Inc. (“MetLife”).
\textsuperscript{72} See FCAG Final Report.
\textsuperscript{73} See the IASB’s Web site at http://www.iasb.org for more information on IASB process.
\textsuperscript{74} The IFRS Interpretations Committee interprets IFRS and reviews accounting issues that are likely to receive divergent or unacceptable treatment in the absence of authoritative guidance, with a view to reaching consensus on the appropriate accounting treatment. The IFRS Interpretations Committee is comprised of fourteen voting members, appointed by the IFRS Foundation Trustees for renewable terms of three years, and two observers (IOSCO and the European Commission). Interpretations by the IFRS Interpretations Committee are ratified by the IASB prior to becoming effective.
\textsuperscript{75} In 2008, the Trustees agreed to change the membership structure of the SAC, so that members would serve primarily as representatives of organizations. The Trustees believe that this adaptation of the IFRS Advisory Council will enable the IASB to receive views reflecting a wider range of interested parties and would give greater authority to views received. The Commission also participates as an observer of the IFRS Advisory Council.
\textsuperscript{76} For additional information, see IASB, Statement of Best Practice: Working Relationships between the IASB and other Accounting Standard-Setters (February 2006). (available at:}
The due process of the IASB is subject to the active oversight of the Trustee Due Process Oversight Committee.

The Staff will analyze for the Commission’s benefit the extent to which the IASB’s standard-setting process is independent and objective. Specifically, in conjunction with the other steps in this section related to the oversight, composition, and funding of the IFRS Foundation and the IASB, the Staff will review the IASB’s practices, as compared to the requirements detailed in relevant IFRS Foundation and IASB documents and constituent expectations, to assess the adequacy of the IASB’s independence and objectivity during recent standard-setting efforts.
III. Investor Understanding and Education Regarding IFRS

A. Introduction

Incorporation of IFRS into the financial reporting system for U.S. issuers requires consideration of the impact on investors. This consideration includes focus on the extent to which the accounting standards and the standard-setting process promote the reporting of transparent and useful financial information to support investors in their investment decision-making process. In addition, this consideration requires an assessment of investor understanding and education regarding IFRS, as 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 the reported results.

Investor considerations regarding IFRS and investor confidence in IFRS and its standard setting are discussed in more detail in sections I and II, respectively. This section focuses on investor understanding and education regarding IFRS. In particular, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers, transitional considerations related to investor understanding and education regarding IFRS require evaluation to assess the scope of, timing of, and approach to changes that would be necessary for effective incorporation.

B. Investor Understanding and Education

IFRS currently differs from U.S. GAAP in a number of areas; consequently, incorporation of IFRS into the financial reporting system for U.S. issuers may require significant investor education regarding IFRS. However, as noted by one commenter, many U.S. investors already possess some understanding of IFRS due to global industry focus, cross-border investment decisions, and investments in foreign private issuers.77 Moreover, through the convergence process undertaken by the Boards, we expect the differences between the two sets of standards should become fewer and narrower. As part of this Work Plan, the Staff will consider U.S. investors’ current familiarity with IFRS and how they currently become educated about changes to accounting standards, in order to better assess the extent of investor educational effort necessary to effectively incorporate IFRS into the financial reporting system for U.S. issuers.

Because standard setters are continually improving accounting standards, mechanisms already exist for investors to become educated about the effects of changes to the accounting standards. By considering the general education process currently used by investors in understanding changes to U.S. GAAP, the Staff will evaluate how this process could apply to investor education with respect to IFRS in preparation for its potential incorporation into the financial reporting system for U.S. issuers. In addition, the staff will consider whether additional educational efforts are needed.

Existing mechanisms to educate investors traditionally are considered in the context of

77 See EY.
education after a standard has been developed. Also important, however, is investor education during the standard-setting process, which may occur in two ways. First, active investor outreach by the standard setters may increase both the extent and quality of understanding of new standards. In the past, both Boards have used a number of tools to facilitate investor, issuer, and auditor education about new standards, including education sessions, roundtables, and Web casts. Second, the Boards’ convergence projects will be completed in accordance with their due process procedures, providing investors with time to become familiar with the new converged standards as they are developed. The Staff believes the effectiveness of these two areas in educating investors during the standard-setting process needs to be evaluated.

The Staff will analyze for the Commission’s benefit how to promote investor understanding of IFRS, as well as the existing mechanisms to educate investors about changes in the accounting standards, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Conduct 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.

- Gather input from various investor groups to understand how investors educate themselves on changes in accounting standards and the timeliness of such education.

- Consider 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.
IV. Regulatory Environment

A. Introduction

In addition to filing financial statements with the Commission, U.S. issuers commonly provide financial information to a wide variety of other parties for different purposes. While the federal securities laws provide the Commission with the authority to prescribe accounting principles and standards to be followed by public companies and other regulated entities that file financial statements with the Commission, the provision and content of information to other regulators generally is not determined by the Commission. However, these other regulators frequently rely on U.S. GAAP as a basis for their regulatory reporting regimes.

Therefore, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers, transitional considerations related to the role of financial reporting in various regulatory regimes and how such incorporation would affect issuers, investors, and others in those contexts, require evaluation to assess the magnitude and logistics of changes that would be necessary for effective incorporation.

Accordingly, this section explores considerations related to the following:

- Manner in which the SEC fulfills its mission;
- Industry regulators;
- Federal and state tax impacts;
- Statutory dividend and stock repurchase restrictions;
- Audit regulation and standard setting;
- Broker-dealer and investment company reporting; and
- Public versus private companies.

B. Manner in which the SEC Fulfills its Mission

Incorporation of IFRS into the financial reporting system for U.S. issuers may affect the manner in which the Commission fulfills its mission in two ways. First, the Commission must consider how to incorporate IFRS into its rules and regulations and Staff application guidance, to the extent they refer to accounting standards and requirements. Second, as stated in the Commission’s 2003 Policy Statement:

The federal securities laws set forth the Commission’s broad authority and

78 See Proposed Roadmap.
responsibility to prescribe the methods to be followed in the preparation of accounts and the form and content of financial statements to be filed under those laws (citations omitted), as well as its responsibility to ensure that investors are furnished with other information necessary for investment decisions. To assist it in meeting this responsibility, the Commission historically has looked to private-sector standard-setting bodies designated by the accounting profession to develop accounting principles and standards.

Commenters questioned how a move to IFRS would affect the Commission’s relationship with the standard setter. For example, some questioned whether, under securities law, as amended by the Sarbanes-Oxley Act, the SEC has the ability to designate the IASB as the U.S. standard setter. If the IASB were designated as the U.S. standard setter, commenters observed that the Proposed Roadmap is unclear as to how the Commission would exercise oversight of the IASB. Accordingly, commenters urged the Commission to determine how it would react in a crisis situation and how the Commission would protect U.S. investors if the IASB did not address U.S.-specific issues in a timely manner. For example, some commenters indicated the Commission should retain the authority to interpret IFRS.

At the same time, other commenters have cautioned against a “U.S. version of IFRS,” as follows:

We do not believe the Commission should supplement any missing accounting or disclosure requirements or the financial statements would not be considered to be prepared in accordance with IFRS as issued by the IASB. We believe any additional disclosures the Commission would consider requiring should be included outside of the audited financial statements.

In response to these concerns, the 2010 Statement states:

[The Commission] believe[s] 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.

The Staff will analyze for the Commission’s benefit the impact on Commission rules and procedures and potential approaches for the ongoing role of the FASB in accounting standard setting and interpretation, should the Commission determine in the future to

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79 See, e.g., American Bar Association Business Law Section (“ABA Committee”).
80 See, e.g., Darden Restaurant, Inc. (“Darden”) and Intel Corporation (“Intel”).
81 See, e.g., ABA Committee and Travelers.
82 See section I.D for further discussion regarding jurisdictional variations of IFRS.
83 PPL. See also, e.g., Cisco Systems, Inc. (“Cisco”) and Liberty Global.
incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Analyze 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.

- Consider 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.

- Analyze 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.

C. Industry Regulators

In the Proposed Roadmap, the Commission observed:

Various federal and state regulators, including regulators of financial institutions, insurance companies and public utilities, are provided with periodic financial information on an on-going basis. For example, U.S. GAAP financial statements frequently are used as the basis for determining capital requirements for financial institutions.

Due to the prevalence of financial information provided to different U.S. regulators, incorporation of IFRS into the financial reporting system for U.S. issuers may significantly affect different regulators and issuers subject to those regulators’ compliance requirements. As such, it is important to identify the full range of regulatory regimes that rely on information developed for financial reporting purposes.

A number of commenters suggested that the Commission determine the extent to which industry regulators would continue to accept financial statements prepared for SEC reporting purposes as a starting point for regulatory filings. Otherwise, commenters cautioned that a move to IFRS for financial reporting purposes risks creating costly dual-reporting requirements for issuers. Further, if regulators continue to accept reporting prepared for SEC purposes, any changes in the reporting as a result of incorporating IFRS

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84 See, e.g., Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, and Office of Thrift Supervision (collectively, “BankReg”), Committee of Annuity Insurers, Dominion Resources Services (“Dominion”), First Data Corporation (“First Data”), and National Association of Regulatory Utility Commissioners (“NARUC”).

85 See, e.g., Boeing and Honeywell.
could have regulatory impacts. The Staff recognizes that acceptance of IFRS-based financial statements by industry regulators may have consequences on issuers and others that require analysis.

The Staff will analyze for the Commission’s benefit the effects on issuer compliance with industry regulatory requirements, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Analyze the effects on issuer compliance with industry regulatory requirements.
- Consider the impact of a change in SEC reporting on industry regulators.
- Analyze constituent concerns associated with any potential changes, or lack thereof, to regulatory regimes.

**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., Internal Revenue Code). As explained in the Proposed 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 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.

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 into the financial reporting system for U.S. issuers. Several commenters expressed that 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, would need to be modified.

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86 26 U.S.C. § 1 et seq. [1986.]
88 See, e.g., Allergan, Inc. and tw telecom.
Alternatively, if federal and state tax regulators continued to align their tax codes with reporting for SEC purposes, companies may experience significant changes to their expected tax liabilities. Commenters expressed that the SEC should work with the Internal Revenue Service and other tax authorities to mitigate the LIFO transitional issue, as well as address the transfer pricing arrangements and franchise tax considerations that may be affected in the transition.

The Staff will analyze for the Commission’s benefit the effects on federal and state tax regulations, as well as issuers subject to such regulations, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

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

E. Statutory Dividend and Stock Repurchase Restrictions

Certain legal standards may be tied to amounts determined for financial reporting purposes. For example, companies may declare dividends to or repurchase stock from shareholders. While the amount, timing, and manner of payment of dividend distributions and stock repurchases are typically determined by the companies’ boards of directors, the amount available may be restricted by state statute. For example, some jurisdictions provide that dividends may only be paid from retained earnings or may be paid from current earnings despite an accumulated deficit.

To the extent that jurisdictions base legal standards on amounts determined for financial reporting purposes, incorporation of IFRS into the financial reporting system for U.S. issuers could affect a company’s ability to undertake certain actions and an investor’s expectations in that regard. In addition, to the extent that legal standards do not change based on changes in SEC reporting, companies would need to maintain two sets of records. Accordingly, the Staff will analyze for the Commission’s benefit the effects on such legal standards, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Analyze the effect of such incorporation on legal standards, such as a company’s ability to pay dividends or repurchase stock, on issuers and investors.

89 See, e.g., KPMG, The LIFO Coalition (“LIFO”), and National Association of Wholesaler-Distributors.
90 See KPMG.
Consider the impact of a change in SEC reporting on state statutes in this regard.

Analyze constituent concerns associated with any potential changes, or lack thereof, to such state statutes.

