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

Progress Report
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OFFICE OF THE CHIEF ACCOUNTANT
DIVISION OF CORPORATION FINANCE
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

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Background

In the *Commission Statement in Support of Convergence and Global Accounting Standards*,[1] the U.S. Securities and Exchange Commission ("SEC" or "Commission") directed the staff of the Office of the Chief Accountant of the SEC, with appropriate consultation with other Divisions and Offices of the Commission (collectively, the "Staff"), to develop and execute a work plan ("Work Plan").[2] The Staff published the Work Plan in February 2010. The purpose of the Work Plan is to consider specific areas and factors relevant to a Commission determination in 2011 as to 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").[3] The Work Plan addresses the following areas:

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 process 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 transition 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.[4]

Since February 2010, the Staff has invested significant time and effort in executing the Work Plan. This progress report ("Progress Report") summarizes the objectives of each

[1] See SEC Release No. 33-9109 (February 24, 2010), Commission Statement in Support of Convergence and Global Accounting Standards ("2010 Statement").

[2] See Appendix to 2010 Statement.

[3] Hereafter, the term "IFRS" refers to "IFRS as issued by the International Accounting Standards Board ('IASB')" unless otherwise noted.

[4] Work Plan.

section of the Work Plan and discusses the Staff's efforts and preliminary observations to date, as applicable. Many of the Staff's efforts are currently in process and are not expected to be completed until 2011, particularly as they relate to consideration of the sufficient development and application of IFRS for the U.S. domestic reporting system and the independence of standard setting for the benefit of investors.

The Staff developed the Work Plan based on its understanding of the environment at the time of publication, with the expectation that the Work Plan would be re-assessed and adjusted as new information is obtained, developments occur, or constraints are encountered, with the intention of accomplishing each section's stated objective to the maximum extent possible.

In June 2010, the Financial Accounting Standards Board ("FASB") and the IASB (collectively, the "Boards") announced modifications to their timetable for and prioritization of standards being developed under the Boards' joint agenda in response to stakeholder concerns regarding "their ability to provide high-quality input on the large number of major [e]xposure [d]rafts planned for publication in the second quarter of this year."[5] In particular, the Boards committed to publishing exposure drafts in phases to enable more effective stakeholder participation in the standard-setting process and to improve the Boards' re-deliberation process. Consequently, the Boards have prioritized completion of certain of their joint projects by June 2011, while delaying completion of other projects until after the original June 2011 target date.[6]

In response to these modifications, SEC Chairman Schapiro stated the following:

> I foresee no reason that the adjustment to the targeted timeline for certain joint projects should impact the staff's analyses under the Work Plan issued in February 2010, particularly when that adjustment is designed to enhance the quality of the standards. Indeed, focused efforts on those standards the boards consider highest priority for the improvement of U.S. [generally accepted accounting principles ("GAAP")] and IFRS will facilitate the staff's analysis.[7]

In August 2010, the Board of Trustees of the Financial Accounting Foundation ("FAF"), which oversees the FASB, announced that the FASB will return to a seven-member structure, from its current five-member structure, to "enhance the FASB's investment in

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[5] See "IASB and FASB Issue Statement on their Convergence Work," IASB Web Announcement (June 2, 2010).

[6] The Boards have committed to completing their projects on financial instruments, revenue recognition, leases, the presentation of other comprehensive income, fair value measurement, balance sheet netting of derivative and other financial instruments, and the consolidation of investment companies by June 2011. Delayed projects include financial instruments with characteristics of equity, financial statement presentation, and presentation of discontinued operations. The timing of projects related to the consolidation of voting interest entities and derecognition is yet to be determined. (Collectively, these projects are referred to as "MoU projects.")

[7] "Chairman Schapiro Statement on FASB-IASB Decision to Modify Timing of Certain Convergence Projects," SEC Press Release No. 2010-96 (June 2, 2010).

the convergence agenda with the [IASB], while addressing the unprecedented challenges facing the American capital markets in the months and years ahead."[8] The transition to a seven-member board will occur as soon as the process to recruit and evaluate candidates is completed, which is expected in early 2011.[9] At the same time, FASB Chairman Robert Herz announced his plan to retire from the FASB.[10] Remarking on these changes, Chairman Schapiro expressed confidence in the FASB's ability to work with the IASB on "their important convergence work plan" and "to address issues facing the U.S. capital markets and the needs of investors."[11]

In addition, the following is a statement from Chairman Schapiro regarding the October 12, 2010 announcement by the Trustees of the IFRS Foundation, which oversees the IASB, that Hans Hoogervorst will be appointed chairman and Ian Mackintosh as vice-chairman of the IASB, upon retirement of current chairman Sir David Tweedie at the end of June 2011:[12]

> I commend the IFRS Foundation on the appointment of Hans Hoogervorst as chairman and Ian Mackintosh as vice-chairman of the IASB. Mr. Hoogervorst has a demonstrated track record representing the needs of investors, most recently in his roles as chairman of the Netherlands Authority for the Financial Markets, chairman of the Technical Committee of the IOSCO, and co-chair of the Financial Crisis Advisory Group. The IASB will also benefit from Mr. Mackintosh's considerable experience in standard setting, both as chairman of the UK Accounting Standards Board and chairman of an international group of national and regional standard setters. In their years of service, both Mr. Hoogervorst and Mr. Mackintosh have exhibited a commitment to improving financial reporting and protecting the independence of the standard setting process.

This Progress Report is the first update on the Staff's efforts and observations under the Work Plan. The Staff expects to continue to report periodically on the status of the Work Plan.

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[8] See "Financial Accounting Foundation to Increase Size of FASB; FASB Chairman Herz to Retire After More Than Eight Successful Years," FASB News Release (August 24, 2010).

[9] Ibid.

[10] Ibid.

[11] "Statement from Chairman Schapiro on Financial Accounting Foundation Developments," SEC Press Release No. 2010-154 (August 24, 2010).

[12] See "Trustees appoint Hans Hoogervorst to succeed Sir David Tweedie," IASB Press Release (October 12, 2010).

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

A. Introduction

The 2010 Statement noted 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."[13] 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."[14]

Accordingly, the Work Plan identified the following three components of an evaluation of whether IFRS is sufficiently developed and applied to be the single set of globally accepted accounting standards for U.S. issuers:

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

B. Description of Work Plan Efforts

The Staff is considering each of these three components by analyzing: (1) IFRS as issued by the IASB and (2) IFRS as applied in practice.

In considering the written standards, the Staff is evaluating the sufficiency of development of IFRS by comparing it to U.S. GAAP. The Staff is performing this comparison to provide a context in which to frame its evaluation, rather than to establish a minimum threshold of development that must be met for the incorporation of IFRS into the financial reporting system for U.S. issuers. The Staff is using U.S. GAAP specifically as its reference point because it is the body of standards that currently applies to U.S. issuers and from which investors would be required to adjust their analyses of U.S. issuers' financial statements.

In light of the Boards' efforts to converge IFRS and U.S. GAAP, this comparison focuses on those areas that are unaffected by the Boards' MoU projects. The Staff is separately evaluating the development of MoU projects through monitoring of the Boards' deliberations, review of exposure documents, and consideration of constituent comment

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[13] SEC Release No. 33-7801 (February 16, 2000), International Accounting Standards ("2000 Concept Release").

[14] Ibid.

letters, among other activities. The Staff's working assumption is that the results of the MoU projects, if finalized in accordance with the spirit and objectives of the MoU, will satisfy its considerations in those particular accounting areas.

The Staff's examination of IFRS as applied in practice involves a number of methods including: (1) constituent outreach, (2) research into the experiences of regulators in other jurisdictions that have incorporated or intend to incorporate IFRS into their financial reporting systems, and (3) a review of financial statements prepared under IFRS.

Through its outreach efforts, the Staff seeks to obtain constituent perspectives regarding the application of IFRS. These efforts largely consist of researching reports and publications; issuing requests for comment; and holding discussions with investors, issuers, auditors, regulators, and academics.

The Staff is also in the process of researching the experiences of regulators in other jurisdictions. In this regard, the Staff is seeking direct input from other jurisdictions on best practices, lessons learned, and other input based on their experience by surveying a sample of other securities regulators from the larger capital markets. This outreach covers not only the application of IFRS in practice, but also other areas of the Work Plan, as discussed throughout this Progress Report.

Finally, the Staff is reviewing IFRS financial statements of a significant number of entities, including non-SEC registrants, across a number of jurisdictions and industries, to evaluate the application of IFRS in practice. In conducting these reviews, the Staff has been analyzing accounting and disclosure policies and practices. These efforts are substantially underway and are intended to evaluate the extent to which entities in the Staff's sample reflect similar transactions in a similar manner under IFRS. For example, where IFRS provides limited guidance or options, such as with respect to certain aspects of financial statement presentation, the Staff is studying the effects on the comparability of IFRS financial statements across jurisdictions and industries.

As discussed further below, each of these steps is being tailored to evaluate the comprehensiveness of IFRS, the auditability and enforceability of IFRS, and the comparability of financial statements prepared under IFRS.

