IFRS Foundation publishes analysis of the SEC staff’s final report on IFRS

What you need to know

- The IFRS Foundation has published its staff analysis of the SEC’s final Staff Report on IFRS.
- The IFRS Foundation Report addresses the following issues: IFRSs as global accounting standards; the IASB as a global standard setter; and the challenges for US transition.
- The IFRS Foundation staff welcomes several of the SEC Staff Report’s recommendations, but they also refute some of the findings on funding and oversight.
- As the IASB’s convergence programme with the FASB comes to an end, it is seeking to develop a more formal arrangement with National Standard-Setters (NSSs) has become more pressing. The Accounting Standards Forum will be established in 2013 for this purpose. From the IASB's perspective, it is clear that the US's contributions to the future Accounting Standards Forum would weigh significantly if the US were to employ an endorsement approach to the use of IFRS.
- This publication summarises the findings and views of the IFRS Foundation staff.

Highlights

On 23 October 2012, the IFRS Foundation published its staff analysis Report to the Trustees of the IFRS Foundation - IFRS Foundation staff analysis of the SEC Final Staff Report (IFRS Foundation Report)1 of the US SEC’s final staff report on the Work Plan for the Consideration of Incorporating IFRSs into the Financial Reporting System for U.S. Issuers (the SEC Staff Report),2 which addresses some of the issues discussed in the SEC Staff Report issued back in July 2012.

Several of the issues identified in the SEC Staff Report have been or are currently being addressed in ongoing initiatives as a result of the Trustees’ Strategy Review.3 In the IFRS Foundation’s report, IFRS Foundation staff refuted some of the SEC Staff’s findings on the funding and oversight of the IASB. On the use of the LIFO (last-in-first-out) inventory method, the IFRS Foundation staff noted that this is fundamentally a taxation matter, for which the US Treasury would have discretion to permit the use for tax purposes, “to ensure that a decision about financial reporting for investors is insulated from tax consequences.”

As the IASB’s convergence programme with the FASB comes to an end, the need for the IASB to develop a more formal, cohesive and collective arrangement with National Standard-Setters (NSSs) has become more pressing. The Accounting Standards Forum will be established in 2013 for this purpose. From the IASB’s perspective, it is clear that the US’s contributions to the future Accounting Standards Forum would weigh significantly if the US were to employ an endorsement approach to the use of IFRS.

Meanwhile, some of the US’s concerns regarding the cost of transition in the current economic environment and the extent of consistent application of IFRS by preparers and regulators are to do with process and enforcement, which other countries have successfully addressed, rather than fundamental issues of accounting.

2 See IFRS Developments, Issue 36: SEC staff issues its final report on IFRS
3 See IFRS Developments, Issue 24: IFRS Foundation announces changes to its governance
Background
The publication of the final SEC Staff Report in July represents an important milestone for the SEC in its consideration of the incorporation of IFRS into the US financial reporting framework. The SEC Staff Report was designed to inform the SEC commissioners should they decide whether, and if so, how, IFRS should be incorporated into the US financial reporting system. Following the publication of the SEC Staff Report, the Trustees of the IFRS Foundation (the Trustees) made a statement to confirm that they would carefully consider the findings and observations in the SEC Staff Report. The publication of this report summarises the IFRS Foundation staff’s assessment of those findings and observations.

The IFRS Foundation staff’s report addresses the following issues:

- IFRSs as global accounting standards
- The IASB as a global accounting standard-setter
- The challenges for a US transition to IFRSs (including endorsement approaches, cost of transition, human capital readiness, and smaller versus larger issuers)

The IFRS Foundation staff acknowledges and welcomes several of the recommendations made in the SEC Staff Report, but the staff supplements and, in some instances, refutes the findings and observations made by the SEC staff. Some of the issues addressed by the IFRS Foundation report are discussed further below.

The IASB as a global accounting standard-setter

Oversight
The SEC Staff Report finds that the overall design of the governance structure of the IFRS Foundation strikes a “reasonable balance of providing oversight of the IASB while at the same time recognising and supporting its independence.” However, the SEC Staff Report notes concerns expressed by constituents that the IASB’s objectivity could be undermined because of outside political influence.