F. Audit Regulation and Standard Setting

Another regulatory body that may be affected by incorporation of IFRS into the financial reporting system for U.S. issuers is the Public Company Accounting Oversight Board ("PCAOB"), which is responsible for overseeing public company audit firms and establishing audit, quality control, ethics, and independence standards used by those firms. The Proposed Roadmap and commenters raised two primary considerations related to the PCAOB. First, commenters questioned whether a move to global accounting standards should be coupled with a move to global auditing standards in the United States, for example, through convergence of PCAOB standards with or adoption of auditing standards issued by the International Accounting and Assurance Standards Board. Second, commenters noted that PCAOB auditing standards may require better alignment with IFRS. For example, one commenter expressed a general concern that there would be a mismatch between the less prescriptive standards in IFRS and U.S. auditing standards. In addition, the Proposed Roadmap identified a general need for conforming amendments to PCAOB standards where they refer to current U.S. GAAP literature.

Commenters also provided specific examples of PCAOB auditing standards that may require better alignment with IFRS. For example, commenters suggested that the PCAOB issue additional guidance for auditors engaged in auditing market risk information included in the audited financial statements pursuant to IFRS 7 (currently U.S. issuers provide similar information outside the financial statements pursuant to Item 305 of Regulation S-K).

Further, the Proposed Roadmap discussed the audit of legal contingencies as follows:

One of the conditions under IFRS for recognizing a provision for a legal contingency is that it is more likely than not that an obligation exists (footnote omitted). This recognition threshold is lower than the current recognition threshold in U.S. GAAP, resulting in the potential for an earlier income statement recognition of costs associated with litigation (footnote omitted). Concerns have been raised about an auditor’s ability to corroborate the information furnished by management related to litigation, claims, and assessments by obtaining an audit inquiry letter from a client’s

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92 See, e.g., CalPERS and FEE.
93 See AAA-FASC.
94 See, e.g., KPMG.
Notwithstanding the above examples of areas where PCAOB auditing standards may require better alignment with IFRS, most auditors that responded to the Proposed Roadmap did not have concerns regarding their ability to opine on financial statements prepared under IFRS.96

The Staff will analyze for the Commission’s benefit the effects on audit standard setting and auditor requirements, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

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

G. Broker-Dealer and Investment Company Reporting

The Proposed Roadmap excluded investment companies registered under the Investment Company Act of 1940 and certain other regulated entities that are required to file or furnish certain types of financial reports (e.g., broker-dealers).

Some commenters expressed that no issuers should be exempt from the scope of the Proposed Roadmap97 and that the final Roadmap should include a plan so that all filings with the SEC are based on IFRS and allow adequate time for the IASB and SEC to consider the appropriate financial reporting model for these entities.98

Alternatively, some commenters supported the exclusion of investment companies from

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95 As further discussed in the Proposed Roadmap:

Some believe that changes to the American Bar Association Statement of Policy Regarding Lawyers’ Responses to Auditors’ Requests for Information may be necessary. See AU § 337C. The Statement of Policy, commonly referred to as the “Treaty,” recognizes the professional responsibilities of attorneys and auditors and seeks to preserve confidentiality while providing the necessary level of assurance for the audit. The Treaty recognizes that the confidentiality of communications between an attorney and a client may be impaired by the disclosure of the substance of such communications to third parties, including auditors. By describing thresholds for disclosure and limitations on responses, the Treaty sets the scope of the attorney’s responses to audit requests for information on legal matters. Some believe that the thresholds and limitations described in the Treaty are inconsistent with certain provisions within IFRS.

See also, e.g., ABA Committee (echoed the Commission’s statements in the Proposed Roadmap regarding the audit of legal contingencies).

96 See, e.g., CAQ (stated that the U.S. auditing profession stands ready to support the use of IFRS by all U.S. issuers, including early adopters under an option), J.H. Cohn LLP (confirmed its readiness to prepare for audits of IFRS financial statements once the SEC reaches a decision), and PwC.

97 See, e.g., BDO Seidman, LLP (“BDO”), CAQ, and Verizon Communications, Inc.

98 See, e.g., EY.
the rule proposal. Another commenter expressed the view that the Commission has not sufficiently articulated its rationale for excluding investment companies and other regulated entities from the scope of the Proposed Roadmap and would agree with excluding these issuers “only if there are unique considerations surrounding these entities that could delay the Commission’s decision making process.”

Finally, commenters also expressed concerns regarding costs imposed by the reduced comparability introduced by the continued use of another basis of accounting (e.g., for private companies (see below), and/or Investment Company Act registrants). As another example, excluding broker-dealer reporting could result in a broker-dealer subsidiary being required to report to the Commission under one set of standards with the public holding company that consolidates that subsidiary required to report under another. Also, to the extent reporting results changed if IFRS were to be incorporated for these entities, such a change could impact compliance with financial responsibility rules, such as net capital requirements.

In light of the different views noted above, the Staff will analyze for the Commission’s benefit possible approaches for financial reporting requirements for broker-dealers and investment companies, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Assess 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 any potential Commission decision.

- Evaluate the effect on investors of excluding broker-dealers and investment companies from the scope of any potential Commission decision.

H. Public versus Private Companies

The Proposed Roadmap focused only on companies that file with the Commission. However, existing U.S. GAAP also is used by private companies.

Commenters expressed concern over the impact a move to IFRS would have on U.S. private companies. One concern raised in the Proposed Roadmap and echoed by commenters was that, to the extent two sets of standards existed, a requirement to file different financial statements with the Commission would increase costs of capital for private companies. Another commenter expressed the view that the Commission has not sufficiently articulated its rationale for excluding investment companies and other regulated entities from the scope of the Proposed Roadmap and would agree with excluding these issuers “only if there are unique considerations surrounding these entities that could delay the Commission’s decision making process.”

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99 See, e.g., AICPA and Investment Company Institute (who expressed that convergence in accounting standards as applied to investment companies and resolution of conflicts between IFRS and Article 6 of Regulation S-X should be prerequisites to a move to IFRS).

100 GT.

101 See, e.g., Private Equity Council.

102 See, e.g., The New York State Society of Certified Public Accountants (“NY CPAs”) and Ohio CPAs.
private companies considering an initial public offering. It could also impact the evaluation of business combinations between public and private companies. Some commenters acknowledged that private company reporting is largely outside of the mandate of the Commission, but stated that the Commission should assess the consequences its decision on IFRS would have to this large and important part of the U.S. economy. Specifically, certain of these commenters believed that if a “dual-GAAP” system emerged for private versus public companies, this could adversely affect the efficiency of the U.S. capital markets. Even if U.S. private companies were to report under IFRS, a “dual-GAAP” system may evolve, if private companies followed IFRS for small- and medium-sized entities (“SMEs”), which:

[I]s a self-contained standard of about 230 pages tailored for the needs and capabilities of smaller [private] businesses. Many of the principles in full IFRSs for recognising and measuring assets, liabilities, income and expenses have been simplified, topics not relevant to SMEs have been omitted, and the number of required disclosures has been significantly reduced. To further reduce the reporting burden for SMEs revisions to the IFRS will be limited to once every three years.

The Staff will analyze for the Commission’s benefit the effects on U.S. private companies, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Analyze the effects of such incorporation for U.S. issuers on private companies, auditors, and investors.
- Assess the extent of, logistics for, and estimated time necessary to undertake changes to accommodate any resulting implications on private companies.

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103 See, e.g., ABA Committee, Center for Capital Markets Competitiveness (“CCMC”), Davey Tree, First Data, and ITAC.

104 See, e.g., CA CPAs and CIGNA Corporation.

V. Impact on Issuers

A. Introduction

Incorporation of IFRS into the financial reporting system for U.S. issuers would significantly affect preparers of financial statements – the several thousand issuers that file reports with the Commission. Numerous commenters expressed the view that the costs, effort, and time involved with a move to IFRS would be considerable, with many asserting that the benefits of such a move may not outweigh those costs. A number of commenters further asserted that the transition time articulated in the Proposed Roadmap was not sufficient and may cause confusion, thereby damaging investor confidence.

Accordingly, this aspect of the Work Plan explores the magnitude and logistics of changes that issuers would need to undertake to effectively incorporate IFRS into the financial reporting system for U.S. issuers, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers in the following areas:

- Accounting systems, controls, and procedures;
- Contractual arrangements; and
- Corporate governance.

The Work Plan will also consider the effect of such incorporation on the following:

- Accounting for litigation contingencies; and
- Smaller issuers versus larger issuers.

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106 See, e.g., Phil Ameen (“Ameen”), Chevron Corporation, Eli Lilly, Shawn S. Fahrer, Hot Topic Inc. (“Hot Topic”), Intel, Graduating Seniors - Jacksonville University (Georgia), Kohl’s Department Stores, Inc. (“Kohl’s”), Molson Coors Brewing Company, NARUC, PPL, Psoras, Mark A. Supin, SIFMA, U.S. Congressman Lee Terry, Tuesday Morning; and U.S. Congressman Zach Wamp.

107 See, e.g., Davey Tree, Exxon Mobil Corporation (“Exxon Mobil”), Marriott, McDonald’s, Pfizer Inc. (“Pfizer”), Plantronics, Inc. (“Plantronics”), Regions Financial Corp., and tw telecom.


109 See, e.g., Association of the Bar of the City of New York, Community Health, CSX Corporation, and Plantronics.

110 The human resource impact on issuers is discussed separately in section VI.
B. Accounting Systems, Controls, and Procedures

U.S. issuers may be required to significantly modify their accounting systems, controls, and procedures, if the Commission incorporates IFRS into the financial reporting system. As stated in the Proposed Roadmap:

Use of any new accounting standards requires changes to financial reporting systems and procedures to identify, collect, analyze and report financial information and the corresponding controls. Changing numerous accounting standards at the same time, regardless of the starting point, would require numerous changes in a company’s policies and procedures and system of internal controls.

For example, commenters expressed the need for:

- A complete survey of accounting policies as a first step because IFRS explicitly requires that all similar transactions in the enterprise (including affiliates) be accounted for similarly;111
- More detailed company policies, as IFRS is viewed as less developed than U.S. GAAP;112 and
- Changes to systems, including ledgers and related internal controls, and related testing of such changes,113 particularly to ensure effectiveness for reporting purposes under section 404 of the Sarbanes-Oxley Act.

Commenters noted that the burden of changes to accounting systems, controls, and procedures would be exacerbated in a number of ways. First, issuers may be required to maintain dual-accounting systems for a period of time (e.g., (1) for periods reported under existing U.S. GAAP after the opening balance sheet date under IFRS 1, First-time Adoption of International Financial Reporting Standards, but before the initial filing under a system incorporating IFRS, (2) if the SEC were to require supplemental U.S. GAAP information for a period of time to aid in transition, (3) if such incorporation were effective in the financial statements of consolidated entities prior to those of the consolidated entities’ stand-alone subsidiaries, and (4) if other regulators continued to require reporting based on U.S. GAAP). One commenter stated:

Maintaining dual reporting presents U.S. issuers with a significant burden since all of the processes, controls, and checks must occur twice for each transaction. Indeed, it is likely that the Sarbanes Oxley control testing requirements could nearly double during the period of parallel reporting.114

111 See, e.g., Ameen.
112 See, e.g., Air Products, Community Health, Darden, and Mead Westvaco.
113 See, e.g., Ameen.
114 UTC.
Second, changes to accounting systems, controls, and procedures require sufficient lead time. However, if IFRS continues to change at a rapid pace during this lead time, U.S. issuers will experience additional challenges in planning for incorporation of IFRS into the financial reporting system. As such, some commenters expressed the need for a “stable platform” for a period of time during which accounting standards do not change. However, a “stable platform” may constrain the standard setters’ ability to address emerging issues.

Third, some commenters asserted that certain industries would be disproportionately impacted by incorporation of IFRS into the financial reporting system for U.S. issuers because of differences between existing U.S. GAAP and IFRS that are specific to their circumstances. One commenter stated that financial institutions will need sufficient time to prepare for conversion to IFRS, given the extent of systems changes and communications that will need to occur. Other commenters expressed concerns about specific differences between U.S. GAAP and IFRS for which they believed the accounting under IFRS would be onerous.

The Staff will analyze for the Commission’s benefit the effects on U.S. issuers’ accounting systems, controls, and procedures, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- 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.