1. Comprehensiveness of IFRS

The Work Plan noted that the Staff will consider the comprehensiveness of IFRS by:

- Inventorying areas in which IFRS does not provide guidance or where it provides less guidance than U.S. GAAP.

- Analyzing how issuers, auditors, and investors currently manage these situations in practice.

- Identifying areas in which issuers, auditors, and investors would most benefit from additional IFRS guidance.

The Staff's evaluation of the comprehensiveness of IFRS is based on a comparison of U.S. GAAP and IFRS. This process is intended to identify the extent to which incorporation of IFRS into the financial reporting system for U.S. issuers would result in an increase or decrease of guidance, the extent to which a differential level of guidance improves financial reporting, and recommendations for improvement prior to any potential incorporation. Further, the Staff's ongoing constituent and foreign regulator outreach is expected to identify areas in practice in which industry groups, auditors, national standard setters, and regulators have published interpretations[15] of IFRS and the reasons for issuing such guidance.

The Staff also is obtaining stakeholder perspectives regarding whether less prescriptive standards result in improved disclosures that facilitate enhanced financial analysis; the areas in which additional guidance would result in the most significant improvements to financial statements prepared under IFRS; the consequences of the absence of specific guidance in these areas; how investors, preparers, and auditors currently address these consequences in practice; and potential recommendations for improvements and standard setting.

2. Auditability and Enforceability

The Work Plan noted that the Staff will consider the auditability and enforceability of IFRS by:

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

The Staff's evaluation of the auditability and enforceability[16] of IFRS in practice involves analysis of: (1) audit and regulatory challenges in the audit of financial statements prepared under IFRS and the enforcement of IFRS, (2) trends in error corrections and accounting-related enforcement actions, and (3) how auditors, private securities litigators, and regulators manage these challenges in practice.

[15] In this Progress Report, the phrases "interpretations of IFRS" and "interpretative IFRS guidance" refer to guidance issued by bodies other than the IASB (e.g., regulators, national standard setters, and audit firms).

[16] Enforceability includes both enforcement of securities laws (e.g., as performed by the Division of Enforcement) and reviews of financial statements (e.g., as performed by the Division of Corporation Finance).

The Staff is in the process of considering challenges in auditing financial statements prepared under IFRS and in enforcing IFRS and the related consequences of such challenges through constituent and foreign regulator outreach and review of foreign private issuer financial statements prepared under IFRS. For example, the Staff seeks to understand whether, and if so, why, there are areas in which auditors and regulators have felt constrained in requiring preparers to account for transactions in what they perceive to be the most meaningful manner under IFRS.

In addition, the Staff is analyzing trends in error corrections and accounting-related enforcement actions in the United States and abroad to determine whether use of IFRS may impair auditor and regulator efforts. For example, the Staff intends to assess the extent to which financial reporting-related enforcement cases under U.S. GAAP rely on the level of prescriptive guidance in accounting standards to determine whether the accounting standards (be it U.S. GAAP, IFRS, or another set of standards) themselves play a significant role in SEC enforcement activities.[17] In light of the different regulatory environments around the globe, the Staff expects this analysis to be affected by differing regulator restatement and enforcement mandates and processes.

The Staff also is exploring how auditors, private securities litigators, and regulators manage these challenges. For example, the Staff is considering the extent to which auditors and regulators have developed interpretative IFRS guidance to alleviate auditability and enforceability concerns, as compared to the extent of interpretative U.S. GAAP guidance, through its survey of such guidance, as discussed in section I.B.1 above, and the need for improvements to IFRS to address these areas. In addition, the Staff will solicit input from auditors regarding their process for determining the appropriate auditing procedures if IFRS or U.S. GAAP lacks specific requirements and the extent to which auditing standards issued by the Public Company Accounting Oversight Board ("PCAOB") may require modification to facilitate the audit of financial statements prepared under IFRS.

3. Comparability Within and Across Jurisdictions

The Work Plan noted that the Staff will consider the comparability of financial statements prepared under IFRS by:

- Analyzing factors that may influence the degree of comparability of financial statements prepared under IFRS on a global basis.

- Assessing the extent to which financial statements prepared under IFRS may not be comparable in practice and how investors manage these situations.

[17] For example, an in-depth evaluation of accounting standards would not be required in enforcement cases that allege an intentional overstatement of revenue through the creation of fictitious invoices. However, careful interpretation and analysis of the relevant accounting standards may be required when evaluating other types of allegations.

- Identifying ways to improve the comparability of financial statements prepared under IFRS on a cross-border basis to provide the most benefit for investors.

The Staff's comparison of U.S. GAAP to IFRS is expected to provide insight into whether use of IFRS may diminish comparability of financial statements due to less prescriptive guidance, silence, or availability of options, as compared to U.S. GAAP, and if so, in which areas. In performing this analysis, the Staff recognizes that while detailed rules may drive uniformity in application, this may not consistently lead to comparability in the reporting of economically similar transactions and, therefore, less detailed guidance cannot unilaterally be equated with diminished comparability.

To analyze the extent to which the use of IFRS promotes comparability in practice, the Staff is undertaking a number of steps. First, the Staff is assessing the manner in which IFRS is incorporated into the financial reporting frameworks of other jurisdictions, as described further in section I.C below. The purpose of this assessment is to identify possible approaches to the incorporation of IFRS into the U.S. financial reporting system; analyze how other jurisdictions incorporate IFRS into their reporting systems and address concerns regarding the sovereignty of capital market regulators, national standard setters, and other bodies responsible for setting accounting standards; and evaluate the effect of these approaches on the comparability of IFRS financial statements on a global basis. The Staff is obtaining this information through research of publicly-available information and is validating its research through its outreach to foreign regulators.

Second, the Staff's review of financial statements prepared under IFRS and the observations of foreign regulators is intended to identify trends regarding compliance with IFRS and comparability of such financial statements across industries and jurisdictions.

Third, the Staff is leveraging its survey of areas in which industry groups, auditors, national standard setters, and regulators have published interpretative IFRS guidance, as discussed in section I.B.1 above, to determine the extent to which this guidance promotes or undermines the comparability of financial statements prepared under IFRS across jurisdictions.

Fourth, the Staff is obtaining an understanding and evaluating the effectiveness of audit and regulatory processes to promote comparability. These processes include those used by audit firms to manage potential diversity among their client base for identical fact patterns within and across jurisdictions and those related to sharing of information among securities regulators, as discussed in the Work Plan. The Staff is in the process of obtaining this information through outreach to foreign regulators, interviews with audit firms, and collection of its own experience.

Finally, the Staff is in the process of obtaining stakeholder perspectives through a survey of reports and publications, comment letter requests, and interviews regarding the areas in which financial statement comparability are of the most significance to them, how they compensate for any diminished comparability, and potential recommendations for improvement.

C. Preliminary Observations

1. Background

Proponents of incorporation of IFRS into the financial reporting system for U.S. issuers maintain that a significant number of jurisdictions already use IFRS and that such incorporation would promote more efficient capital markets on a global basis. Often implicit in this assertion is an assumption that these jurisdictions all incorporate IFRS into their financial reporting systems in the same form and manner or that the manner of incorporation does not impact comparability. The Staff currently is identifying possible approaches to the incorporation of IFRS into the U.S. financial reporting system; analyzing how other jurisdictions incorporate IFRS into their reporting systems and address concerns regarding the sovereignty of capital market regulators, national standard setters, and other bodies responsible for setting accounting standards; and evaluating the effect of these approaches on the comparability of IFRS financial statements on a global basis.

To accomplish these objectives, the Staff is researching the financial reporting framework used in a sample of jurisdictions. These jurisdictions[18] span six continents and encompass over 90 percent of world gross domestic product ("GDP").[19] The Staff is examining each jurisdiction's accounting laws and regulations, as well as public statements and press releases made by the jurisdiction's regulators and accounting standard setters. The Staff also is examining the World Bank's *Reports on the Observance of Standards and Code (ROSC) – Accounting and Auditing* and the United Nations Conference on Trade and Development's *Practical Implementation of International Financial Reporting Standards*: *Country Case Studies on IFRS*, as well as submissions by jurisdictions' professional accounting organizations to the International Federation of Accountants' Member Compliance Program.

2. Approaches to Incorporating IFRS into a Jurisdiction's Financial Reporting System

Based on the Staff's research to date, the majority[20] of the Staff's sample of jurisdictions has incorporated or intends to incorporate IFRS either in full or to some extent into their reporting requirements for listed companies. However, the manner in which these jurisdictions incorporate IFRS into their financial reporting systems covers a broad spectrum of approaches.

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[18] The Staff has included the United States in its sample.

[19] All GDP figures based on the International Monetary Fund's World Economic Outlook Database, Country-level Gross Domestic Product, current prices, in U.S. dollars, published April 2010. (available at: http://www.imf.org)

[20] The majority is both in terms of number of jurisdictions and percentage of GDP.

