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Accountants and Consultants



# SEC Releases Proposed IFRS Roadmap

*On August 27, 2008, the SEC voted to propose a “road map” for transitioning U.S. registrants to reporting in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).*

The proposed road map was released on November 14, 2008 and includes the following key elements:

1. A list of milestones that must be met before the SEC will consider requiring US filers to report in accordance with IFRS
2. Voluntary early adoption of IFRS by a limited number of large U.S. registrants beginning in 2010
3. A Commission decision in 2011 as to whether the milestones have been met and reporting in IFRS should be mandated
4. If the decision in step 3 is yes, adoption of IFRS by U.S. registrants beginning in 2014

## **I. Milestones**

The road map contains milestones that must be achieved before the SEC will consider requiring US filers to report in accordance with IFRS. The milestones include:

- Continued improvement in IFRS, i.e., convergence of IFRS and U.S. GAAP and issuing standards that address topics not currently covered by IFRS with appropriate due process applied
- Achieving independent governance and funding along with a monitoring process of the International Accounting Standards Committee (IASC) Foundation, the body that oversees the standards setter for IFRS, the IASB
- Satisfactory progress on developing the ability to effectively provide IFRS financial statements in XBRL format which would consider the state of development of useful data tags and the level of detail of data available
- Satisfactory progress in education and training which broadly encompasses: Company personnel, audit committees, Boards of Directors, specialists, accountants, auditors, investors, customers, vendors, rating agencies, analysts, industry groups, educators and students, oversight agencies (e.g., PCAOB), etc.
- Limited early use of IFRS where this would enhance comparability for U.S. investors (Refer to Voluntary Reporting section below)

## **2. Voluntary Reporting**

A limited number of large U.S. registrants would be permitted to voluntarily early adopt IFRS if it would enhance the comparability of their financial statements with those of their peers. To be eligible, (1) a company must be one of the largest 20 companies in the world (measured by market capitalization) in its industry and (2) IFRS must be the set of accounting standards used most often by those 20 companies. Companies meeting these conditions would be able to obtain a “no action” letter from the SEC staff permitting them to report in IFRS instead of U.S. GAAP. The SEC estimates that 110 U.S. companies in 34 industries representing approximately 14% of the aggregate U.S. market capitalization would be eligible to early adopt IFRS.

Early adoption would be permitted beginning in fiscal years ending on or after December 15, 2009. Three years of financial statements prepared in accordance with IFRS would be required. The Commission is considering two alternatives for disclosing the effect of converting to IFRS:

- Proposal A: Provide a one-year audited reconciliation of the IFRS amounts to U.S. GAAP amounts, the approach reflected in IFRS 1, *First-Time Adoption of International Financial Reporting Standards*, within a footnote to the financial statements
  - Would include a reconciliation of reported equity as of 1/1/2007 and 12/31/2008 and a reconciliation for the year ending 12/31/2008
- Proposal B: Provide an ongoing unaudited reconciliation of the IFRS amounts to U.S. GAAP amounts for all periods presented
  - Would include the annual report filed as of 12/31/2009 inclusive of the one time reconciliation in Proposal A above *plus* reconciliation for the 12/31/2008 and 12/31/2009 balance sheets and three years of income statements ending 12/31/2009
  - Thereafter, each annual report would include a three year period reconciliation

One commissioner observed that a benefit of the second approach is that it provides early adopters a “way back” if the Commission does not ultimately require the use of IFRS and these companies need to revert to reporting in accordance with U.S. GAAP.

Companies that elect to early adopt IFRS would need to seek confirmation by the Commission prior to filing.

### 3. Commission Decision

The Commission would decide in 2011 whether the milestones have been met and reporting in IFRS should be required.

### 4. Adoption

If the Commission decides to require the use of IFRS, adoption would be required in 2014, and three years of financial statements prepared in accordance with IFRS would be required at the time of adoption. The Commission would need to decide on the appropriate transition. Two approaches are being considered:

- Require all U.S. registrants to adopt in 2014
- Permit sequential adoption, for example requiring large accelerated filers to adopt in 2014, accelerated filers to adopt in 2015 and all other filers to adopt in 2016.

As part of the Commission's evaluation, it also may consider transition rules to expand the eligibility criteria of those U.S. issuers which could elect to use IFRS in their Commission filings, so that additional U.S. issuers would be able to use IFRS prior to a mandatory transition date. In proceeding along the Roadmap, the Commission would consider the circumstances in which the early use of IFRS would be most appropriate for investor protection and capital formation. Another consideration would be how to address the current choices available to foreign private issuers for their financial reporting in filings with the Commission. Currently, foreign private issuers can choose to prepare their financial statements in accordance with U.S. GAAP, IFRS as issued by the IASB without reconciliation to U.S. GAAP, or another comprehensive set of accounting principles with a reconciliation to U.S. GAAP.

### 5. Other Considerations

Any decision the Commission may take to expand the use of IFRS to U.S. issuers would necessitate their evaluation of whether global developments support the assertion of IFRS as the single set of high-quality globally accepted accounting standards that is applied consistently across companies, industries and countries. In addition, if the Commission were to require U.S. issuers to report in accordance with IFRS, a number of considerations and actions with a series of lead times may be required for investors, issuers, and other parties that use financial statements or have a role in the capital markets or the financial reporting infrastructure. These other considerations pertain to changes that may need to be made concerning:

- a. Parties other than the Commission that use financial statements (e.g., federal and state regulators, including the Internal Revenue Service; lenders; market indices; etc.)
- b. Accounting systems, controls and procedures by all who prepare and use financial statements
- c. Auditing profession will need to make systematic changes as U.S. auditors generally have less experience with IFRS than with U.S. GAAP. In the short term, U.S. audit firms may encounter challenges

in establishing policies and procedures, and hiring and training personnel, in order to provide themselves with reasonable assurance that their personnel would possess knowledge appropriate to perform audits of U.S. issuers. Even with appropriate systems of quality control, however, additional auditing guidance still may be necessary.

d. IFRS and the IASB's standard setting process –

- I. IFRS is not as “developed” as U.S. GAAP in certain areas and could *potentially* reduce comparability of financial reporting but the flexibility afforded by IFRS also allows for financial reporting that may more closely reflect the economics of transactions. In these situations, encouraged robust disclosure becomes even more important for users of financial statements.
- II. The U.S. capital markets, while continuing to be a key player, would have a more decreased role within the international standard setting process than it does currently under U.S. GAAP. The IASB is expected to be responsive to broad, world-wide constituencies of investors, issuers, regulators and many others in all facets of its work, including the establishment of its agenda and the development of standards. These constituencies can be expected to represent a wide-range of interests, reflecting varying economic, social and political environments. How this will impact the standard-setting process will depend on numerous factors and could potentially lead to longer deliberation periods for standards setting.

The release of the proposed roadmap is the latest in a series of significant efforts to consider the appropriateness of and best transition approach for requiring all SEC registrants to use a single set of accounting standards. The process began in April 2005 when the Chief Accountant of the SEC described an initial road map for achieving the goal of one set of high quality, globally accepted accounting standards. The Commission followed with (1) a September 2007 concept release on allowing U.S. registrants to file IFRS financial statements and (2) a December 2007 final rule allowing foreign private issuers to file financial statements in accordance with IFRS as issued by the IASB without reconciliation to U.S. GAAP.

The SEC's proposed release covering this action is available at: <http://www.sec.gov/rules/proposed/2008/33-8982.pdf>. Comments were due April 20, 2009.

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