C. Contractual Arrangements

The Proposed Roadmap also noted that companies’ contracts often, either explicitly or implicitly, require the use of U.S. GAAP or are based off of current U.S. GAAP reporting. For example, companies may have issued debt instruments which include financial covenants based on U.S. GAAP or require periodic reporting of financial statements prepared under U.S. GAAP. Similarly, lease contracts and employee compensation plans may be based on metrics computed using U.S. GAAP financial

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115 See, e.g., Eli Lilly, Exxon Mobil, EY, and SIFMA.
116 See ICAEW.
117 See, e.g., Mead Westvaco, Plum Creek Timber Company, Inc., Potlatch Corporation, and Rayonier Inc. (who expressed concerns regarding the costs of complying with the requirement in International Accounting Standard 41, Agriculture, to fair value timberlands). See also, e.g., Hot Topic, J.C. Penney Company, Inc., Kohl’s, and Tuesday Morning (who expressed concerns about the IFRS disallowance of the retail inventory method).
Commenters indicated that a move to IFRS for U.S. issuers may require contract renegotiation or the preparation of two sets of financial statements, depending on how IFRS is incorporated in the U.S. capital markets. In addition, performance under the existing agreements could be affected if the reported information changes. Accordingly, the Staff will analyze for the Commission’s benefit the effects on contractual arrangements, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

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

D. Corporate Governance

Incorporation of IFRS into the financial reporting system for U.S. issuers may affect an issuer’s compliance with corporate governance requirements. For example, in 2003, as required by the Sarbanes-Oxley Act, the SEC 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. Those rules also indicate the education and experience through which those attributes must have been acquired.

Listing rules for U.S. securities exchanges also have requirements regarding audit committee competence. One commenter explained:

[R]ules of the NYSE, NASDAQ, and AMEX require members of the audit committee of each listed company to be financially literate and each listed company audit committee must have at least one member who has accounting or related financial management expertise. Many board members who currently meet the “financial expertise” qualifications are not likely to have had experience with IFRS or its adoption as they have been trained in U.S. GAAP. If a company adopts IFRS, its board is likely to need additional training in IFRS in order to meet the level of financial expertise necessary for them to carry out these functions and satisfy these requirements.

Accordingly, incorporation of IFRS into the financial reporting system may result in challenges for U.S. issuers in identifying audit committee financial experts and in listing

118 See, e.g., AIA, CCMC, Hot Topic, JP Morgan, Psoras, and Tuesday Morning.
120 Metlife.
on securities exchanges, as well as, more broadly, compliance with other aspects of corporate governance. 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 will analyze for the Commission’s benefit the impact on compliance with corporate governance standards, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

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

### E. Accounting for Litigation Contingencies

Commenters expressed concerns regarding the treatment of litigation-related loss contingencies under IFRS. For example, the ABA Committee asserted that accounting for such contingencies under IFRS raises serious concerns by its use of a lower recognition threshold than U.S. GAAP and its requirements to make additional disclosures. Their concerns included “avoidance of prejudice to companies and their shareholders in our highly litigious society” and erosions of the protections of attorney-client privilege and work product. Other commenters expressed similar concerns, with one noting:

[T]he loss contingency disclosures required under IFRS are similar to those proposed by the FASB in 2008. As these disclosures were rejected for use in the U.S. primarily due to objections from the legal community, it is likely that similar issues will arise if IFRS becomes mandatory.121

Incorporation of IFRS into the financial reporting system for U.S. issuers requires careful consideration of the impact of litigation contingency accounting and disclosure requirements under IFRS on issuers and investors. Accordingly, the Staff will analyze for the Commission’s benefit the effects on accounting and disclosure requirements for litigation contingencies under IFRS in the U.S. legal environment, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Discuss with issuers, the legal profession, and investors concerns regarding accounting and disclosure requirements for litigation contingencies under IFRS.

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121 Dominion. See also, e.g., FPL and Pfizer. The Staff notes that the FASB is in the process of re-deliberating loss contingency disclosure requirements. See also section IV.E regarding concerns related to the auditing of loss contingencies accounted for 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.

F. Smaller Issuers versus Larger Issuers

Several commenters asserted that a move to 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.\(^{122}\) Conversely, one commenter stated that “the 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.”\(^{123}\)

In light of the above comments, the Staff will analyze for the Commission’s benefit the extent to which incorporation of IFRS into the financial reporting system for U.S. issuers would affect smaller issuers differently than larger issuers and the extent of, logistics for, and estimated time necessary to undertake any changes, should the Commission determine in the future to do so. Specifically, the Staff will:

- 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.

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\(^{122}\) FAF. See also, e.g., Biotechnology Industry Organization, Business Roundtable, CCMC, CRIFR, and IMA.

\(^{123}\) Xenoport.
VI. Human Capital Readiness

A. Introduction

Should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers, transitional considerations related to the readiness of all parties involved in the financial reporting process, including investors (see section III for further discussion), issuers, attorneys, auditors, regulators, and educators require evaluation to assess the magnitude and logistics of changes that would be necessary to effectively incorporate IFRS into the financial reporting system for U.S. issuers. Accordingly, this section explores considerations related to:

- Education and training; and
- Auditor capacity.

B. Education and Training

In the Proposed Roadmap, the Commission noted that the education and ongoing training of most accountants in the United States are limited to or predominantly focused on the current provisions of U.S. GAAP. As a result, the Commission acknowledged that many parties likely would need comprehensive IFRS training, including:

- Investors, as discussed in section III;
- The personnel of issuers, including their accounting, internal audit, and investor relations departments, and their governing bodies, such as their audit committees and board of directors;
- Specialists, such as actuaries and valuation experts, as they often are engaged by management to assist in measuring certain assets and liabilities for financial reporting purposes;
- Attorneys, who will need to understand financial statements in order to, for example, advise on disclosures required under the securities laws and provide legal representations to external auditors;
- External auditors;
- Regulators, such as the Staff, PCAOB staff, and the staff of other regulatory bodies;124

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124 See, e.g., BankReg (noted that they “collectively employ thousands of examination and policy support personnel that will need to be adequately trained in the use of IFRS if it is adopted before convergence is achieved”).
State licensing bodies, professional associations, and industry groups, who would need to integrate IFRS into their training materials, publications, testing, and certification programs (including the Uniform CPA Examination); and

Colleges and universities that would need to include IFRS in their curricula.

In the Proposed Roadmap, the Commission observed that strategies taken by those participants in markets where issuers already report in accordance with IFRS might serve as examples of approaches to increasing education and awareness of IFRS.

The Commission also expressed that the private sector may respond to any increased demand for IFRS education by making educational materials available. Since the Commission’s issuance of the Concept Release in August 2007, several of the largest accounting firms in the United States have made more material available to the public about IFRS generally, as well as about the application of specific IFRS standards.

Commenters expressed mixed views in terms of the importance of this issue, as well as timing for improvements in this area. Some commenters expressed concerns about the challenges faced in training and educating both existing and future practitioners. For example, the nature of accounting education would require change, as professionals and students would not only need training in IFRS, but in utilizing judgment in the application of less prescriptive standards and in understanding the economic substance of transactions. Accordingly, commenters expressed the view that a move to IFRS for U.S. issuers would be costly for educators, particularly if a dual-reporting system (e.g., due to different systems for public versus private companies) evolved in the United States. Commenters also asserted that educators would not be ready in the near term and that work needs to begin immediately. As such, some commenters recommended that the Commission address how sufficient resources and incentives for training would be achieved.

Others, however, were of the view that educators, issuers, and other impacted parties

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125 See Proposed Roadmap.

126 These materials include publications (e.g., PwC’s IFRS and US GAAP: similarities and differences; EY’s US GAAP vs. IFRS The basics: Oil and gas) and other IFRS-related education initiatives (e.g., the KPMG IFRS Institute; Deloitte’s IFRS University Consortium; EY’s Academic Resource Center; PwC’s IFRS Video Learning Center).

127 See, e.g., CalPERS, CFA, Fund Stockowner Rights, ITAC, NASBA, NYCPAs, and Ohio CPAs.

128 See, e.g., London Ctr Int’l Corp Gov Law and Shyam Sunder.

129 See, e.g., AmerisourceBergen Corporation, Teresa P. Gordon, and Thomas N. Tyson.

130 See, e.g., Travelers.

131 See, e.g., American Accounting Association, Financial Accounting and Reporting Section, and Financial Reporting Policy Committee (pointed to surveys of educators indicating concerns over readiness).

132 See, e.g., ING Insurance Americas.

133 See, e.g., CalPERS and ICGN.
would be prepared in time, particularly once a date for moving to IFRS were established. One commenter expressed that IFRS education and expertise will grow in the United States anyway – even if the United States does not move to IFRS – because of the ongoing increased foreign investment in the United States.

The Staff recognizes that education and training efforts to facilitate incorporation of IFRS into the financial reporting system for U.S. issuers could be significant. Accordingly, the Staff will analyze for the Commission’s benefit the sufficiency of the IFRS education and training infrastructure and the extent of, logistics for, and estimated time necessary to undertake changes, should the Commission determine in the future to do so. Specifically, the Staff will:

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

C. Auditor Capacity

Incorporation of IFRS into the financial reporting system for U.S. issuers could strain audit firm resources if sufficient training and time are not provided. The Proposed Roadmap noted that “[a]udit firms would need to consider elements of their systems of quality control, such as their practices related to hiring, assigning personnel to engagements, professional development and advancement activities.” An increase in the demand for IFRS expertise may affect the availability of audit services, with consequences on audit quality, cost, and audit firm concentration.

While some commenters expressed that moving to IFRS is likely to have little or no effect on the availability of audit services and audit quality, others expressed concerns about a likely reduction in these areas, along with an increase in both internal and external audit costs, due to IFRS being less comprehensive and requiring more application of judgment. For additional discussion regarding the impact of IFRS’s comprehensiveness on its auditability, see section I.C.

Others commented that the consequences of a move to IFRS for U.S. issuers on audit firms may differ based on audit firm size. With respect to the large audit firms, commenters believed that a move to IFRS for U.S. issuers is likely to have little or no effect on the availability of audit services and audit quality. Two large audit-firm

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134 See, e.g., ACCA, Alcoa, CAQ, Dell Inc., EY, and PwC.
135 See Pepsi.
136 See, e.g., Deutsche Bank, UBS, and UTC.
137 See, e.g., Davey Tree.
138 See, e.g., BDO, Deloitte, EY, and PwC.
commenters noted that they currently audit foreign private issuers as well as subsidiaries of foreign multi-nationals that report under IFRS. Further, they anticipated leveraging personnel from other member firms in countries that have already moved to IFRS.

On the other hand, opinions were mixed on the impact of moving to IFRS on “smaller” audit firms. The Proposed Roadmap stated that the potential use of IFRS by U.S. issuers:

[M]ay be particularly challenging for less globally-oriented audit firms, which typically may have fewer resources available through affiliated or network firms located in jurisdictions in which issuers already report in accordance with IFRS. This could be a further factor affecting concentration in the auditing profession.

One commenter expressed concern that current IFRS expertise is concentrated within the “Big Four” public accounting firms, which could allow for opportunistic business behaviors when dealing with other competitors and regulators. However, others commented that an SEC mandate to move to IFRS would not affect the competitive position of smaller firms.

In light of these differing views, the Staff will analyze for the Commission’s benefit potential auditor capacity constraints with respect to IFRS and their consequences, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers. Specifically, the Staff will:

- Analyze concerns regarding auditor capacity constraints, including the effect on audit quality, cost, and audit firm concentration and competitiveness.

- Determine possible approaches to mitigate these concerns and the extent of, logistics for, and estimated time necessary to undertake these approaches.