Generally, jurisdictions have incorporated IFRS by either: (1) use of IFRS as issued by the IASB and (2) use of IFRS after some form of a national incorporation process, which could lead to the full use of IFRS as issued by the IASB or some local variation.[21] The first category could be viewed as representing the purest form of "adoption of IFRS." Under this first approach, countries make no changes to the standards issued by the IASB, because there is no mechanism to make a change. The standards are applicable once issued by the IASB without approval by any local body. While this approach, if adopted by all jurisdictions, would seem to result in the most consistent application of IFRS, it also results in a much greater degree of relegation of the local regulator's authority and responsibility for investor protection to a global private sector and independent standard-setting body with a multinational constituent base. Based on the Staff's research thus far, a very small minority of the largest jurisdictions currently follows this approach.

The second category consists of countries that use IFRS after some form of a national incorporation process. In most cases, these jurisdictions have the objective of full IFRS adoption, but some jurisdictions following this approach have not necessarily adopted the standards as issued by the IASB or done so in the same periods, resulting in the potential for difference in application. While this approach allows for the most flexibility in addressing country-specific issues, it may have an impact on the goal of a single set of global accounting standards, as there is no guarantee that the local or regional standards will be identical to IFRS as issued by the IASB. This category may be further divided into: (1) those countries that converge their local standards with IFRS ("Convergence Approach") without a firm commitment to adopt fully IFRS as issued by the IASB and (2) those countries that undertake some form of local endorsement ("Endorsement Approach").

Convergence Approach

Under the Convergence Approach, jurisdictions do not adopt IFRS as issued by the IASB or incorporate them into their accounting standards directly. Instead, these jurisdictions maintain their local standards but make efforts to converge those standards with IFRS over time.

One example of a country using the Convergence Approach is China, which is moving its standards closer to IFRS without necessarily incorporating IFRS fully into its national framework. The Accounting Law of the People's Republic of China ("Accounting Law") requires companies to prepare financial statements in accordance with Accounting Standards for Business Enterprises ("ASBEs") set by the Ministry of Finance.[22] These standards are drafted by the Accounting Regulatory Department of the Ministry of Finance ("Accounting Department") and based on a conceptual framework developed by

[21] As discussed later, the countries within the European Union ("EU") provide an example of an incorporation process.

[22] See Accounting Law, Article 51. (English translation available at http://extranet.casc.gov.cn/internet/internet/en/kjfg2/acctlaw/chp7.html.)

the China Accounting Standards Committee.[23] The Accounting Department initiates a standard based on the needs of Chinese economic development.[24] After releasing an exposure draft and soliciting public comments, the Ministry of Finance can decide to approve a standard or return it to the Accounting Department for revision.[25]

Though China's Accounting Law makes no reference to IFRS, the country has been converging its standards for several years. In 2006, Ministry of Finance Order No. 33 declared a revised set of ASBEs would become effective in 2007. According to the World Bank, these ASBEs are "substantially converged" with IFRS.[26] On September 2, 2009, China issued an exposure draft of its *Roadmap for Continuing and Full Convergence of the Chinese Accounting Standards for Business Enterprises with the International Financial Reporting Standards*.[27] Based on this exposure draft, China has indicated that it intends to make an effort to eliminate the existing differences between ASBEs and IFRS by 2011.

Endorsement Approach

The vast majority of countries in the Staff's sample appear to be following an Endorsement Approach. This is so because a large number of jurisdictions in the Staff's sample are countries within the European Union ("EU"), as discussed further below. Under this approach, countries incorporate an IFRS standard into their jurisdictions' standards. The degree of deviation from IFRS as issued by the IASB varies under this approach. In some cases, countries adopt standards exactly as issued by the IASB. In other cases, countries translate IFRS as issued by the IASB into their local language. In still other cases, countries make modifications to address country-specific issues or the perceived need for certain industry-specific guidance.

As noted above, the countries within the EU represent the largest example of this method. On July 19, 2002, the European Parliament and European Council passed Regulation (EC) No 1606/2002, on the application of international accounting standards. This regulation requires companies governed by the law of an EU Member State ("Member State") to prepare their consolidated financial statements in accordance with the international accounting standards adopted by the European Commission ("EC"), if the company's securities are traded on a regulated market in any Member State. The requirement entered into force in 2005 and is binding and applicable to all Member States.

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[23] See China Accounting Standards Committee (English translation) Web site: "Procedures for Setting Accounting Standards" (at http://extranet.casc.gov.cn/internet/internet/en/ZZWJJ/zhidingchengx.html) and "Work Outline of the China Accounting Standards Committee" (at http://extranet.casc.gov.cn/internet/internet/en/ZZWJJ/gongzuodagang.html).

[24] Ibid.

[25] Ibid.

[26] See World Bank, Report on the Observance of Standards and Codes (ROSC) – Accounting and Auditing: People's Republic of China (October 2009) ("World Bank Report on China").

[27] See Appendix to World Bank Report on China.

A newly-issued IFRS must go through multiple steps before it becomes authoritative in the EU. With each step, there is an opportunity to consider and potentially modify the standard issued by the IASB, as evidenced by the EU "carve-out" of IAS 39, *Financial Instruments: Recognition and Measurement*, for certain entities and the European Financial Reporting Advisory Group's ("EFRAG") (see discussion below) decision not to finalize its endorsement advice on IFRS 9, *Financial Instruments*.[28] Companies whose securities are admitted to trading on a regulated market of any Member State, as defined, need only apply those IFRS that are adopted by the EC.[29]

Once the IASB issues a standard, EFRAG holds consultations with interest groups[30] and provides advice to the EC on the technical quality of IFRS, filling the role of a technical committee providing support and expertise to the EC.[31] In this role, EFRAG issues opinions assessing whether standards issued by the IASB: (1) allow companies to make a true and fair representation of their financial position, per the Fourth and Seventh Directives of the Council of European Communities, (2) meet the criteria of understandability, relevance, reliability, and comparability for financial information to be useful in making economic decisions and assessing the stewardship of management, and (3) are conducive to the European public good.[32]

Once EFRAG issues it opinion, the Standards Advice Review Group ("SARG") issues its own opinion evaluating the validity of EFRAG's advice. The SARG is a group of independent experts and high-level representatives from national standard setters that was created to advise the EC on whether an EFRAG opinion is well-balanced and objective.[33]

If the advice of EFRAG and the opinion of SARG are favorable, the EC prepares a draft endorsement regulation.[34] Pursuant to this procedure, the Accounting Regulatory

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[28] See "IFRS 9 endorsement advice postponed," EFRAG Web Announcement (November 11, 2009). The Staff notes that application of IFRS 9, as issued by the IASB, is effective for annual periods beginning on or after January 1, 2013. Accordingly, should IFRS 9 be endorsed in the EU prior to its effective date, this delay may have no impact in practice.

[29] See Regulation (EC) No 1606/2002, Article 4.

[30] See EC, chart "International Accounting Standards and Interpretations endorsement process in the EU." ("EU Endorsement Process Chart") (available at: http://ec.europa.eu)

[31] See Regulation (EC) No 1606/2002, Recital 10. See also, "Working Arrangement Between European Commission and EFRAG" (March 23, 2006). (available at: http://www.efrag.org)

[32] See Regulation (EC) No 1606/2002, Article 3.

[33] The SARG was created by 2006/505/EC, *Commission Decision of 14 July 2006 setting up a Standards Advice Review Group to advise the Commission on the objectivity and neutrality of the European Financial Reporting Advisory Group's (EFRAG's) opinions*. See also, EU Endorsement Process Chart.

[34] Subject to regulatory procedure with scrutiny, as required by 1999/468/EC, *Council Decision of 28 June 1999 laying down the procedures for the exercise of implementing powers conferred on the Commission*. See also, EU Endorsement Process Chart.

Committee ("ARC") votes on the draft prepared by the EC.[35] If the draft receives a majority of votes from the ARC, the European Parliament and the Council of the EU have three months to oppose endorsement of the standard; if not opposed, the standard is published in the Official Journal of the EU and becomes enforceable.[36] Once published in the Official Journal, the standards become a binding part of EC regulation, amending the original regulation adopting IFRS to include the new standards.

Australia represents another example of the Endorsement Approach. The Australian Framework includes the IASB Framework, but adds paragraphs specific to Australia where required by the Australian legislative environment.[37] The AASB converts each IASB standard, standard amendment, and interpretation into Australian law in accordance with legislative drafting protocols and in accordance with the Federal Register of Legislative Instruments requirements. In addition, each time the IASB has issued an exposure draft or invitation to comment, the AASB has published an equivalent document, with an Australian Preface. Further, the AASB has kept pace with the final standards issued by the IASB, with each new standard being issued with the same application date as set by the IASB. In the Corporations Amendment (Corporate Reporting Reform) Bill of 2010, enacted as Act. No. 66 of 2010, the Australian Parliament declared that companies required to report in IFRS must include in the notes to their financial statements an explicit unreserved statement of compliance with IFRS.

3. Role of the National Standard Setter

The Staff also has been examining the role of the national standard setter under the above approaches to further consider the existence of jurisdictional variations of IFRS and to identify potential roles for the FASB, should the Commission decide to incorporate IFRS into the financial reporting system for U.S. issuers. In the 2010 Statement, the Commission stated its belief that:

> 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.

