Marks Paneth & Shron LLP
Certified Public Accountants & Consultants
IT ALL ADDS UP.

MP&S ACCOUNTING AND AUDITING ALERT: IRS STAFF ISSUES "FINAL REPORT," BUT IFRS DECISION STILL TO COME

On July 13, the staff of the U.S. Securities and Exchange Commission (SEC) issued its final report on the agency's work plan in relation to International Financial Reporting Standards (IFRS). Although the 127-page report provides analysis of six key areas, what may be most notable is that it doesn't make a recommendation as to what the SEC's decision should be regarding incorporating IFRS into the financial reporting system for U.S. issuers.

In fact, the report's introduction is careful to note that the report "does not imply — and should not be construed to imply — that the Commission has made any policy decision as to whether International Financial Reporting Standards should be incorporated into the financial reporting system for U.S. issuers, or how any such incorporation, if it were to occur, should be implemented."

In other words, the SEC's decision on whether or to what extent IFRS will become authoritative for U.S. issuers is still to come.

A Brief History

For the last several years, the SEC has been exploring the possibility of adopting IFRS for use in the United States. In 2007, it eliminated the requirement that foreign registrants using IFRS reconcile their financial statements to U.S. Generally Accepted Accounting Principles (GAAP). Then in 2008, it issued its proposed "road map" for the adoption of IFRS by U.S. issuers.

In February 2010, the SEC staff issued the "Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers." The work plan's purpose was to help the SEC assess whether, when and how the current financial reporting system for U.S. issuers should be transitioned to a system incorporating IFRS. The SEC had planned to vote in 2011 on whether to make IFRS mandatory for U.S. issuers beginning as early as 2015, but the decision was pushed back into 2012. In February 2012, an SEC staff member said that a decision on IFRS was "a few months away." But now, after more than a few months have passed, only the final staff report on the 2010 work plan has been issued.

While the SEC has been contemplating its decision on IFRS, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB), which oversees IFRS, have been working toward "convergence" of GAAP and IFRS. FASB and the IASB had planned to complete their major convergence projects by mid-2011, but several are still in progress.

Six Key Areas

The SEC's final staff report on the 2010 work plan summarizes the findings from the staff's research over approximately the last two and a half years. During that period, the staff issued several papers addressing such topics as possible methods of incorporation, a comparison of U.S. GAAP to IFRS and an analysis of IFRS in practice.
Here are brief summaries of the final staff report's observations on the work plan's six areas of concern:

1. ***Sufficient development and application of IFRS for the U.S. domestic reporting system.*** The comprehensiveness of IFRS has improved through a combination of independent standard setting by the IASB and the completion of various joint IASB-FASB

convergence projects. However, additional joint projects still need to be completed, and other projects are in need of improvement. In addition, the lack of industry-specific guidance under IFRS could be a problem for some U.S. issuers.

In terms of application, IFRS is being used more globally, which “appears to promote general comparability.” However, improvements in the quality and consistency of the application of IFRS could be made to enhance comparability.

2. ***Independent standard setting for the benefit of investors.*** The IFRS Foundation’s governance structure reasonably balances oversight of the IASB with supporting its independence. However, the IASB’s ongoing reliance on large U.S. accounting firms for funding is a concern.

   Regarding the IASB’s standard-setting *process*, project issues appear to be resolved based on the technical merits and usefulness to investors and other financial statement users. In addition, improvements have been made in gathering feedback from investors, but timeliness in addressing emerging issues still has room for improvement.

3. ***Investor understanding and education regarding IFRS.*** Investors appear to have widely varying degrees of familiarity with IFRS. Institutional and professional investors already seem to have sufficient IFRS knowledge. But investors that focus on U.S. issuers are hesitant to devote time and resources to learning about IFRS until it’s clearer to what extent IFRS will apply to U.S. issuers.

   Feedback from investors has indicated that they generally — but conditionally — support transitioning U.S. issuers to a single set of globally accepted accounting standards. Investors don’t want quality to be sacrificed to achieve this goal. They’re also concerned about the IASB’s independence and funding, as well as the timeliness of the IFRS Interpretations Committee, which is responsible for reviewing common accounting issues arising under IFRS and providing additional guidance on these issues.

4. ***Regulatory environment.*** Many federal and state laws refer directly to U.S. GAAP. Regulators have suggested that incorporating IFRS through GAAP could help address these issues and reduce otherwise problematic issues.

   Other regulator concerns relate to the extent to which they’d be able to provide input on IFRS standard-setting projects and the regulatory impact of IFRS’s lack of many industry-specific standards.

5. ***Impact on issuers.*** Feedback from issuers overall has shown support for transitioning to a single set of high-quality, globally accepted accounting standards, with larger issuers generally more supportive than their smaller counterparts. Issuers of all sizes, however, are looking for more clarity from the SEC on what its ultimate approach to further IFRS incorporation will be.

   Issuers are also concerned about the resources and costs associated with implementation of different standards. Many would like to see FASB incorporate IFRS into U.S. GAAP so that there’s a managed transition over time.

6. ***Human capital readiness.*** The degree to which issuers’ personnel are prepared for IFRS ranges from minimal to significant. Various other factors will also affect the human capital demands, including the transition method and the length of the transition period. A “big bang” approach with a short timeframe generally would put more pressure on human capital than an endorsement approach over a longer timeframe, which would provide an opportunity for personnel to develop their IFRS knowledge and skills following more traditional methods.

Alternatively, rather than investing substantial time and money in training current personnel (and incurring the opportunity cost of taking these employees away from their normal duties), issuers could hire new employees with IFRS knowledge and skills or retain consultants with the necessary expertise. But the demand for such candidates could far outweigh the supply, making this a costly option.

Next Steps

While the final report emphasizes that it isn't indicative of an SEC decision on IFRS, it's easy to infer that many concerns about incorporating IFRS into the financial reporting system for U.S. issuers will have to be addressed before the SEC will be ready to issue its decision. Combined with the delays in the IASB-FASB convergence projects, the report's findings seem to make it likely that it will be some time before we know the extent to which IFRS will apply to U.S. issuers. If you have questions about how the latest developments affect what, if anything, your company should be doing to prepare for the possibility of IFRS, please contact us.

FOR MORE INFORMATION

If you have questions, please contact Steven L. Henning, Partner-in-Charge of the Litigation and Corporate Financial Advisory Services Group, at 212.201.3179 or shenning@markspaneth.com.

ABOUT MARKS PANETH & SHRON

Marks Paneth & Shron LLP (MP&S) is a large, regional professional services firm offering a wide range of accounting, auditing, tax, consulting, restructuring, bankruptcy and advisory services as well as litigation and corporate financial advisory services to domestic and international clients. Click here to learn more.

IRS CIRCULAR 230 DISCLOSURE

Treasury Regulations require us to inform you that any Federal tax advice contained in this communication is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.