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139 See Deloitte and PwC.
140 See ITAC.
141 See, e.g., ACCA, Deloitte, EY, ICAEW (indicated that a move to IFRS did not have an identifiable impact on audit concentration in Europe), and PwC.
Via electronic transmission

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Re: Measurement of Liabilities in IAS 37: Proposed Amendment to IAS 37

Ladies and Gentlemen:

This letter is submitted on behalf of the Law and Accounting Committee of the Section of Business Law of the American Bar Association. The American Bar Association’s Task Force on Attorney-Client Privilege has participated in the preparation of this letter. We are responding to the invitation of the International Accounting Standards Board (the “IASB”) to comment on the IASB’s Exposure Draft, “Measurement of Liabilities in IAS 37: Proposed Amendment to IAS 37” (ED/2010/1) (the “proposal”).

The comments expressed in this letter represent the views of the Law and Accounting Committee and have not been approved by the American Bar Association’s House of Delegates or Board of Governors and therefore do not represent the official position of the American Bar Association. In addition, this letter does not represent the official position of the Section of Business Law, nor does it necessarily reflect the views of all members of the Law and Accounting Committee.

As part of the IASB’s project to revise IAS 37, “Provisions, Contingent Liabilities and Contingent Assets,” the proposal seeks to provide guidance on the measurement of liabilities, including what are referred to as contingent liabilities in generally accepted accounting principles in the United States (“U.S. GAAP”). If a reporting entity recognizes a contingent liability under IAS 37, the proposal would require the entity to measure the amount the entity would rationally pay at the end of the relevant reporting period to be relieved of the liability. The proposal specifies that, normally, this amount would be the present value of the resources required to fulfill

May 19, 2010
the obligation relating to the contingent liability. Estimates of this amount would take into account the expected outflows of resources, the time value of money and the risk that the actual outflows might ultimately differ from those expected. If the outflows of resources required to fulfill the obligation were uncertain, the entity would estimate their expected value according to the probability-weighted average of the outflows for the range of possible outcomes.

The IASB has also published a working draft of its consolidated proposed new standard to replace IAS 37 (the “working draft”).1 Existing IAS 37 basically establishes three criteria to be met for a contingent liability to be recognized in a reporting entity’s financial statements: (1) the reporting entity has a present obligation (legal or constructive) as the result of a past event; (2) it is probable (which, for IASB purposes, means more likely than not) that an outflow of resources will be required to settle the obligation; and (3) a reliable estimate can be made of the amount of the obligation. Existing IASB states that “only in extremely rare cases” will a reasonable estimate not be possible.

The working draft revises the conditions for recognizing a liability. Under the revised standard, a liability would be recognized if there existed an “obligation,” generally defined as a duty or responsibility to perform in a particular way that is owed to another party or parties. The standard elaborates in some detail on how to assess whether an obligation exists. In particular, the standard considers situations in which there is uncertainty about the existence of a present obligation. The revised standard would have management “judge whether an obligation exists, taking into account all available evidence and giving more weight to the evidence that is more persuasive.”2 It identifies factors that management can consider to make this determination, including “opinions of experts.”3 The standard eliminates the “probable (more likely than not)” test in present IAS 37. It also requires that the liability be reliably measurable, but, as with present IAS 37, it indicates that only in “extremely rare” cases can a liability not be recognized because it is not measurable.4

I. Introduction

As the IASB is aware, the U.S. Securities and Exchange Commission is actively considering whether to incorporate International Financial Reporting Standards (“IFRS”) in U.S. financial reporting standards. In light of that, and in order achieve convergence of accounting standards, we believe that the IASB should consider how the proposal and the working draft will affect the recognition and measurement of litigation contingencies in light of the unique litigation environment in the United States. As used herein, “litigation” refers broadly to civil and criminal legal proceedings, government and regulatory investigations and enforcement

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2 Working draft Paragraph 14.
3 Working draft Paragraph 14(e).
4 Working draft Paragraph 24.
proceedings, administrative proceedings, arbitration and other adversary proceedings and similar matters. We discuss below our concerns with the proposal and the working draft as they relate to litigation. We urge the IASB to reconsider its approach to litigation contingencies in light of these concerns and the need to reconcile international and U.S. standards as part of the SEC’s consideration of incorporation of IFRS.5

As set forth in more detail below, from a U.S. legal perspective, we believe that the standards set forth in the proposal and the working draft may:

- create difficulties for many defendants in United States litigation to the extent it requires them to make definitive determinations as to whether the litigation relates to a present obligation, as defined by the proposal;
- even if litigation is considered to relate to an obligation, pose difficulties for defendants in much U.S. litigation in complying with the measurement provisions of Appendix B of the proposal because of inherent uncertainties as to the probability of different outcomes to the litigation and the associated estimates of outflows of resources for those outcomes;
- pose a danger to protected attorney-client communications, create auditability difficulties and potentially prejudice the defense of U.S. litigation;
- impede international accounting convergence;
- result in potentially misleading public disclosure about U.S. litigation;
- prove excessively burdensome for reporting entities; and
- create confusion due to a variety of drafting ambiguities.

Parts II and III below set forth comments on the proposal and the working draft more generally, and Part IV sets forth several specific comments on the language of the proposal.

II. The Proposed Revisions to IAS 37, If Implemented in the United States, Could Have Significant Adverse Impacts on Parties to Major Litigation

We believe that the proposal and the working draft, if implemented in the United States, could have significant adverse impacts on parties’ ability to defend themselves in substantial litigation as well as create significant practical difficulties.

5 While the IASB has not invited comments on the working draft other than the measurement proposal, we believe that the proposal must be viewed in the larger context of the entire proposed revision to IAS 37.
Difficulties of determining existence of a present obligation

We think the proposed new standard for recognition based on whether a present obligation exists is problematic. As framed in the working draft, and amplified in the April 7, 2010 Staff Paper, “Recognising liabilities arising from lawsuits,” the question is a binary one—Is there or is there not a present obligation? Even while recognizing that in disputed litigation it may be uncertain whether the defendant has a present obligation, the proposed new standard would nonetheless require the reporting entity to decide whether or not the claim is “valid.”6 In many complex cases, however, there may simply be no way to conclude that a plaintiff’s claim is or is not “valid” short of a final, non-appealable judgment in the case. Liability may depend on a wide range of variables, any one of which could be subjective. These include such matters as how a governing statute or contract would be interpreted; whether or not the defendant has meritorious legal defenses; what documents or other evidence exist that might point in favor of or against a finding of liability on a claim; and how an adjudicator will decide contested questions of law or how a trier of fact (often a jury) will decide disputed issues of fact. Even assuming an initial adjudicator enters a finding of liability against the entity, the claim may be subject to reversal on appeal on legal or factual grounds.

Moreover, the Staff Paper does not provide guidance as to which way the presumption applies. Does an entity have to affirmatively determine that a claim is not valid to avoid recognition, or is the threshold met only if the entity determines that the claim is valid? In addition, whichever way the presumption lies, there is no concept of level of certainty. U.S. GAAP uses a “probable / reasonably possible / remote” framework, while IAS 37 uses “more likely than not.” As noted above, the Staff Paper seems to assume that there is a binary (on/off) determination.

Attorneys, of course, do counsel their clients with respect to the merits of the case and the potential outcome. In many cases, that is an inherently judgmental exercise, not an objective determination of whether or not there is liability on the claim. Thus, we believe that a standard that is based on a judgmental analysis, and does not purport to require an objective determination, is preferable.

The proposed formulation also is not easily adaptable to the possibility of settlement. In much U.S. litigation, the most likely outcome may be a settlement. Whether to settle and on what terms will be informed, in part, by management’s (and counsel’s) judgments as to the merits of the claim and the anticipated costs of litigation. But a decision to consider settlement does not mean that the entity has concluded that a present obligation exists. Yet under U.S. standards, a liability might be recognized if management concludes that a settlement is “probable” and the amount of the settlement is reasonably estimable. That outcome more reasonably follows the

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6 The Staff Paper states at some points that the standard for non-recognition is that the claim “has no merit.” If that is the standard, then it is likely that many more liabilities would have to be recognized than even under current IAS 37. Under U.S. standards, we would interpret “has no merit” to mean a “remote” or perhaps an even more unlikely claim.
highly judgmental aspect of the determination in connection with litigation contingencies than does the question whether or not the claim is valid.\(^7\)

**Difficulty of making litigation measurements in U.S. system**

For every recognized contingent liability, the proposal will require the application of present value measurement techniques. We address some specific concerns about the present value language of the proposal below. More generally, we wish to point out that determining the present value of U.S. litigation claims often presents difficulties for companies. As noted above, U.S. litigation features a variety of complex, class action, governmental and low-merit claims. These claims may be difficult or impossible to evaluate during the course of the litigation, especially during the early stages. Complaints from plaintiffs or government authorities may allege unreasonably high amounts of purported damages or fines or no amount at all. In addition, results in the American jury system are difficult to predict. Complex cases may present a large number of legal issues, each of which may on its own create difficult evaluation and measurement problems. Individual court rulings on these issues may also be difficult to predict. Evaluation of U.S. legal claims requires gathering sufficient information, both internally and externally through the discovery process, and is often time consuming. The assumption in paragraph BC 15(c) of the proposal that present valuation of litigation will be impossible in only “extremely rare” cases is unlikely to be correct for many U.S. litigation claims. The assumption in paragraph B4 of the proposal that only a few possible outcomes will need to be studied in many cases is also unlikely to be correct for U.S. litigation claims.

Given the many uncertainties involved in U.S. litigation, performing the proposed liability and present value analysis is also likely to impose significant new costs on companies. See “The proposal may impose excessive computational burdens on companies” under Part IV below.

**Impact on attorney-client privilege and work product protection**

Critically, the proposal and the working draft may undermine the attorney-client privilege and work product protections afforded to reporting entities facing litigation in the U.S. These protections are a fundamental part of the U.S. system of justice. They promote the confidentiality of communications between attorneys and clients in the U.S. Privilege and work product protections encourage candid and open advice from legal counsel and compliance with

\(^7\) The April IASB Staff paper asserts that the removal of the “probable” standard in the proposed revised standard does not greatly change IAS 37. We appreciate the intention of the deletion, but we fear that this change will not be well understood and will not be applied consistently. We also recognize that the standard for recognition under IAS 37 already differs from U.S. GAAP, particularly in the contrast between the “more likely than not” criterion under IAS 37 versus “probable” as understood under U.S. GAAP. These differences are all the more reason to use the opportunity of revising IAS 37 to address the convergence issues discussed below, while crafting a standard that preserves attorney-client privilege, is auditable and is workable.
Privilege and work product protections empower clients to decide whether or not to keep the legal advice they receive confidential. When a client discloses protected legal advice, even if to a limited number of outside parties, U.S. courts often treat the protections as waived, not just for the information disclosed but for all purposes. Litigation adversaries may be able to obtain access to the lawyer’s confidential legal advice as well as to the lawyer’s assessment of the case and litigation strategy.

The working draft would require reporting entities to make a determination whether a present obligation does or does not exist. Under the proposal, reporting entities must then apply present value measurement techniques to the liabilities by evaluating possible outcomes and magnitudes of outflows. The revised process for recognizing and measuring litigation contingencies appears to necessitate detailed input from legal counsel. As suggested in the April 7 Staff Paper, companies may need “legal opinions” about these uncertain litigation liabilities. Under U.S. GAAP standards, and consistent with the Statement of Auditing Standards No. 12 and its counterpart in the American Bar Association, Statement of Policy Regarding Lawyers Responses to Auditors’ Requests for Information, which are part of U.S. GAAS, at most legal counsel may address litigation matters under a “probable” / “remote” framework. Under revised IAS 37, legal counsel is likely to be asked to opine on the merits of claims and to explain recommended defense strategies and the likely outcomes of various strategies to a far greater extent than is currently the case. That analysis would likely require legal counsel to explain how matters such as fact development, venue, forum, choice of law, class certification, survival of claims, admissibility of evidence, jury composition, plaintiff strategies and a variety of other issues may affect outcomes. Reporting entities will need to discuss this information with their auditors. Auditors are likely to seek to discuss the details of the legal analysis directly with the reporting entity’s in-house or external legal counsel. In-house attorneys particularly may face pressures to disclose sensitive legal advice. In their financial statements, reporting entities will need to disclose, with respect to recognized liabilities that are subject to estimation uncertainty, the expected timing of payments and an indication of the uncertainties about the amount or timing of such payments.