Not all jurisdictions make use of a private sector standard-setting body. Instead, in some jurisdictions, accounting standards are set directly by the securities regulator, the ministry

[35] The ARC was established by Regulation (EC) No 1606/2002, Article 6. See also, EU Endorsement Process Chart.

[36] See Regulation (EC) No 1606/2002. See also, EU Endorsement Process Chart.

[37] The law does not specify the exact mechanism by which the Australian Accounting Standards Board ("AASB") translates IFRSs into Australian standards. IFRS adoption in Australia by the AASB occurred under a broad strategic direction given to the AASB by the Financial Reporting Council ("FRC") under the powers given to the FRC by the legislation. The FRC is the peak body responsible for the broad oversight of the accounting and auditing standards setting processes in Australia.

of finance or its equivalent, or some other government entity. For situations in which a jurisdiction previously made use of a private sector standard setter, the Staff has observed to date that the majority of these jurisdictions retain their national standard setter subsequent to incorporating IFRS into their financial reporting systems. In these cases, the national standard setter's ongoing role may involve, depending on the jurisdiction's approach to incorporation, converging local standards with IFRS, adopting IFRS standards after IASB issuance, issuing interpretations of IFRS for application in their jurisdiction, contributing to the IASB standard setting process, facilitating a dialogue between the IASB and constituents in their jurisdiction, and providing advisory assistance to the securities regulator.[38]

The national standard setter also may be involved in issuing standards for entities not required to apply IFRS, such as certain private companies, not-for-profit entities, and governmental entities, and for statutory reporting purposes. While listed companies in the majority of countries in the Staff's sample are required to use IFRS in some form for consolidated financial reporting purposes, as discussed above, their statutory reporting requirements vary. Some jurisdictions permit the application of IFRS by listed companies for statutory purposes if applied for consolidated financial reporting purposes. However, some jurisdictions require listed companies to apply a modified version of IFRS, local standards, or a hybrid of IFRS and local standards for areas not covered by IFRS.[39]

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[38] For example, see comment letter from UK Financial Reporting Council 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, SEC Release No. 33-8982 (November 14, 2008) ("Proposed Roadmap").

[39] The Staff notes that the latter two approaches may indirectly diminish comparability across jurisdictions to the extent that listed companies select accounting policies to minimize differences between consolidated financial reporting and statutory reporting, effectively creating a statutory jurisdictional variation to the application of IFRS for consolidated financial reporting. The Staff expects feedback from foreign regulators and its review of financial statements prepared under IFRS to provide insight into this issue.

II. Independent Standard Setting for the Benefit of Investors

A. Introduction

The 2010 Statement noted 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." Pursuant to the Work Plan, the Staff is considering the following four components 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:

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

Subsequent to the date of publication of the Work Plan, the Monitoring Board, which oversees the IFRS Foundation, committed to a review of its governance framework and that of the IFRS Foundation and, in doing so, has established a working group to conduct the review. According to the Monitoring Board's statement, this review involves assessment of:

> Whether the current governance structure adequately:
> - provides appropriate representation for relevant authorities such as capital market and other public authorities;
> - creates sufficient transparency and accountability of the IASB to relevant authorities such as capital market and public authorities;
> - ensures the appropriate involvement of all relevant stakeholders in the standards elaboration process;
> - ensures that all relevant public policy objectives are taken into account in the standard setting process; and
> - protects the IASB's independent standard setting process.
>
> The review will focus on the overall governance model of the IFRS Foundation including the composition of the Monitoring Board. The [w]orking [g]roup aims to finish its job at the end of the year.[40]

[40] "Statement of the Monitoring Board for the International Financial Reporting Standards Foundation regarding the Governance Review of the IFRS Foundation," IFRS Foundation Monitoring Board Press Release (July 2, 2010).

B. Description of Work Plan Efforts

1. Oversight of the IFRS Foundation

The Work Plan stated that the Staff would consider the oversight of the IFRS Foundation by:

> Analyz[ing]…the extent to which the Monitoring Board is functioning as designed…. Specifically, the Staff will analyze the operations of the Monitoring Board and assess any areas for improvement.[41]

The Staff is considering the Monitoring Board's existing governance materials and materials from its meetings and plans to consider the results of the Monitoring Board's governance review to assess whether the current and any planned future changes to the governance structure and operations provide for the effective "monitor[ing] and reinforce[ment] [of] the public interest oversight function of the [IFRS Foundation], while preserving the independence of the IASB."[42]

In addition, the Staff will consider stakeholder perspectives regarding the Monitoring Board, as obtained through a survey of reports and publications, review of comment letters received on the Commission's Proposed Roadmap and the IFRS Foundation's Constitution Review, and interviews with constituents.

Critical to this evaluation will be the extent to which the Monitoring Board's oversight role continues to support the independent setting of standards that promotes the Monitoring Board's previous statement on the purpose of financial reporting:[43]

> We view the primary objective of financial reporting as being to provide information on an entity's financial performance in a way that is useful for decision-making for present and potential investors. To be considered decision-useful, information provided through the application of the accounting standards must, at a minimum, be relevant, reliable, understandable and comparable.

In light of the timing of the Monitoring Board's governance review, the Staff expects to perform a significant portion of the work on this component in early 2011.

2. Composition of the IFRS Foundation and the IASB

The Work Plan stated that the Staff would consider:

> The extent to which the composition of the IFRS Foundation and the IASB

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[41] Work Plan.

[42] Charter of the IASCF Monitoring Board (April 2009).

[43] See "Statement of the Monitoring Board for the International Accounting Standards Committee Foundation on Principles for Accounting Standards and Standard Setting," IFRS Foundation Monitoring Board Press Release (September 22, 2009).

> promotes the independent development of accounting standards for the ultimate benefit of investors….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.

The Staff will analyze the IFRS Foundation and IASB's governance documents, as supplemented by the results of the Monitoring Board's governance review, to assess the composition of the IFRS Foundation and the IASB. In addition, the Staff will analyze stakeholder perspectives in this area, as obtained through a survey of reports and publications, requests for comment, review of comment letters received on the Proposed Roadmap and the IFRS Foundation's Constitution Review, and interviews with constituents.

In light of the timing of the Monitoring Board's governance review, the Staff expects to perform a significant portion of the work on this component in early 2011.

3. Funding of the IFRS Foundation

In the 2010 Statement, the Commission recognized the importance of independent funding to support a standard-setting process free of undue influence for the ultimate benefit of investors. The Work Plan noted that the Staff would consider: (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 by:

- Evaluating whether the Trustees' four characteristics governing the establishment of a funding approach are appropriate.
- Monitoring 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.
- Exploring alternatives for funding mechanisms in the United States.

To accomplish these objectives, the Staff is evaluating the Trustees' four principles governing their funding efforts through review of publicly available documents and outreach and analysis of constituent perspectives.

In addition, the Staff is analyzing how the IFRS Foundation and IASB are funded in practice through review of publicly available data and outreach to foreign regulators. This assessment will involve funding mechanisms currently used, as well as those proposed or intended to be used in the future.

The Staff is also in the process of considering a range of possibilities with respect to contributions to the IFRS Foundation and the IASB from the United States, as described further in the section II.C below. In this regard, the Staff is considering approaches utilized by other jurisdictions, based on its research above; mechanisms used to fund the FASB; and other potential alternatives, as provided by relevant legal statutes, such as the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley Act"). The Staff further intends to gather and analyze constituent perspectives regarding the role the United States should play in funding of the IFRS Foundation and the IASB.

4. IASB Standard-Setting Process

This component of the Work Plan involves three areas: (1) pre-eminence of investors, (2) timeliness, and (3) objectivity. The Work Plan stated that the Staff would perform the following in these areas:

- Explore the extent to which the IASB promotes the pre-eminence of investor views.
- Assess the IASB's ability to resolve emerging issues in a timely and effective manner without compromising due process.
- Assess the adequacy of the IASB's independence and objectivity during recent standard-setting efforts.

For each area, the Staff is in the process of reviewing the IASB's policies and procedures and its compliance with those policies, as supplemented by the results of the Monitoring Board's governance review, to accomplish the above objectives. In addition, the Staff will continue to analyze stakeholder perspectives in each area, as obtained through a survey of reports and publications, requests for comment, review of comment letters received on the Proposed Roadmap and the IFRS Foundation's Constitution Review, and interviews with constituents. Further, the Staff will form views regarding the extent to which the IASB promotes the above areas through its monitoring of the development of IASB standards. For example, the Staff will compare investor views as expressed in comment letters and at roundtables to recent, final standard-setting outcomes to assess why there are differences between these views and the outcomes and the extent to which these differences are justifiable. The Staff considers the interpretations process an integral part of the standard-setting process, and, as such, will review the functioning of the IFRS Interpretations Committee as part of these procedures.

C. Preliminary Observations

1. Current IFRS Foundation Funding Model

According to its governance structure, the IFRS Foundation has the responsibility for securing stable funding for the IASB,[44] but, as a non-governmental organization, it has

[44] The IFRS Foundation Monitoring Board confers with the IFRS Foundation Trustees regarding their oversight responsibilities regarding the adequacy and appropriateness of the sources of funding and any other revenue arrangements of the IFRS Foundation, as well as the annual budget of the IFRS Foundation.

no authority to impose funding requirements.[45] In principle, the IFRS Foundation believes that it is appropriate to determine the amount of funding to seek from each country based on each country's GDP.[46] IFRS Foundation Trustees assigned to specific countries are charged with the fundraising effort for that jurisdiction.[47] According to the IFRS Foundation, the Trustees work closely with regulatory and other public authorities and key stakeholder groups to generate the targeted contribution level from each jurisdiction.[48] In addition, a number of jurisdictions have introduced or are considering more formal contribution mechanisms through government entities, standard-setting authorities, or stock exchanges, as discussed further below.

Despite these efforts, the effort to achieve long-term mandatory funding commitments for the IFRS Foundation is not complete. Based on current existing funding commitments, the IFRS Foundation has indicated that it could be in an operating deficit for fiscal year 2010.[49] In addition, the IFRS Foundation indicated it could expect a $4 million funding "gap" with respect to its self-determined contribution target for the United States.[50]

In 2009, contributions to the IFRS Foundation from international accounting firms accounted for approximately a third of the IFRS Foundation's total contributions.[51] This statistic increases slightly when contributions from affiliated firms in individual jurisdictions are included.

In its 2009 Annual Report, the IFRS Foundation cited contributions from organizations in 31 jurisdictions from the Americas, Europe, Asia-Oceania, and Africa.[52] Not all jurisdictions that have incorporated IFRS in some form as part of their financial reporting system contribute to the IFRS Foundation. In fact, based on the Staff's initial research, it appears that less than 25% of these countries contribute; in other words, three out of four

(See Memorandum of Understanding to Strengthen the Institutional Framework of the International Accounting Standards Committee Foundation (April 2009).)

[45] See IASC Foundation Constitution (Effective March 1, 2010). The discussion in this section also draws heavily from the description of financing on the IFRS Foundation Web site. ("IFRS Foundation - Financing page") (http://www.ifrs.org/The+organisation/Governance+and+accountability/Financing/Financing.htm)

[46] See, e.g., "Four Principles ensuring sustainable funding," Insight: The Journal of the IASB and the IASC Foundation (Q1/Q2, 2008).

[47] See Notes to the Financial Statements, "3. Contributions," IFRS Foundation Annual Report 2009 ("2009 Annual Report").

[48] See IFRS Foundation - Financing page.

[49] See 2009 Annual Report.

[50] Ibid.

[51] Calculated based on data in the 2009 Annual Report.

[52] See 2009 Annual Report.

countries reported by the IFRS Foundation as permitting or requiring some form of IFRS provide no monetary funding.[53]

Conversely, the two national jurisdictions with the largest contributions in 2009 were the United States (£1.85 million)[54] and Japan[55] (£1.74 million),[56] neither of which have formally incorporated IFRS into the financial reporting system for their domestic reporting issuers. In fact, voluntary contributions from the United States, principally from large U.S. companies, have been the largest country-specific source of funds to the IFRS Foundation. During 2009, 2008, and 2007, payments from U.S.-based contributors accounted for 17 percent,[57] 22 percent,[58] and 26 percent,[59] respectively, of the IFRS Foundation's country-specific funding. The amount of contributions from the United States, relative to those from other jurisdictions, would be even higher if "contributed services" from the FASB through the FASB's convergence efforts with the IASB were included.[60]

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

The Staff is in the process of researching various models used to contribute to the IFRS Foundation through a review of publicly-available information from the IFRS Foundation, securities regulators, national standard setters, and other sources. The Staff intends to supplement and validate this data through outreach to foreign regulators.

The Staff's review thus far has shown that contributions to the IFRS Foundation are generated through several methods. Some countries contribute from the general funds of their financial sector regulators (e.g., securities commission, central bank, ministry of finance or equivalent body), stock exchanges, or national standard setters. In other countries, these bodies may assess a levy on listed companies and make their contribution

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[53] The 2009 Annual Report lists the number of countries that provide funding and indicates that almost 120 countries make use of IFRS in their local jurisdictions.

[54] The Commission allows IFRS reporting by foreign private issuers. Further, in May 2008, the governing Council of the American Institute of Certified Public Accountants' ("AICPA") voted to designate the IASB as an accounting body for purposes of establishing international financial accounting and reporting principles, thus granting AICPA members the option to use IFRS as an alternative to U.S. GAAP. See "AICPA Council Votes to Recognize the International Accounting Standards Board as a Designated Standard Setter," AICPA News Release (May 18, 2010).

[55] The Japanese Cabinet Office Ordinances allow Japanese listed companies that meet certain requirements the option to prepare their consolidated financial statements for fiscal years ending on or after March 31, 2010 using IFRS designated by the Commissioner of the Financial Services Agency.

[56] See 2009 Annual Report.

[57] Calculated based on data in the 2009 Annual Report.

[58] Calculated based on data in the IFRS Foundation 2008 Annual Report.

[59] Calculated based on data in the IFRS Foundation 2007 Annual Report.

[60] The Staff notes that the IASB also contributes services to the FASB, as part of the Boards' convergence efforts.

from this assessment. In some cases, these levies are required to be paid by law or regulation, whereas in others, amounts suggested by the levies are voluntary. Alternatively, contributions in some countries, such as the United States, come directly from voluntary contributions by the private sector.[61] Further, a significant amount of intellectual capital and staffing is provided to the IASB by national standard setters and others, but the IASB does not pay a market rate for such support.

The EU has traditionally left funding of the IFRS Foundation to occur on a per country basis. In addition to individual country contributions, the EU passed a regulation in 2009 establishing an EC program that would support the IFRS Foundation. Decision No 716/2009/EC ("Decision") creates a program through which the EC supports the IFRS Foundation through grants of up to €12.75 million from 2011 – 2013.[62] The Decision cites the goal of ensuring that the IFRS Foundation benefits from clear, stable, diversified, sound, and adequate funding, enabling it to accomplish its mission in an independent and efficient manner.[63] The Decision also states, however, that beneficiaries of funds shall not continue to benefit from contributions unless they make significant progress towards securing a majority of their total funding arrangements from neutral funding agreements, including third-country participants within two years.[64]

3. Funding of the FASB

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

Before enactment of the Sarbanes-Oxley Act, funding for the FASB was provided through the FAF via a combination of fundraising contributions and publication revenue. This model generated concerns both as to the potential or perceived risks that contributions could be affected by FASB actions, as well as the involvement of accounting firms in the funding process.[65]

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[61] See 2009 Annual Report.

[62] *Decision No 716/2009/EC of the European Parliament and of the Council of 16 September 2009 establishing a Community programme to support specific activities in the field of financial services, financial reporting and auditing,* Article 9.

[63] Decision No 716/2009/EC, Recital 15.

[64] Decision No 716/2009/EC, Article 4.

[65] 148 CONG. REC. S6633 (July 11, 2002) (statement of Sen. Sarbanes). ("Their problem in the past has been that they are voluntarily funded from the industry. They have to go to them and beg for money in order to carry out their activities. And if the industry thinks they are going to do a ruling that is contrary to what they want, then they are not as willing to support their activity. We eliminate that in this bill because we have a mandatory fee...So that, in itself, is a very important and significant step in establishing the independence of the accounting standards board.")

The Sarbanes-Oxley Act statutorily codified the Commission's ability to recognize a private entity's accounting standards as "generally accepted" for purposes of the federal securities laws. Specifically, Section 108 of the Sarbanes-Oxley Act amended the Securities Act of 1933 to provide that the Commission may recognize accounting principles established by a standard-setting body as "generally accepted" if the body:

- is organized as a private entity;
- has, for administrative and operational purposes, a board of trustees serving in the public interest, the majority of whom are not, concurrent with their service on such board, and have not been during the two-year period preceding such service, associated persons of any registered public accounting firm;
- is funded as provided in Section 109 of the Sarbanes-Oxley Act;
- has adopted procedures to ensure prompt consideration, by majority vote of its members, of changes to accounting principles necessary to reflect emerging accounting issues and changing business practices; and
- considers, in adopting accounting principles, the need to keep standards current in order to reflect changes in the business environment, the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors.

In 2003, the Commission issued a policy statement finding that the FAF and the FASB met these criteria and recognized FASB's standards as "generally accepted" for purposes of the federal securities laws.[66] In that policy statement, the Commission also articulated additional expectations related to Commission oversight of the FAF and the FASB, including timely response by the FASB to referrals from Commission staff and participation in the appointment process for FAF and FASB members.

As to funding, the legislative history of the Sarbanes-Oxley Act indicates that a stable and independent funding source without involvement from the accounting industry was an important consideration.[67] There also were concerns that funding through legislative appropriation could present potential and perceived risks to independence.[68] Section 109

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[66] See SEC Release No. 33-8221 (April 25, 2003).