These disclosures of legal advice to outside parties may result in reporting entities continually waiving the attorney-client privilege and work product protections available to them in the U.S. Thus, the proposal and the working draft may chill the ability of reporting entities to obtain candid legal advice. Paragraph BC 17(b) of the proposal acknowledges this serious waiver issue, but the proposal does not address it.

Auditability

As mentioned above, the proposal and the working draft will likely require auditors to assess the substance of the counsel’s advice and assessment of litigation matters. Otherwise, auditors will
be unable to form judgments about the reasonableness of a company’s litigation contingency reporting. The auditors’ assessment will encompass both recognition—involving consideration of management’s determination whether the legal claim is valid and the basis for that determination—and measurement—consideration of management’s identification and valuation of the numerous outcomes that enter into the determination of the amount recorded on the financial statements. Auditors, however, will be placed in a difficult position. They will have no independent basis for evaluating the legal opinions provided by a company and its attorneys. It is unrealistic to expect auditors to have the legal training and experience necessary to evaluate the legal opinions of the company’s counsel. Auditors may struggle to design and perform appropriate audit procedures in respect of the detailed legal advice shared by in-house and external counsel. Will auditors need to engage their own legal counsel to perform a second analysis of these legal positions? Discarding the probability test for recognizing litigation contingencies, and then requiring present value measurement, is likely to radically alter the audit environment for reporting entities. It is not obvious to us how these auditability concerns will be resolved or how they can be resolved without jeopardizing the attorney-client privilege and work product protection.

Prejudice to defense of U.S. litigation

Because of the nature of the U.S. legal system, the proposal and the working draft may prejudice the ability of reporting entities to defend U.S. litigation. The U.S. adversarial legal system has an active plaintiffs’ bar. Lawsuits are filed prolifically. Jury trial is often available to litigants. In addition to commercial disputes, U.S. courts hear a wide variety of complex class action claims, shareholder derivative suits, securities law claims, competition claims, fiduciary claims and product liability claims. Plaintiffs may seek compensatory, punitive and treble damages. U.S. courts are also called upon to adjudicate complex federal and state government regulatory claims. In some cases, these may involve civil and criminal charges.

In this environment, adversaries, including government authorities, may be able to employ the proposed measurement standard to their advantage against reporting entities. Adversaries are likely to seek discovery of the reporting entity’s analysis of its liability and the range of outcomes studied by the entity. Under the open discovery procedures used in many U.S. courts, companies may have no choice but to produce these materials to adversaries, if they are deemed to have waived applicable privileges and protections by virtue of disclosures to auditors or in their public reports. Adversaries may also seize on a company’s evaluation of potential outcomes and probabilities to obtain advantage in settlement negotiations.

The April 7 Staff Paper emphasizes that entities will only be required to disclose information about IAS 37 liabilities in aggregate for each class of liability. However, this approach provides no protection for an entity reporting a single large piece of litigation, or a single material government investigation, as may often be the case. This problem exists even if there are several lawsuits but they must be treated as being in different classes. In these instances, adversaries may be able to read a reporting entity’s disclosures to form a view about minimum settlement
amounts. Estimates that adversaries identify through discovery or uncover through financial statements will become settlement floors, potentially ratcheting up litigation costs for reporting entities.

The Staff Paper defends the deletion of the “probable” standard in IAS 37 on the ground that recognition will still require liability to actually exist. Nonetheless, the working draft could still result in reporting entities being forced to enter into settlements of low merit litigation. The new analysis and measurement requirements of the working draft may encourage adversaries to file questionable lawsuits and then use the threat of onerous IAS 37 analysis, measurement and audit to obtain swift settlements. For example, as reporting periods come to a close, companies may face pressure to settle open matters to avoid the IAS 37 burdens and the risk of making these uncertain litigation disclosures to the market.

**Estimates of the valuation of outcomes in U.S. litigation may be misleading**

Because of the inherent difficulties in evaluating the possible outcomes in U.S. litigation, disclosures made by entities under the proposal may be misleading to investors. Investors may treat IAS 37 disclosures with an unwarranted level of certainty. As described above, evaluating U.S. litigation involves a number of difficult and uncertain judgments. In hindsight, many of these judgments may prove to be incorrect.

In addition, despite the requirement in the proposal for unbiased estimates of present value outcomes, many reporting entities, practically speaking, may feel compelled to make high estimates so that they do not understate litigation liabilities. The results over time may be variability and unreliability in financial statement results for entities with U.S. litigation exposures. See “The proposal may lead to misleading disclosure” under Part IV below.

**Companies may face new litigation in the U.S. over IAS 37 disclosure**

Because estimates of the potential liabilities from U.S. litigation may sometimes prove wrong in hindsight, reporting entities will face new litigation risks in the U.S. created by IAS 37 itself. For example, if the amount recognized for a liability turns out to be materially lower than the entity’s ultimate loss in the litigation, that could lead to disclosure claims that the entity manipulated its assessment of outcomes and probabilities to minimize the potential exposure. In the litigious U.S. environment, the proposal thus creates the risk of spawning more complex litigation for reporting entities.

**III. The Proposal May Impede International Accounting Convergence**

We recommend that the IASB consider the impact of the proposal and the working draft on the potential adoption of IFRS in the United States. The Securities and Exchange Commission has recently indicated that accounting for litigation contingencies will be a factor in its consideration of incorporation of IFRS into the financial reporting system for U.S. issuers. As the SEC staff’s
Work Plan for the consideration of incorporation of IFRS noted, substantial concerns about the treatment of litigation-related loss contingencies under IFRS were raised by commenters on the SEC’s 2008 Roadmap for possible adoption of IFRS. The staff indicated that it will analyze the effects of accounting and disclosure requirements for litigation contingencies under IFRS in the U.S. legal environment as part of its comprehensive review.\(^8\) In light of the SEC’s concerns, adoption of the proposal will, in our view, complicate the ability of the SEC to move towards adoption of IFRS and could thereby impede achievement of the goal of international accounting convergence and adoption of a single, world-wide high-quality accounting standard.

In this regard, the IASB’s analysis of convergence is based on a faulty assumption as to the incidence of the recognition of liabilities in the United States. In Paragraph BC18 of the proposal, the IASB notes, among other things, that “[t]he recognition threshold for litigation liabilities in US GAAP is so high that relatively few liabilities are recognized.” We do not agree. Liabilities are routinely recognized under U.S. GAAP. If there is an issue, which would be the same under the proposal, it is that in many situations the amount that is recognized is lower than the amount of a settlement or ultimate judgment.

IV. Specific Comments

We have several specific comments on the language of the proposal.

The proposal may lead to misleading disclosure

As described above, we are concerned that the proposed disclosure requirements could lead to misleading financial statements. Paragraph 36F provides that the changes in the carrying amount of a liability resulting from the “passage of time” are recognized as a borrowing cost. Paragraph 36F implies that changes in the carrying amount of liability resulting from “factual changes” would be accounted for in the amount of the liability itself, resulting in a potential bifurcation of the amounts accrued. The proposed standard is ambiguous as to whether this bifurcation is intended, and, if so, how it is practically implemented. In addition, classifying this difference as a borrowing cost is counter-intuitive and may lead to confusion and misinterpretation. Moreover, it is not clear if an entity is to recognize borrowing income due to changes in the applicable discount rate.

The proposal may impose excessive computational burdens on companies

We are also concerned that proposal will impose excessive computational burdens on reporting entities. Paragraphs B2 and B3 on the one hand, and Paragraph B4 on the other hand, seem to provide conflicting and misleading requirements. Paragraph B2 provides that “[a]ll possible

outcomes’ affect the amount an entity would rationally pay to be relieved of the obligation, and B3 provides that the entity should identify each possible outcome. We believe that the effort to identify all possible outcomes could be excessively burdensome. Paragraph B4, on the other hand, states that it is “not always necessary” to consider distributions of all the possible outcomes using “complex methods and techniques,” and that a limited number of distinct outcomes and probabilities can provide a reasonable estimate. Paragraph B4 implies, however, that there are circumstances in which an entity should use complex methods and techniques. It is not clear when such methods are necessary.

Paragraph B11 seems to add to this ambiguity and overall burden. Paragraph B11 provides that in some cases management should supplement its judgment with input from independent experts. It is not clear when independent experts should be consulted. Moreover, we are concerned that the cost of consulting independent experts would far outweigh the benefits. In the context of litigation, we believe that such experts often would add little, if any, value.

Other elements of the proposal are ambiguous

Paragraph B16 provides that there are different ways to compute a risk adjustment. We believe that using three different alternative methods to compute a risk adjustment could lead to significant subjectivity. Additionally, Paragraph B16 provides that if a risk adjustment for a liability is determined by adjusting the discount rate, the adjusted discount rate is “typically lower than the risk free rate.” This guidance is ambiguous. Moreover, since typically the borrowing cost is deemed to be the sum of (i) the risk free rate plus (ii) a risk premium, we are unsure as to why the risk adjusted rate would be “below the risk free rate in most circumstances.”

In determining the amount of an obligation fulfilled by making payments to a third party, paragraph B7 provides that associated costs, such as costs of external legal fees or costs of an in-house legal department that are attributed to that obligation, should be included. We believe that further guidance is necessary, as the allocation of in-house overhead would be subjective and may vary between reporting entities.

We also believe that the distinction in paragraph B13 between (i) future events that might affect the outflows of resources without changing the nature of the obligation, and (ii) future events that would change or discharge the present obligation or create a new obligation, is confusing and debatable. Additionally, if there is a likelihood that a future event would discharge an obligation, it would appear under the terms of the proposal that the likelihood of this future event is a relevant factor in determining the amount that the entity would rationally pay to be relieved of the obligation.

V. Conclusion

We are concerned about the application of the proposal and the working draft to litigation-type loss contingencies. As discussed above, we particularly have concerns about the effect of the
We fear the proposal and the working draft may create considerable measurement difficulties and may potentially prejudice the defense of litigation brought against reporting entities in the U.S. We have concerns about the usefulness to financial statement users of the potential disclosures under the proposal. Finally, we believe that any revision of IAS 37 should be coordinated between the FASB and the IASB to address in a comprehensive manner this key impediment to international accounting convergence.

We appreciate the opportunity to comment on the proposal.

Respectfully submitted,

Thomas W. White
Chair, Law and Accounting Committee

Drafting Committee:

Abigail Arms
Linda L. Griggs
Stanley Keller
Randall D. McClanahan
James J. Rosenhauer
Richard H. Rowe
Robert J. Teply
I. Background

The SEC has reaffirmed its support for international accounting convergence and is actively considering whether to incorporate International Financial Reporting Standards (“IFRS”) in U.S. financial reporting standards.

As part of that process, the SEC has indicated that accounting for litigation contingencies will be a factor in its consideration of IFRS. The SEC Staff’s February 2010 IFRS Work Plan noted that substantial concerns about the treatment of litigation-related loss contingencies under IFRS were raised by commenters on the SEC’s 2008 Roadmap for possible adoption of IFRS, and the SEC Staff indicated that it will analyze the effects of accounting and disclosure requirements for litigation contingencies under IFRS in the U.S. legal environment as part of its comprehensive review.

Thus, it is clear that litigation-related loss contingencies under IFRS are an important issue to be addressed as part of international accounting convergence.

The International Accounting Standards Board (the “IASB”) is currently undertaking a project to revise International Accounting Standard 37 (“IAS 37”), “Provisions, Contingent Liabilities and Contingent Assets.” IAS 37 is the IFRS standard that deals with litigation contingencies, and thus the revision is of interest in light of the SEC’s IFRS conversion process.


In certain respects, IAS 37 is similar to Statement of Financial Accounting Standards 5. (FAS 5 is now largely codified in ASC 450.)
Under IAS 37, a provision/recognition is required if:

- An entity has a present obligation (legal or constructive) as a result of a past event;
- It is “probable” (i.e., more likely than not) that an outflow of resources will be required to settle the obligation; and
- A reliable estimate can be made of the amount of the obligation. However, the standard also notes that “it is only in extremely rare cases that a reliable estimate will not be possible.”