[67] See, e.g., 148 CONG. REC. S7362 (July 25, 2002) (statement of Sen. Dodd). ("Having FASB now be compensated for and paid for from public money and not relying on the largess and generosity of the accounting industry to receive compensation will make a significant difference in establishing accounting rules and procedures"). See also, 148 CONG. REC. S6696-S6697 (July 22, 2002) (statement of Sen. Levin) ("The [FASB] issued an exposure draft called, 'Accounting for Stock-Based Compensation,' and they decided that stock option values should be expensed.….Then in paragraph 60 of their findings, the FASB board said the following, that 'the debate on accounting for stock-based compensation unfortunately became so divisive that it threatened the board's future working relationship with some of its constituents. The nature of the debate threatened the future of accounting standards-setting in the private sector.' This is an extraordinary document and everybody should read it so people understand the kind of pressure that not only that board was under—hopefully, the newly independently funded board will not be under—but the kind of pressure which exists in this Congress. We have, in essence, a new board, because it has an independent source of funding.")

[68] See 148 CONG. REC. S7355 (July 25, 2002) (statement of Sen. Enzi) ("We did something marvelous for the FASB. We made sure of its independence. One way we made sure of its independence, besides citing

of the Sarbanes-Oxley Act provides that all of the budget of a standard-setting body that satisfies the criteria under Section 108 of the Sarbanes-Oxley Act must be payable from an annual accounting support fee assessed and collected against issuers, as may be necessary or appropriate to pay for the budget and provide for the expenses of the standard setting body, and to provide for an independent, stable source of funding, subject to review by the Commission.[69]

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

4. Next Steps

As noted above, the Staff will continue to study potential contribution mechanisms from the United States. The Commission has previously recognized that the international nature of the IASB, including the expectation that it be responsive to many different constituencies, would mean that the interaction of the Commission and the Staff with the IASB would differ from interactions and oversight with respect to the FASB.[70] The IASB and the IFRS Foundation do not meet some of the structural requirements in Section 108, such as the requirement for standard-setter action by majority vote, as the IASB acts by super-majority vote. In addition, the requirements of existing Section 109, such as that all of the budget of the standard setter should come from an accounting support fee assessed on SEC-registered entities and is subject to annual Commission review of the fee, also are likely not possible for an international body such as the IASB.

The Staff will continue to gather additional information about contribution alternatives, including the funding mechanisms used in other jurisdictions. For example, in several jurisdictions, the national standard setters may participate in efforts to develop contributions, either through a direct payment[71] or by assisting with fundraising

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in the law, was to make sure FASB has independent funding. They will not have to come to Congress with a budget. And they will not have to go to corporate America for funding. They will get independent funding to be able to do the job they need to do. That will inhibit us from trying to change what they are doing in setting accounting standards.")

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

[70] See Proposed Roadmap.

[71] For example, some national standard setters directly contribute to the IFRS Foundation from their operating budgets.

activities.[72] Several other alternatives, such as creating a separate fee or authorizing the Commission to use appropriated funds to contribute to the IFRS Foundation and the IASB, could potentially require Congressional action. The Staff's consideration also will be informed by the legislative history concerning the funding mechanism established for the FASB, which appears to express a preference against mechanisms that could result in pressures on its standard setting, such as funding from contributions from the accounting industry or through direct Congressional appropriations.

[72] For example, we understand that some national standard setters help organize contribution campaigns that tap into their constituent networks.

III. Investor Understanding and Education Regarding IFRS

A. Introduction

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

The Staff is assessing U.S. investors' current familiarity with IFRS and how investors currently become educated about changes to accounting standards in order to assess the scope of, timing of, and approach to changes that would be necessary for effective incorporation of IFRS into the financial reporting system for U.S. issuers.

B. Description of Work Plan Efforts

The Work Plan noted that the Staff will analyze how to promote investor understanding of IFRS, as well as the existing mechanisms used to educate investors about changes in the accounting standards by:

- Conducting 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.

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

- Considering 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.

The Staff is currently researching and analyzing each of these three components. In August, the Commission issued a request for comment that solicits public comment to aid in the Staff's analysis of these components.[73] The comment period ended on October 18, 2010, and the Staff is reviewing the input from the comment letters received and determining the nature of further public input. In addition, the Staff will consider whether further outreach with investors and others, including those who responded to the request for comment, would facilitate the Staff's understanding of investors' perspectives on these three components.

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[73] SEC Release Nos. 33-9133; 34-62699 (August 12, 2010), Notice of Solicitation of Public Comment on Consideration of Incorporating IFRS into the Financial Reporting System for U.S. Issuers.

Additionally, through outreach to foreign regulators, the Staff intends to consider foreign regulators' experiences with investor perspectives on the three components described above.

The Staff has received initial feedback that indicates that U.S. investor understanding and education has begun to develop, at least in certain instances, with respect to IFRS. [74]

[74] For example, in understanding how investors educate themselves, the Staff has considered the content of the Chartered Financial Analyst examination and notes that IFRS is included as prominently as U.S. GAAP. (CFA Institute, *Financial Reporting and Analysis, CFA Program Curriculum, Volume 3* (2011)).

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.[75] 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, the Staff is evaluating the following:

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

The Staff's assessment of the transitional considerations for regulatory regimes primarily will be performed through outreach to the various affected parties. These discussions have commenced with numerous regulators and will continue into 2011. Based on the outreach to date, the Staff has identified a consistent area of concern and focus for many regulators. That is, the method of any incorporation of IFRS is exceedingly important due to the prominence of "U.S. GAAP" references currently in U.S. laws, contractual documents, regulatory requirements and guidelines, and similar documents. Therefore, regulators have expressed that if U.S. GAAP is the mechanism used for incorporation of IFRS into the financial reporting system for U.S. issuers, this would resolve a number of the more significant issues currently identified in the Staff's outreach.

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[75] See Proposed Roadmap.

B. Description of Work Plan Efforts

1. Manner in which the SEC Fulfills its Mission

The Work Plan noted that the Staff will analyze potential approaches for the ongoing role of the FASB in accounting standard setting and interpretation and the impact of the incorporation of IFRS into the financial reporting system for U.S. issuers on Commission rules and procedures by:

- Analyzing approaches to the FASB's ongoing role in accounting standards used in the United States, and the extent of, logistics for, and estimated time necessary to undertake these approaches.

- Analyzing references to accounting standards and requirements in existing Commission rules and interpretations and Staff application guidance to identify the extent of, logistics for, and estimated time necessary to implement any changes prior to such incorporation.

- Considering how, if at all, such incorporation would affect the nature, manner, or frequency in which the Commission and its Staff provide interpretative accounting guidance and enforce accounting standards, and the extent of, logistics for, and estimated time necessary to implement any changes.

The FASB's ongoing role in U.S. standard setting is interdependent with the manner of incorporation of IFRS, as more fully discussed in section I of this Progress Report. Once additional progress has been made on the Work Plan, the Staff will be able to more thoroughly evaluate the FASB's ongoing role.

In the interim, as discussed in section I, the Staff is evaluating feedback from foreign regulators to understand the manner in which they have determined to use their national standard setters and to determine the mechanisms and procedures employed by the foreign regulators to interpret IFRS, to the extent that IFRS is modified prior to incorporation in the financial reporting system in foreign jurisdictions.

In order to assess the potential impact of incorporation of IFRS into the financial reporting system for U.S. issuers on the Commission's rules and procedures, the Staff has performed an initial survey of the existing references to U.S. GAAP in SEC rules and regulations and other published guidelines. Based on this survey, and depending on the method of incorporation, the Staff believes that efforts would be required to catalog and update all specific references to U.S. GAAP. If the Commission reaches any decision to incorporate IFRS into the financial reporting system for U.S. issuers outside of U.S. GAAP, those efforts would need to be completed prior to any compliance date.

2. Industry Regulators[76]

As it relates to regulators for various industries, the Work Plan noted that Staff will analyze the effects of the incorporation of IFRS into the financial reporting system for U.S. issuers by:

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

The Staff has reached out to a number of industry regulators in order to obtain their perspectives on the expected impact on regulatory reporting should the Commission decide to incorporate IFRS into the financial reporting system for U.S. issuers. The outreach includes a request for the regulators to provide information to facilitate the Staff's identification of the areas in which the regulatory agencies use financial information and the nature of its use. Additionally, the outreach solicits information about transition considerations such as the mechanism for incorporation of IFRS; the nature and extent of expected process and systems changes; the discrete quantifiable costs of incorporation, to the extent possible; and the time necessary to develop a sufficient understanding of IFRS.

Based on discussions to date with several industry regulators, the Staff has received broad support for a single set of high-quality global accounting standards that provide for transparent and comparable financial reporting. Among other perceived benefits, a single set of global accounting standards will facilitate and simplify the industry regulators' interactions with foreign regulators and allow for greater exchange of more comparable information across jurisdictions.

Consistently, the feedback to date from the regulators has indicated that the manner of incorporation of IFRS into the financial reporting system for U.S. issuers is a significant factor to the level of effort required by the regulatory agencies upon any such incorporation because many regulatory agencies have statutes or regulations that require the use of GAAP. While GAAP is not specifically defined in many of the statutes, this requirement generally has been interpreted by certain industry regulators to mean U.S. GAAP (or GAAP as currently established by the FASB). For instance, the Federal Financial Institution Regulatory Agencies[77] have informed the Staff that, depending on

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[76] The term "industry regulators," "regulators," "regulatory agencies," and any other similar terms used in the report are used interchangeably to refer to regulators in the general sense, and not a specific regulator or group of regulators.