IAS 37 differs from FAS 5 in that IAS 37 applies a “more likely than not” standard to define “probable.” FAS 5 uses a “probable / reasonably possible / remote” framework, and defines “probable” in terms of an event being “likely” to occur.

The amount recognized under IAS 37 is a “best estimate,” i.e., “that amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party.” This amount is determined using estimates of outcomes, probabilities and discounting to present value.

Under IAS 37, as under FAS 5, certain disclosures about contingencies must be made in the reporting entity’s financial statements. Under current IAS 37, the disclosure provides a description of the nature of the obligation and an “indication of uncertainties about the amount or timing” of outflows, which may include major assumptions about future events. Aggregation by class of liability is permitted in the disclosures. Updates to the disclosures, including changes in carrying amounts, must be made period-to-period. In “extremely rare” cases where disclosure would be “prejudicial,” IAS 37 allows entities to omit to make the disclosure.

III. Proposed Revised IAS 37 (first published for comment in 2005, with additional proposal published in 2010)

The IASB proposed revisions to IAS 37 in 2005 and proposed further revisions in January 2010. These revisions have not been finalized yet.

The major changes proposed in these revisions are outlined below.

Recognition

The proposed revision deletes the second recognition bullet outlined above—that an outflow of resources to settle the obligation must be “probable.” Instead, entities must recognize an item if it meets the definition of a liability—“a present obligation arising from past events, the settlement of which is expected to result in an outflow from the entity of resources”—and if it can be measured reliably.

This change puts the key emphasis for IAS 37 recognition on the definition of an “obligation.” An entity has an obligation only if:

- It has a duty or responsibility to perform in a particular way; and
It owes that duty or responsibility to a third party

Management’s decision or intention to act is not sufficient to create an obligation.

Management of an entity would be required to “judge whether an obligation exists, taking into account all available evidence and giving more weight to the evidence that is more persuasive.” This evidence can include “opinions of experts” (i.e., legal opinions).

The proposed deletion of IAS 37’s “probability” prong has drawn criticism as essentially requiring an entity’s management to make an affirmative determination of the merits of each lawsuit facing the entity, but, at the same time, not taking into account that the probability of a loss may depend on factors other than management’s assessment of merits, such as likelihood of settlement.

As with current IAS 37, the proposed new standard provides that only in “extremely rare cases” will an entity be unable to “identify a range of possible outcomes and determine a measure of a liability that is sufficiently reliable to meet the recognition criteria.”

Measurement

In January 2010, the IASB issued a new proposal aimed specifically at the measurement standards in IAS 37.

In its January 2010 proposal, the IASB proposed changing the IAS 37 measurement standard from what an entity “would pay to settle or transfer” an obligation to the amount “that it would rationally pay to be relieved of the present obligation.” The proposal would also eliminate the former “best estimate” notion.

Under the proposal, the amount an entity would rationally pay is the lowest of:

- The present value of the resources required to fulfill the obligation (a rule that would apply in most cases);
- The amount necessary to cancel the obligation (a settlement amount); or
- The amount necessary to transfer the obligation to a third party.

The proposed measurement standard employs expected present value techniques, requiring the identification of each possible outcome, potential outflows from each outcome, the probability of each outcome and the discount to present value.

Under the proposal, it would not be necessary for entities to evaluate literally all possible outcomes. Rather, in the words of the proposal, “a limited number of discrete outcomes and probabilities can often provide a reasonable estimate of the distribution of possible outcomes.”

The proposal would allow estimates to be based on the judgment of management, supplemented by experiences with similar transactions and, in some cases, input from
independent experts. Management has to assure it has “used all available evidence … giving
more weight to evidence that is more persuasive.”

Disclosure

The proposed revisions to IAS 37 would require more detailed disclosures than under the
prior standard.

These more detailed disclosures would include the following:

- For recognized liabilities, indication of uncertainties about amounts or timing, and
  identification of major assumptions regarding future events.

- For unrecognized liabilities, description of why they cannot be measured reliably, and
  indication of the uncertainties as to amounts or timing.

- In situations of uncertainty where liability is not recognized, unless the probability of
  an outflow is remote, description of the circumstances and the possible financial
  effects and indication of uncertainties about amounts or timing of outflows.

The proposal would preserve the exception to disclosure where, in “extremely rare
cases,” disclosure would be “prejudicial.”

IV. IASB Staff Paper on Recognizing Liabilities for Litigation (published in April 2010)

In April 2010, the IASB Staff published a Staff Paper focused specifically on how the
revisions of IAS 37 would apply to litigation. The paper is available on the IASB’s website
(www.iasb.org).

The IASB Staff Paper particularly focused on responding to suggestions that eliminating
the probability prong of the IAS 37 recognition standard meant that all litigation will have to be
recognized at fair value under IFRS. The Staff Paper argues that the removal of the probability
prong from the new standard does not mean that liabilities must be recognized for all lawsuits:

- Recognition would be required only where there is a present “obligation.”

- The existence of a lawsuit does not necessarily mean that an entity has a present
  “obligation.” The IASB Staff Paper states: “An entity has a present obligation only
  if, and to the extent that, the claim against it is valid.”

- Management needs to consider the available evidence and reach a judgment as to the
  validity of each claim. This process can include reports from those investigating the
  claim and legal opinions.

- In the course of discussion, the IASB Staff suggested that recognition will not be
  required if a claim “lacks merit.”
V. Law and Accounting Committee Comment Letter

The IASB invited comments on the measurement proposal described above. On May 19, 2010, the Law and Accounting Committee of the Section of Business Law submitted a comment letter expressing a number of concerns about both the measurement proposal and the other changes to IAS 37, particularly emphasizing the issues raised for international accounting convergence. The comment letter also emphasized the unique nature of the U.S. legal system and potential threats to attorney-client privilege and work product doctrine posed by aspects of the proposal, as well as other issues.
IASB proposes significantly different measurement model for non-financial liabilities

What is the issue?

The IASB has exposed revised proposals to amend the measurement of non-financial liabilities (formerly provisions) under IAS 37, ‘Provisions, contingent liabilities and contingent assets’. The revised proposals would affect the measurement of most provisions and will be relevant to almost every entity. The initial proposals were originally issued in 2005 and the remainder of the amendments exposed at that time are not expected to change significantly.

A new IFRS to replace IAS 37 is expected to be published in third quarter of 2010.

New measurement guidance

Provisions will be measured at the present value of the amount that an entity would rationally pay to be relieved of an obligation at the balance sheet date. This is a measure of the value and not of the expected cost to the entity. It is expressed in the exposure draft as the “lowest of;

- The present value of the resources required to fulfil the obligation;
- The amount the entity would have to pay the counterparty to cancel the obligation; and
- The amount the entity would have to pay a third party to transfer the obligation to that third party.”

When the amount of resources required to fulfil the obligation is uncertain, the provision will be measured using the weighted average of all possible outcomes (“expected value”). This will rarely be the amount eventually paid, but will reflect the uncertainty inherent in the estimate. The provision will be discounted using a rate that reflects the time value of money and any risks specific to the obligation that are not reflected in the expected value calculation.

It is seldom possible to cancel an obligation or transfer the liability to third party at a lower amount than the value of the resources required to fulfil the obligation, so provisions will often be measured at this value. When the obligation is to pay cash, for example to settle litigation, it will be measured at the expected cash payment plus any associated costs.

When an obligation is to deliver a service, for example a warranty or an asset decommissioning obligation, it will be measured at the amount that would be paid to a contractor to undertake the service, based on the market price for the relevant service. When there is no market price for the service, the amount that would be paid to a contractor will be estimated, and this estimate will include the direct and indirect and costs and margin that would be recovered by a contractor undertaking the service.

The proposed guidance is different to the way provisions are often measured today. Many provisions are measured using management’s best estimate of the amount that will be paid rather than expected value and provisions could be higher or lower when a weighted average probability is used. Most provisions for an obligation to deliver a service are measured under the existing standard at the expected cost of fulfilling the obligation rather than the value of the resources required. There is some diversity in practice in the extent to which indirect costs are included and the margin that would be charged by a contractor is rarely added. The revised proposals are therefore likely to result in some provisions being higher than the amount currently recorded.
For example, management might currently record a provision for decommissioning an asset as the direct costs of the labour and materials required. The revised proposals would require that the provision include the recovery of direct and indirect overhead cost and the margin that would be charged by a third party contractor.

There is a limited exception to the proposals. The proposed measurement guidance will not apply to onerous contracts arising from transactions in the scope of IAS 18 and IFRS 4 pending completions of the IASB’s revenue and insurance projects.

**Am I affected?**

The revised proposals are likely to apply to most entities and the impact could be significant, particularly for entities that currently record significant provisions, for example in connection with environmental restoration or asset decommissioning.

**What do I need to do?**

The comment period will close on 12 April 2010. The proposed changes are significant; management should first consider whether to comment on the IASB’s proposals. Management should also begin to consider how the proposals would affect the measurement of existing liabilities and whether it would be necessary to collect additional information.

A working draft of the standard that will replace IAS 37 will be published on the IASB website in February. This working draft will reflect a number of other changes to the existing model, including the removal of the requirement that an outflow of resources be probable for a liability to be recorded. Management should also begin to consider this and other changes to recognition of provisions and the implications for the financial statements.

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Contingencies
A new IASB approach for some liabilities

Accounting for contingencies has long been a challenge for companies, as they evaluate whether a liability exists and the uncertainties associated with both the amount and timing of the potential liability. The IASB has recently released an exposure draft to address some of these challenges.

Overview. The IASB’s proposed approach would significantly change the recognition and measurement of contingent liabilities – relevant to almost every entity reporting under IFRS. Companies reporting under U.S. GAAP will also want to monitor this project because the proposals could influence how the FASB continues to evaluate similar issues. Right now, the FASB’s current project on contingencies is limited to enhancing the disclosures of contingent liabilities. However, the issue of liability recognition and measurement may have tentacles into other projects as well, such as revenue recognition and insurance contracts.

A “no-threshold” approach. Under current IFRS, an entity assesses whether to record an obligation based, in part, on an assessment of whether it is more likely than not that it may have to settle the liability. In contrast, the recognition threshold is higher within U.S. GAAP, which requires the recognition of a liability when a future payment to settle the liability is probable. In its exposure draft, the IASB is proposing to eliminate the more-likely-than-not threshold. Thus, the recognition of a liability will require judgment about whether an obligation exists. The consequence of the proposed guidance could be volatility in the income statement from both the recognition and measurement provisions.

Measurement. Under the proposed IFRS model, liabilities would be measured at the present value of the amount that an entity would “rationally pay” to be relieved of the liability at each balance sheet date. The liabilities would be measured using a weighted average of possible outcomes. This is a significant change from practice under U.S. GAAP and IFRS since currently, these types of liabilities are measured based on the entity’s best estimate. The new approach would require close collaboration among management, the company’s attorneys, and its auditors.

Next steps. Comments on the IASB’s exposure draft are due in April 2010. Companies may want to consider weighing in on the proposals given the possibility that any new standard adopted by the IASB may be a proposed starting point if the FASB decides to re-evaluate the U.S. GAAP contingency standard. A final IASB standard is expected to be published in the third quarter of this year.
International Financial Reporting Standards: Implications for Business Lawyers

ABA Business Law Section
August 8, 2010
Index of Presentations

- IFRS Overview and Update (Sam Doolittle, Deloitte)
- Transfers of Financial Assets (Melanie Pinto, Morgan Stanley)
- Loss Contingencies (John Formica, PwC)
- Accounting Covenants in Financing Agreements (Thomas White, WilmerHale)
IFRS overview and update
What is IFRS?

- **Principles-based** – IFRS is a “principles-based” approach versus U.S. GAAP which is more of a “rules-based” approach.

- **Professional judgment** – IFRS places greater emphasis on interpretation and judgment and less reliance on “bright-line rules” than U.S. GAAP.

- **Less authoritative literature** – Determining the appropriate accounting treatment under IFRS will rely heavily on professional judgment and “thinking” about how to account for the transaction based on these principles versus “finding” where in the rules the appropriate accounting treatment is stated.

  ![IFRS and U.S. GAAP literature](image)

  IFRS currently contains about 2,500 pages of literature while U.S. GAAP has been estimated to reach about 18,000 pages.

  Is IFRS seven times simpler than U.S. GAAP?

- **Substance and economic reality** – IFRS focuses on assessing the *substance* of transactions and evaluating whether the accounting presentation reflects the *economic reality*.

- **IFRS requires greater disclosure** –
  
  - Greater emphasis on disclosure of transactions that do not have clearly defined accounting in the limited IFRS literature
  
  - IFRS is expected to lead to a new perspective on financial reporting with a focus on “transparency” of financial information versus uniformity of practices.
Worldwide IFRS adoption map – global capital markets

- **United States**: 2015-16?
- **South Africa**: 2005
- **China**: 2007
- **Japan**: 2010/2015-2016
- **Global use**: Used in over 100 countries by more than 40% of the Global Fortune 500
  - **Current**: European Union (EU) countries, Chile, Hong Kong, Australia, New Zealand and many Middle East and South American countries
  - **Future**: Brazil (2010); Canada, India, South Korea (2011); Argentina, Mexico (2012), Japan early adopters (2010)
  - **Proposed**: U.S. mandatory (2015) may provide early adoption, Japan mandatory (2015) – based on regulatory roadmaps
Regulatory updates on use of IFRS

Global statutory environment

- Foreign territories are permitting or requiring IFRS for statutory financial reporting
- Creates a near-term compliance challenge
- Creating potential opportunities for Companies to streamline and standardize statutory reporting policies and procedures
- Lower compliance costs by taking advantage of shared service centers
  - Countries requiring IFRS-based statutory financial reports (e.g. Australia, South Africa, Hong Kong, Singapore, Philippines)
  - Countries that have recently announced proposals to move to IFRS in the near future
    - United Kingdom/Ireland – Proposal is pending that would replace UK GAAP with IFRS-based reporting in 2012
    - Brazil – Brazilian GAAP is subject to accounting changes that will result in substantial convergence to IFRS by 2010
  - Others countries provide companies with the option to use IFRS or are converging local GAAP standards and IFRS standards
IFRS in the US: Two possible approaches

**Conversion**
- Replacement of US GAAP with IFRS
- Requires SEC (or other regulatory body) to require use of IFRS for financial statements

**Convergence**
- Modification of US GAAP to ‘converge’ with IFRS
- In process since 2002
FASB Timeline of Current Convergence Projects

Rate and volume of change is unprecedented. Changes expected to be applied retrospectively, requiring comparative periods to be restated.

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Common IFRS Challenges

Our IFRS conversion experience has demonstrated that certain common accounting differences and common enabling challenges occur, to a greater or lesser degree, on many IFRS conversions.

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<td><strong>Biological Assets</strong> being recorded at fair value</td>
<td><strong>Training</strong></td>
</tr>
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<td><strong>Policy alignment</strong> - Subsidiaries must have consistent accounting policies</td>
<td><strong>Communications</strong></td>
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<td><strong>Consolidation</strong> including the assessment of control and significant influence under IFRS</td>
<td><strong>Strategy — When to adopt</strong></td>
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<td><strong>Leases</strong> including classification criteria**</td>
<td><strong>Statutory reporting — When to adopt</strong></td>
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<td><strong>Provisions</strong> including timing and amount recorded**</td>
<td><strong>Shared services — Statutory reporting</strong></td>
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<td><strong>Other accounting issues</strong></td>
<td><strong>Compensation plans and other legal contracts</strong></td>
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<tr>
<td></td>
<td><strong>Other enabling issues</strong></td>
<td><strong>Coordination and management with auditor</strong></td>
</tr>
</tbody>
</table>

*Impact may change due to joint FASB/IASB convergence project
**Impact may change due to IASB project

Illustrative assessment for discussion purposes only; Illustrative impacts do not encompass all potential differences or areas which may be impacted. Assessment of Impact (high, medium, low) would be determined by the Company.
Transfers of Financial Assets

- US GAAP is a control based model
  - Transferred asset must be legally isolated from the transferor
    - Evidenced by a “would level” true sale legal opinion
  - Transferee has ability to pledge or exchange the asset
  - Transferor does not maintain effective control

- IFRS is a risks and rewards and control based model
  - Does not require legal isolation of assets in bankruptcy
  - Control relinquished if transferee has the unilateral ability to sell the asset
Balance Sheet Netting

To offset assets and liabilities on the Balance Sheet

• US GAAP requires
  – Intent to net settle
  – Legally enforceable right to set off
  – Exception for derivatives with master netting arrangements

• IFRS requires
  – Intent to net settle or simultaneously settle
  – Legally enforceable right to net settle
Loss Contingencies

Agenda

• Background and Recent Developments

• IFRS Overview
  • Current Guidance
  • Proposed Guidance

• US GAAP Overview
  • Current Guidance
  • Proposed Guidance

• Comparison of IFRS and US GAAP
Loss Contingencies
Background and Recent Developments

Overview

• Current guidance
  • IFRS  IAS 37
  • US GAAP  ASC 450 (formerly, FAS 5)

  – Earlier in 2010, the IASB proposed revised guidance on recognition and measurement of loss contingencies

• In July, 2010, the FASB proposed revised guidance on disclosures
Loss Contingencies
IFRS – Current Guidance (IAS 37)

Recognition

• An accrual is recorded when all of the following condition are met:
  1) It is more-likely-than-not that there is a present obligation
  2) It is more-likely-than-not that an outflow of resources will be required to settle the obligation
  3) The amount can be reliably estimated
Loss Contingencies
IFRS – Current Guidance (IAS 37)

Recognition (continued)

- **More-likely-than-not** means a greater than 50% chance that the event will occur
- An entity determines whether a **present obligation** exists by taking into account all available evidence
- IAS 37 considers cases where no **reliable estimate** can be made to be extremely rare
Loss Contingencies
IFRS – Current Guidance (IAS 37)

Measurement

• Accrual is measured at best estimate
  – Best estimate is what an entity would rationally pay to settle the obligation
  – Uncertainties surrounding the estimate can be dealt by utilizing a weighted average of possible outcomes
  – If no individual estimate is better than others in the range, the mid-point of the range is used
  – Assumptions about future events are reflected in the estimate
  – If time value of money is material, use present value
Loss Contingencies
IFRS – Current Guidance (IAS 37)

Disclosures

• Disclosures required for all but remote contingencies

• Similar contingencies can be aggregated by class

• For amounts recorded in the financial statements, disclose for each class:
  - The accrued amount, and the rollforward of the accrued amount,
  - Nature of the obligation and the expected timing,
  - Uncertainties about the amount or timing of any outflow,
  - The amount of any expected reimbursement (e.g., insurance recovery)
Loss Contingencies
IFRS – Current Guidance (IAS 37)

Disclosures (continued)

• For unrecorded contingencies, disclose for each class:
  – Nature of the contingent liability, and an estimate of its financial effect
  – Uncertainties about the amount or timing of any outflow
  – Possibility of any reimbursement

• If any of the above information is not disclosed because it is not practical to do so, state that fact

• In extremely rare cases, a ‘prejudicial exemption’ is provided for disclosures

• In those cases, the entity still has to disclose the general nature of the dispute and the reason why the information has not been disclosed
Loss Contingencies
IFRS – Proposed Guidance

Overview

• Earlier in 2010, the IASB proposed new guidance on recognition and measurement of loss contingencies

• The proposal removes the more-likely-than-not criterion for recognition

• As a result, entities would record liabilities for all present obligations that can be measured reliably

• The IASB also added guidance specifying more precisely how entities should measure the accrued amount.

• In April 2010, the IASB issued a staff paper on recognizing liabilities arising from lawsuits
Loss Contingencies
IFRS – Proposed Guidance

Recognition

• Removing the more-likely-than-not criterion does not require entities to recognize liabilities for all contingencies

• For example, the existence of a lawsuit does not mean that an entity has a present obligation

• An entity has a present obligation only if the claim against it is valid (i.e., claim has merit)

• Management needs to consider all available evidence and reach a judgment as to the validity of the claim
Loss Contingencies
IFRS – Proposed Guidance

Recognition (continued)

- IASB believes in only in limited circumstances would entities recognize more liabilities under the new guidance.

- More liabilities would be recognized under the new guidance when:
  - There is a present obligation, but
  - It is less than 50% likely that a payment will be required.

- IASB expects this situation to be rare, because if a claim is valid (i.e., a present obligation exists), evidence will often support that it is more-likely-than-not that a payment will be required.
Loss Contingencies
IFRS – Proposed Guidance

Recognition (continued)

- Some entities may recognize less liabilities when:
  - There is no present obligation, but
  - It is more-likely-than-not that a payment will be required

- This situation could arise if, for example, an entity expects a court judgment that is inconsistent with the evidence, or intends to settle out-of-court as a cost-efficient alternative.
Loss Contingencies
IFRS – Proposed Guidance

Recognition (continued)

• Worse than expected outcomes would not mean that previous judgments were wrong

• Removing the more-likely-than-not criterion would focus decisions on judgments about whether a liability exists, not on predictions of the most likely outcome

• This change creates tensions with the IASB’s Framework which states that liabilities should be recognized only if it is more-likely-than-not that an outflow of resources will be required
Loss Contingencies
IFRS – Proposed Guidance

Measurement

• The IASB proposed to remove the term ‘best estimate’ because of current diversity in practice

• The liability would be measured at the present value of the amount an entity would rationally pay using a weighted average of possible outcomes
Accounting Covenants in Financing Agreements

Thomas White
August 2010

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IFRS Impact on Agreements

All kinds of legal agreements contain financial or reporting covenants that are defined by reference to generally accepted accounting principles

- Financial covenants in loan agreements, note agreements, indentures
- Reporting requirements in these and other agreements, such as partnership and investment agreements
- Purchase price adjustments and earnouts in M&A agreements

How to plan for adoption of IFRS?
Bank Loan Agreement

"GAAP" means generally accepted accounting principles in the United States set forth in the opinions and pronouncements of the Accounting Principles Board and the American Institute of Certified Public Accountants and statements and pronouncements of the Financial Accounting Standards Board or such other principles as may be approved by a significant segment of the accounting profession in the United States, that are applicable to the circumstances as of the date of determination, consistently applied.
Bank Loan Agreement

_Generally._ All accounting terms not specifically or completely defined herein shall be construed in conformity with, and all financial data (including financial ratios and other financial calculations) required to be submitted pursuant to this Agreement shall be prepared in conformity with, GAAP applied on a consistent basis, as in effect from time to time, applied in a manner consistent with that used in preparing the Audited Financial Statements, except as otherwise specifically prescribed herein.
Changes in GAAP. If at any time any change in GAAP would affect the computation of any financial ratio or requirement set forth in any Loan Document, and either the Borrowers or the Required Lenders shall so request, the Administrative Agent and the Borrowers shall negotiate in good faith to amend such ratio or requirement to preserve the original intent thereof in light of such change in GAAP (subject to the approval of the Required Lenders); provided that, until so amended, (i) such ratio or requirement shall continue to be computed in accordance with GAAP prior to such change therein and (ii) the Borrowers shall provide to the Administrative Agent and the Lenders financial statements and other documents required under this Agreement or as reasonably requested hereunder setting forth a reconciliation between calculations of such ratio or requirement made before and after giving effect to such change in GAAP.
International Financial Reporting Standards. If at any time a change in Law, regulation or applicable accounting standards would require adoption of the International Financial Reporting Standards and the computation of any financial covenant set forth herein would be altered thereby, and either the Company or the Required Lenders shall so request, the Administrative Agent, the Lenders and the Company shall negotiate in good faith to amend this Agreement accordingly, and the Lenders shall not assess an amendment fee for such amendment.
Issues Raised by IFRS Conversion

Will agreement to agree on changes provide a feasible method for dealing with changes?