[77] The Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve System, National Credit Union Administration, and Office of Thrift Supervision (collectively, the "Federal Financial Institution Regulatory Agencies") have formed a working group consisting of policy, supervision, and legal staff members to assess the effects incorporation of IFRS

the interpretation of statutes, financial information in many financial institutions' regulatory reports may be statutorily required to be prepared using accounting principles that are uniform and consistent with U.S. GAAP.[78] The members of the regulatory agencies with whom the Staff has met have indicated that further legal analysis would need to be completed prior to concluding whether their statutory requirements for use of U.S. GAAP or GAAP as currently established by the FASB could be interpreted to mean IFRS or if changes to their statutes and rules would be necessary prior to adoption. However, any such efforts could be reduced to the extent that U.S. GAAP is the mechanism for incorporation such that existing references to GAAP or U.S. GAAP could remain unmodified within the legal and regulatory frameworks.

Regardless of the mechanism for incorporation of IFRS, members of several regulatory agencies have informed the Staff that any potential incorporation of IFRS will entail significant effort by the agencies. This effort will be necessary because the regulators would need to invest a potentially significant amount of human capital to evaluate and modify the financial metrics currently derived from U.S. GAAP financial reports, as the accounting results under IFRS may materially differ from those under current U.S. GAAP. For example, the Federal Financial Institution Regulatory Agencies have minimum and maximum thresholds for a variety of financial institutions' financial metrics and transactions (e.g., minimum regulatory capital or limits on amounts a financial institution may lend to a single borrower) that are established through laws and regulations, and those thresholds presuppose use of U.S. GAAP financial information. Additionally, the Federal Financial Institution Regulatory Agencies extensively use financial institutions' regulatory reports and internal management reports that are prepared on the basis of U.S. GAAP to evaluate the safety and soundness of financial institutions, both on an individual basis and across the industry. Therefore, any multiple, concurrent changes to U.S. GAAP will require extensive and concentrated efforts to assess and modify the metrics used to analyze and evaluate the regulated institutions.

The industry regulators' broad support for a single set of high-quality global accounting standards is tempered by their concerns in several areas. One such area of concern relates to the anticipated significant costs to modify internal processes and systems in support of full convergence, particularly if IFRS is applicable to some regulated institutions but not others. For example, industry regulators are concerned about the potential for a two-GAAP regime to the extent that U.S. issuers may be required to report using IFRS while private companies, including a significant number of non-public financial institutions, may be subject to a different set of standards (e.g., if there is delayed use by private companies or to the extent private companies continue to report under existing U.S. GAAP) because it could affect how the regulatory regimes are implemented. There are a number of ways in which regulators could approach this situation, including continuing to require all regulatory reporting under existing U.S. GAAP (which would have the

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may have on their collective regulatory regimes. The Staff has had several meetings with members of the working group.

[78] If certain conditions are met, the regulator may prescribe an alternative accounting principle that is no less stringent than U.S. GAAP.

potential to result in a requirement for U.S. issuers to maintain two sets of accounting systems and records) or creating regulatory systems that could accept both U.S. GAAP and IFRS, at potentially significant costs in terms of systems development and human capital.

A second area of concern is the regulators' perceived diminished ability to influence the standard-setting process. Due to the IASB's multinational constituent base, an individual U.S. industry regulator may provide its perspective to the IASB; however, regulators in different jurisdictions may have different or conflicting perspectives, thus reducing the potential impact that the industry regulator's views may have on the IASB.

Another area of concern is founded in the general absence of industry-specific guidance in IFRS. Comparatively, U.S. GAAP currently contains several industry-specific standards and practices that have developed over time to address the transactions in different industries. For example, IFRS does not currently have a rate-regulated standard similar to ASC Topic 980.[79] The absence of a rate-regulated standard in IFRS may create numerous challenges for regulators of entities currently subject to this standard.

3. Federal and State Tax Impacts

The Work Plan noted that the Staff will analyze the effects of the incorporation of IFRS into the financial reporting system for U.S. issuers on federal and state tax regulations, as well as issuers subject to such regulations by:

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

To accomplish the objectives set forth in the Work Plan, the Staff has met on multiple occasions with senior members of the Internal Revenue Service ("IRS") and the U.S. Department of the Treasury ("Treasury") (collectively, the "Agencies"). Both Agencies are in the process of evaluating the potential impacts that incorporation of IFRS into the financial reporting system for U.S. issuers could have on federal tax regulations. Currently, the Agencies are focused on areas that may have the most significant ramifications from IFRS incorporation, including: (1) taxpayers' ability to use the last-in-first-out (LIFO) inventory method for tax purposes, (2) changes in U.S. tax accounting methods, to the extent changes in accounting policies made in the transition to IFRS are considered changes in accounting methods under the U.S. tax code, (3) changes in the computations of U.S. earnings and profits for U.S. tax purposes, and (4) the impact on

[79] See Accounting Standards Codification Topic 980, *Regulated Operations*.

organizations' existing transfer pricing policies and documentation.

Similar to the initial comments received from other regulatory agencies, the staffs of the Agencies have emphasized the importance of the manner of incorporation. As previously discussed within this Progress Report, some of the effort and complexity of any potential incorporation of IFRS into the financial reporting system for U.S. issuers could be reduced to the extent that U.S. GAAP is the mechanism for incorporation.

The Staff will continue the dialogue with key staff members of both Agencies throughout the term of the Work Plan to ensure the relevant matters are appropriately included in the consideration of the incorporation of IFRS into the financial reporting system for U.S. issuers. The Staff also plans to perform outreach to representatives of state taxing authorities to consider the effect on state taxing regimes.

4. Audit Regulation and Standard Setting

The Work Plan noted that the Staff will analyze the effects of the incorporation of IFRS into the financial reporting system for U.S. issuers on audit standard setting and auditor requirements by considering the impact of such incorporation on PCAOB standards and the extent of, logistics for, and estimated time necessary to undertake any changes to the auditing standards.

Currently, there are approximately 160 foreign private issuers[80] that file financial statements using IFRS that are audited by audit firms using PCAOB standards as the basis for issuing an audit opinion. Therefore, the Staff will meet with a sample of representatives of the audit firms to understand the changes, if any, that were necessary in the audit approach to enable these firms to issue audit opinions for foreign private issuers.

The Staff also will continue its dialogue with members of the PCAOB staff to understand the nature and magnitude of auditing standard updates that would be required, if any, before a larger group of registrants would be filing IFRS-incorporated financial statements.

5. Broker-Dealer and Investment Company Reporting

The Work Plan noted that the Staff will analyze 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 by:

- Assessing the effects of such incorporation on broker-dealers, investment companies, and investors, including whether IFRS includes sufficient standards, and the extent of,

[80] The number of foreign private issuers that file financial statements using IFRS that are audited by firms using PCAOB standards is expected to increase after January 2011, the date of incorporation of IFRS in Canada. The Staff intends to include the auditors of these issuers in its outreach.

logistics for, and estimated time necessary to undertake any changes, should broker-dealers and investment companies be included in the scope of any potential Commission decision.

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

The Staff will assess the potential qualitative and quantitative impacts on broker-dealer and investment company financial reporting if included in the scope of entities incorporating IFRS. This assessment will include the impact to preparers and investors by broker-dealers' and investment companies' use, or lack of use, of IFRS.

In support of this assessment, the Staff is in the process of performing outreach to the Financial Industry Regulatory Authority and the Securities Industry and Financial Markets Association with the goal of obtaining an understanding of the relevant differences between U.S. GAAP and IFRS specific to broker-dealers. Separately, the Staff intends to reach out to the Investment Company Institute to understand the implications to the regulatory regime for investment company financial reporting and the differences between U.S. GAAP and IFRS specific to investment companies. To the extent such differences relate to MoU projects, the Staff will use that information in the consideration of the time necessary for transition should IFRS be incorporated into the financial reporting system for U.S. issuers. Separately, if the significant differences relate to accounting standards not subject to the MoU projects, the Staff will assess how changes to those standards will affect the regulatory environment for broker-dealers and investment companies, including any potential impacts on financial responsibility rules, such as net capital requirements. The Staff also is working closely with staff in the Commission's Division of Trading and Markets and Division of Investment Management on these matters.

6. Public versus Private Companies

The Work Plan noted that the Staff will analyze 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 by:

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

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

Previously, there have been studies that have assessed whether there should be separate standards for private companies. The Staff is inventorying and reviewing these studies, any recommendations from these studies, and the basis for such recommendations. The Staff plans to reach out to other interested parties such as the National Association of State Boards of Accountancy to understand their views. Finally, the Staff is considering how other jurisdictions have addressed this issue.