Is it possible to identify in advance matters that would be adjusted for in the event of a conversion to IFRS?

- Some agreements now except out some changes in GAAP (fair value of debt, capitalized leases)

Is it feasible to maintain “two sets of books” to reconcile GAAP to IFRS?

Will auditors be prepared to audit under GAAP?
Note Purchase Agreement

All accounting terms which are not expressly defined in this Agreement have the meanings ascribed to them in GAAP. Except as otherwise specifically provided herein, all computations made pursuant to this Agreement shall be made in accordance with GAAP, and all financial statements shall be prepared in accordance with GAAP.

“GAAP” means generally accepted accounting principles as in effect from time to time in the United States of America.
Issues

How to adjust for changes in accounting standards where negotiation with lenders impractical?

- Let it ride? Calculate in accordance with prevailing accounting standards, even if they change
  - Define GAAP to include IFRS if adopted?
- Pre-negotiate? Agree on revised covenants if IFRS is subsequently adopted

Problem if "GAAP" is different for public and non-public companies

Speaker Biographies
John R. Formica, Jr.
Partner, PricewaterhouseCoopers

John R. Formica, Jr. is a partner with the National Professional Services Group of PricewaterhouseCoopers located in Florham Park, NJ. He is a leader in the Firm's thought-leadership efforts in the loss contingencies area. John has closely followed the IASB's recent deliberations on the accounting for loss contingencies and the FASB's deliberations on its loss contingency disclosure project. Previously, John spent more than 25 years serving public and large private manufacturing companies as an audit partner in the Hartford, CT office. John is a graduate of Providence College, with a BS in Accounting. He is a Certified Public Accountant and is licensed to practice in ten states. John is a member of the American Institute of Certified Public Accountants, and the Connecticut Society of Certified Public Accountants. He is on the Board of Directors of The Connecticut Forum, serving as its Treasurer, and the National Multiple Sclerosis Society - Connecticut Chapter. John lives with his wife Wendy and their family in Madison, NJ.
Since 1995, Professor Hamermesh has been a member of the Council of the Corporation Law Section of the Delaware State Bar Association, which is responsible for the annual review and modernization of the Delaware General Corporation Law, and served as Chair of the Council from 2002 to 2004. In 2002 and 2003 he served as the Reporter for the American Bar Association’s Task Force on Corporate Responsibility. From 2001 to 2007 he also was an elected member of the Committee on Corporate Laws of the American Bar Association Section of Business Law, which supervises the drafting of the Model Business Corporation Act. A member of the American Law Institute since 1999, Professor Hamermesh also served from 1985 to 2009 on the Board of Directors of ACLU Delaware, Inc., and represented that organization on the ACLU National Board from 2004 to 2009.

Professor Hamermesh's recent publications include:

Linda L. Griggs is a partner in Morgan Lewis’s Securities Practice. Ms. Griggs’s practice focuses on securities regulatory matters, including financial reporting and accounting and other disclosure requirements under the securities laws and public and private securities offerings. Ms. Griggs also handles corporate law matters, including advising with respect to the fiduciary duties of directors and corporate governance matters.

Ms. Griggs recently served on the SEC’s Advisory Committee on Improvements to Financial Reporting, which submitted its final report and recommendations to the SEC in August 2008. Before joining Morgan Lewis, Ms. Griggs served as chief counsel to the chief accountant of the SEC for five years. Prior to that, she worked in the Division of Corporation Finance at the SEC as a special counsel, as an attorney in the Division’s rule-writing office, and as a reviewer of registration statements, proxy statements and reports filed by companies covered by federal securities laws.

Ms. Griggs is admitted to practice in the District of Columbia and Ohio.

practice accolades
Employee Benefits & Executive Compensation
Listed, Employee Benefits & Executive Compensation (various states) in Chambers USA (2009)

honors + affiliations
Member, SEC Advisory Committee on Improvements to Financial Reporting (8/2007–8/2008)
Chair, American Bar Association, Committee on Law and Accounting (8/2005–8/2008)
Member, American Bar Association, Subcommittee on Registration Statements, 1993 Act of the Federal Regulation of Securities

education
University of Cincinnati College of Law, 1974, J.D.
Smith College, 1971, B.A.
Thomas W. White

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Thomas White is a partner in the Corporate and Bankruptcy and Financial Restructuring Practice Groups. He joined the firm in 1979. Mr. White has practiced corporate and bankruptcy law at the firm since 1983. He is one of the firm’s leading practitioners in the area of corporate governance, and also has extensive experience representing corporate and institutional clients in complex business transactions. Mr. White also serves as General Counsel of WilmerHale.

Practice

Since passage of the Sarbanes-Oxley Act in 2002, Mr. White has developed a multi-disciplinary corporate governance practice. He has advised numerous Fortune 100, mid-cap, and small-cap companies and their boards and management on key issues under the Act, including internal control over financial reporting, attorney responsibility policies, director/officer loans, whistleblowers and auditor independence. He also advises clients and their boards and management on difficult corporate law, securities and accounting issues, and in conducting internal investigations.

Recent Highlights

Mr. White is corporate and securities counsel for a Houston oilfield services company. Mr. White and WilmerHale helped this company successfully navigate a difficult multi-year financial reporting process, which included restating prior year financial statements, bringing the company current in its public SEC filings and obtaining relisting on the New York Stock Exchange, advising with respect to management separation issues, and responding to government investigations. Mr. White also provides ongoing advice to the Board on corporate governance matters.

Mr. White recently advised an institutional investment manager with respect to restructuring of its short-term investment fund.
IASB proposes significantly different measurement model for non-financial liabilities

What is the issue?

The IASB has exposed revised proposals to amend the measurement of non-financial liabilities (formerly provisions) under IAS 37, ‘Provisions, contingent liabilities and contingent assets’. The revised proposals would affect the measurement of most provisions and will be relevant to almost every entity. The initial proposals were originally issued in 2005 and the remainder of the amendments exposed at that time are not expected to change significantly.

A new IFRS to replace IAS 37 is expected to be published in the third quarter of 2010.

New measurement guidance

Provisions will be measured at the present value of the amount that an entity would rationally pay to be relieved of an obligation at the balance sheet date. This is a measure of the value and not of the expected cost to the entity. It is expressed in the exposure draft as the “lowest of:

- The present value of the resources required to fulfil the obligation;
- The amount the entity would have to pay the counterparty to cancel the obligation; and
- The amount the entity would have to pay a third party to transfer the obligation to that third party.”

When the amount of resources required to fulfil the obligation is uncertain, the provision will be measured using the weighted average of all possible outcomes (“expected value”). This will rarely be the amount eventually paid, but will reflect the uncertainty inherent in the estimate. The provision will be discounted using a rate that reflects the time value of money and any risks specific to the obligation that are not reflected in the expected value calculation.

It is seldom possible to cancel an obligation or transfer the liability to a third party at a lower amount than the value of the resources required to fulfil the obligation, so provisions will often be measured at this value. When the obligation is to pay cash, for example to settle litigation, it will be measured at the expected cash payment plus any associated costs.

When the obligation is to deliver a service, for example a warranty or an asset decommissioning obligation, it will be measured at the amount that would be paid to a contractor to undertake the service, based on the market price for the relevant service. When there is no market price for the service, the amount that would be paid to a contractor will be estimated, and this estimate will include the direct and indirect costs and margin that would be recovered by a contractor undertaking the service.

The proposed guidance is different to the way provisions are often measured today. Many provisions are measured using management’s best estimate of the amount that will be paid, rather than expected value, and provisions could be higher or lower when a weighted average probability is used. Most provisions for an obligation to deliver a service are measured under the existing standard at the expected cost of fulfilling the obligation rather than the value of the resources required. There is some diversity in practice in the extent to which indirect costs are included, and the margin that would be charged by a contractor is rarely added. The revised proposals are therefore likely to result in some provisions being higher than the amount currently recorded.
For example, management might currently record a provision for decommissioning an asset as the direct costs of the labour and materials required. The revised proposals would require the provision to include the recovery of direct and indirect overhead costs and the margin that would be charged by a third party contractor. There is a limited exception to the proposals. The proposed measurement guidance will not apply to onerous contracts arising from transactions in the scope of IAS 18 and IFRS 4 pending completions of the IASB’s revenue and insurance projects.

Am I affected?

The revised proposals are likely to apply to most entities and the impact could be significant, particularly for entities that currently record significant provisions, for example in connection with environmental restoration or asset decommissioning.

What do I need to do?

The comment period will close on 12 April 2010. The proposed changes are significant; management should first consider whether to comment on the IASB’s proposals. Management should also begin to consider how the proposals would affect the measurement of existing liabilities and whether it would be necessary to collect additional information.

A working draft of the standard that will replace IAS 37 will be published on the IASB website in February. This working draft will reflect a number of other changes to the existing model, including the removal of the requirement that an outflow of resources be probable for a liability to be recorded. Management should also begin to consider this and other changes to the recognition of provisions and the implications for the financial statements.
Contingencies
A new IASB approach for some liabilities

Accounting for contingencies has long been a challenge for companies, as they evaluate whether a liability exists and the uncertainties associated with both the amount and timing of the potential liability. The IASB has recently released an exposure draft to address some of these challenges.

**Overview.** The IASB’s proposed approach would significantly change the recognition and measurement of contingent liabilities – relevant to almost every entity reporting under IFRS. Companies reporting under U.S. GAAP will also want to monitor this project because the proposals could influence how the FASB continues to evaluate similar issues. Right now, the FASB’s current project on contingencies is limited to enhancing the disclosures of contingent liabilities. However, the issue of liability recognition and measurement may have tentacles into other projects as well, such as revenue recognition and insurance contracts.

A “no-threshold” approach. Under current IFRS, an entity assesses whether to record an obligation based, in part, on an assessment of whether it is more likely than not that it may have to settle the liability. In contrast, the recognition threshold is higher within U.S. GAAP, which requires the recognition of a liability when a future payment to settle the liability is probable. In its exposure draft, the IASB is proposing to eliminate the more-likely-than-not threshold. Thus, the recognition of a liability will require judgment about whether an obligation exists. The consequence of the proposed guidance could be volatility in the income statement from both the recognition and measurement provisions.

**Measurement.** Under the proposed IFRS model, liabilities would be measured at the present value of the amount that an entity would “rationally pay” to be relieved of the liability at each balance sheet date. The liabilities would be measured using a weighted average of possible outcomes. This is a significant change from practice under U.S. GAAP and IFRS since currently, these types of liabilities are measured based on the entity’s best estimate. The new approach would require close collaboration among management, the company’s attorneys, and its auditors.

**Next steps.** Comments on the IASB’s exposure draft are due in April 2010. Companies may want to consider weighing in on the proposals given the possibility that any new standard adopted by the IASB may be a proposed starting point if the FASB decides to re-evaluate the U.S. GAAP contingency standard. A final IASB standard is expected to be published in the third quarter of this year.
Professional Activities

In August 2009, Mr. White was appointed by the President of the American Bar Association as one of the ABA’s representatives on the National Conference of Lawyers and CPAs.

Mr. White is Chair of the Law and Accounting Committee of the Business Law Section of the American Bar Association.

Together with Carrie Wofford, Mr. White is the author of the chapter on "Whistleblowers" in The Practitioner's Guide to the Sarbanes-Oxley Act published by the ABA Business Section.

Mr. White has appeared frequently in programs and panels on corporate governance and Sarbanes-Oxley issues, including before organizations such as ALI-ABA, Practicing Law Institute, the International Bar Association, the Organization for International Investment and Glasser Legal Works.

Mr. White is a member of the Columbia Law School Board of Visitors.

Community Involvement

Mr. White is Chair of the Board of Covenant House Washington, which serves homeless and at-risk youth in Washington, DC and adjacent communities.

Honors and Awards

- Named a "Virginia Super Lawyer" in the July 2006 issue of Richmond Magazine