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 thousands of issuers that file reports with the Commission. Therefore, an important aspect of the consideration of incorporation of IFRS relates to the costs, effort, and time involved for U.S. issuers with a move to IFRS and whether the benefits of such a move justify those costs. Also important to the Staff's analysis is the transition time issuers should be afforded in order to appropriately address the needs of investors while balancing the costs and efforts involved in making the transition.[81]

Accordingly, the Work Plan considers analysis of the magnitude and logistics of changes that issuers would need to undertake in the following areas to effectively incorporate IFRS into the financial reporting system for U.S. issuers, should the Commission determine in the future to mandate such incorporation:[82]

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

The Work Plan also requires consideration of the effect of such incorporation on the following:

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

B. Description of Work Plan Efforts

1. Accounting Systems, Controls, and Procedures

The Work Plan noted that the Staff will determine the extent of, logistics for, and estimated time necessary to undertake changes to issuer accounting systems, controls, and procedures should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers.

As discussed in section I, the Staff is in the process of comparing IFRS to U.S. GAAP for non-MoU projects. Upon completion, the Staff intends to assess the extent of, logistics

[81] See Work Plan.

[82] The human resource impact on issuers is discussed separately in section VI.

for, and estimated time necessary to undertake changes to issuer accounting systems, controls, and procedures.

Based on discussions with issuers to date, the Staff understands that the extent and significance of differences in applicable accounting requirements and their effect on internal processes will vary among issuers. For multinational issuers with subsidiaries already applying IFRS for local purposes, it also may be necessary to consider whether there is any existing inconsistency in application of IFRS from one jurisdiction to another.

The Staff intends to issue a request for comment seeking input that will facilitate its understanding of the time and effort necessary to undertake any changes to issuer accounting systems, controls, and procedures as they relate to non-MoU projects. The FASB separately has issued a discussion paper requesting comments on effective dates and transition issues associated with the MoU projects.[83] This input will be incorporated into the Staff's analysis on potential transition methods. The Staff also intends to engage in constituent outreach in those jurisdictions that have previously incorporated IFRS to assess the magnitude of these changes.

2. Contractual Arrangements

The Work Plan noted that the Staff will analyze the effects on contractual arrangements, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers by:

- Assessing the types and pervasiveness of contractual arrangements that would be affected by such incorporation and the manner in which they would be affected.

- Determining the costs, ability, plans, and estimated time required to address concerns regarding affected contractual arrangements.

In August, the Commission solicited public comment to aid in the Staff's analysis of these areas.[84] The request for comment solicited feedback in a number of areas including, but not limited to: (1) what types of contractual commercial arrangements would likely be affected by the incorporation of IFRS into the financial reporting system for U.S. issuers and to what extent the application, interpretation, or enforcement of those arrangements would be affected, (2) how parties to such arrangements would most likely address such effects of incorporation, and (3) how the potential effects of incorporation could be mitigated through a transition period and, if so, the amount of time necessary for effective transition.

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[83] See FASB Discussion Paper, *Effective Dates and Transition Methods* (October 19, 2010). See also IASB Request for Views, *Effective Dates and Transition Methods* (October 19, 2010).

[84] SEC Release Nos. 33-9134; 34-62700 (August 12, 2010), Notice of Solicitation of Public Comment on Consideration of Incorporating IFRS into the Financial Reporting System for U.S. Issuers.

The comment period ended on October 18, 2010, and the Staff is analyzing the input from the comment letters received and determining the nature of further public input. In addition, the Staff may, if necessary, meet with or otherwise engage issuers and others, including those who responded to the request for comment, to facilitate the Staff's understanding of issuers' perspectives on these components.

3. Corporate Governance

The Work Plan noted that the Staff will analyze 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 by:

- Assessing the potential effects on corporate governance and related concerns of such incorporation.

- Determining possible approaches to address corporate governance concerns and the extent of, logistics for, and estimated time necessary to undertake these approaches.

In August, the Commission solicited public comment to aid in the Staff's analysis of these components.[85] The request for comment solicited feedback regarding the challenges that issuers may encounter in identifying audit committee financial experts and in satisfying corporate governance and related quantitative stock exchange listing requirements, as well as, more broadly, compliance with other aspects of corporate governance that may result from the incorporation of IFRS into the financial reporting system for U.S. issuers.

The comment period ended on October 18, 2010, and the Staff is analyzing the input from the comment letters received and determining the nature of further public input. In addition, the Staff may meet with or otherwise engage issuers and others, including those who responded to the request for comment, to facilitate the Staff's understanding of issuers' perspectives on these components.

4. Accounting for Litigation Contingencies

The Work Plan noted that the Staff will analyze for the Commission's benefit the effects on accounting and disclosure requirements for litigation contingencies under IFRS in the context of the U.S. legal environment, should the Commission determine in the future to incorporate IFRS into the financial reporting system for U.S. issuers by:

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

- Determining possible approaches to address concerns regarding accounting and

[85] SEC Release Nos. 33-9134; 34-62700.

disclosure requirements for litigation contingencies under IFRS and the extent of, logistics for, and estimated time necessary to undertake these approaches.

The Staff notes that the FASB currently is working on a project related to the disclosure of certain loss contingencies.[86] The IASB also currently is working on a project related to the recognition, measurement, and disclosure of certain loss contingencies.[87] The Staff is following these two projects and tracking their potential effects on differences between IFRS and U.S. GAAP, should they be finalized.

The Staff is also in the process of reviewing comment letters on both projects to understand constituent concerns with existing and proposed requirements. The Staff hopes to use the knowledge obtained from the responses to these projects as the foundation to consider the differences of opinion among the various stakeholders. In addition, the Staff may meet with or otherwise engage those who responded to the FASB's request for comment to facilitate the Staff's understanding of issuer and investor perspectives and concerns on this component.

5. Smaller Issuers versus Larger Issuers

The Work Plan noted that the Staff would analyze the extent to which incorporation of IFRS into the financial reporting system for U.S. issuers would affect smaller issuers differently than larger issuers by:

- Determining the manner in which the impact of such incorporation varies based on issuer size.

- Determining 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.

The Staff will continue to gain an understanding of the impact of incorporation on issuers specifically based on the size of the issuer. The Staff also will identify transition provisions that other jurisdictions have used for issuers based on size and determine whether similar provisions should be provided to the Commission for consideration for any potential incorporation of IFRS for U.S. issuers.

[86] See FASB Proposed Accounting Standards Update, *Contingencies (Topic 450): Disclosure of Certain Loss Contingencies* (July 20, 2010).

[87] See the IASB's project on amendments to IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.

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 for effective incorporation.[88]

Accordingly, the Work Plan requires evaluation of the following two components to provide the Commission with the information necessary to assess human capital readiness with respect to incorporation of IFRS into the financial reporting system for U.S. issuers:

- Education and training; and

- Auditor capacity.

The Staff initially has determined that the assessment of human capital readiness is most efficiently conducted after the Staff has progressed further on the Work Plan.

B. Description of Work Plan Efforts

1. Education and Training

The Work Plan noted that the Staff would consider the education and training of IFRS by:

- Evaluating the current level of IFRS expertise and extent of IFRS education and training needs among constituents.

- Considering the extent of, logistics for, and estimated time to implement plans for future training among constituents.

The Staff will obtain the perspectives of key stakeholders including, but not limited to, market participants, academics, and members of selected professional associations to understand the level of effort that would be required and the estimated time that would be needed prior to transition to IFRS. Specifically, the Staff will perform targeted outreach to various market participants to assess their current understanding of IFRS and the current level of IFRS training efforts. Additionally, the Staff will consider the existing processes market participants apply to identify and incorporate changes in accounting standards and whether such processes could be employed if the Commission were to

[88] Work Plan.

decide to incorporate IFRS into the financial reporting system for U.S. issuers.

The Staff also will survey academics to understand the current level of IFRS training and the processes that would be necessary to increase the level of IFRS education in the college curriculum. Finally, through outreach to foreign regulators, the Staff will attempt to identify the mechanisms foreign regulators have used to facilitate constituent education on IFRS in their respective jurisdictions.

2. Auditor Capacity

The Work Plan noted that the Staff would analyze auditor capacity constraints with respect to IFRS by:

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

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

The Staff will meet with members of accounting firms (including large, medium and small size firms) to discuss their expectations regarding availability and cost of audit services and understand how they intend to address client concerns in this regard. The availability and cost of services are, at least in part, influenced by each firm's experience with IFRS and the manner and extent to which the firms have developed training courses to educate their employees on IFRS. Also important in this assessment is an understanding of how the firms have incorporated IFRS into their quality control systems, including hiring, staffing of audits, professional advancement, and any changes in these areas that are planned for the future. Accordingly, the Staff will focus on these aspects of the firms' development in assessing the level of effort and estimated time that would be needed to transition to IFRS.

In addition to the inquiries of accounting firms, the Staff will consider feedback from foreign regulators, relevant academic studies and other literature, and the recommendations contained in the final report of the Advisory Committee on the Auditing Profession[89] to assess the implications of transition on the availability and cost of audit services.

[89] See "Final Report of the Advisory Committee on the Auditing Profession to the U.S. Department of the Treasury" (October 6, 2008).