The IFRS Foundation staff acknowledges the fine line between being responsive to feedback and being subject to undue political influence. Furthermore, the creation of the Monitoring Board, the heterogeneous nature of the IFRS community, and internationally and professionally diverse composition of the IASB, would all help to dilute undue pressure from any one jurisdiction or special interest group.

Funding
The SEC Staff Report raises concerns about a number of issues, including: the continued reliance by the IFRS Foundation on the large public accounting firms; less than 30 countries contributing to the funding of the IFRS Foundation; and the Trustees having been unsuccessful in obtaining funding from the US for the portion allocated to the US.

The IFRS Foundation staff notes that 69 countries provide funding to the Foundation, not the “fewer than 30” that SEC staff mentioned in their report. Indeed, the biggest contribution to the Foundation’s budget comes from European countries and the European Union. In addition, the issue of the lack of public funding coming from the US can only be resolved, directly or indirectly, by the US authorities themselves, not by the IFRS Foundation.

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**IFRS as global accounting standards**

**Comprehensiveness**

The SEC Staff Report notes that IFRS guidance is limited in a number of areas, such as accounting for common control transactions, and lacking altogether for certain industries, such as insurance and extractive activities. Although IFRS covers a broad range of activities, there are clearly some gaps that, over time, will be addressed. The IASB has identified such areas as a result of its consultation on its future agenda and priorities have been established. As with any established set of accounting standards, there are areas where IFRS can be improved. With the agenda consultation process, annual improvements process and the work of the Interpretations Committee, these mechanisms would allow for improvements over time.

**Maintenance**

In response to the observation made in the SEC Staff Report that the IFRS Interpretations Committee (the Committee) could address issues in a more timely manner, IFRS Foundation staff notes that as part of the Trustees’ Strategy Review, the Trustees conducted a review on the efficiency and effectiveness of the Committee earlier this year, and published recommendations to improve the efficiency and effectiveness of the Committee in May 2012. These recommendations have since been implemented in full.

**National standard-setters**

One of the SEC staff’s recommendations is for the IASB to extend its involvement with NSSs in processes such as the development of a new standard. In response to this recommendation, the IASB has begun preparatory work to establish the Accounting Standards Forum (the Forum), to further strengthen and formalise its connection with NSSs and regional bodies. The purpose of the Forum is to enable the IASB to better engage with national standard-setters and regional bodies collectively. The role of the Forum will be to advise and provide feedback to the IASB on major technical issues related to its standard-setting activities. The aim is to have representation at a high level of professional capability together with a strong knowledge of each jurisdiction/region, so that views can be expressed clearly and discussed thoroughly with the IASB.

**Enforceability**

The SEC Staff Report notes the importance of achieving greater consistency in the enforcement of IFRS if the benefits of a single set of global accounting standards are to be fully realised. The IFRS Foundation staff agrees with this. If the SEC decides to incorporate IFRS, enforcement in the US will remain the sole responsibility of the SEC, with no danger of US standards of enforcement being affected by outside influences. Furthermore, if and when the US completes its transition to IFRS, the SEC could extend its existing leadership in worldwide enforcement to the IFRS domain, while sharing with the rest of the world its experience and practices in accounting standards enforcement.

**Challenges related to adoption, endorsement and transition to IFRS**

The SEC Staff Report discusses various issues related to incorporating IFRS into US GAAP, which are specific to the US and can only be addressed by US authorities in the environment in which they operate. Regarding the methods of incorporation of IFRS, IFRS Foundation staff notes that the endorsement approach is used by the majority of IFRS jurisdictions, which is an important ‘sovereignty circuit-breaker’ to ensure that international rules do not automatically form a part of national law.

On the implementation of IFRS, the IFRS Foundation staff has not found evidence of a jurisdiction that has successfully adopted IFRS using a gradual standard-by-standard approach.

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The multiple challenges that the SEC staff reported regarding the adoption of IFRS, have already been encountered by various IFRS jurisdictions over the years with the adoption of IFRS.

Findings of the IFRS Foundation staff suggest that the costs of transition from the experience of other jurisdictions, while not insignificant, have not been prohibitive overall. For the US, following the convergence programme (which has resulted in fewer differences between IFRS and US GAAP than other jurisdictions may have encountered when moving from national standards to IFRS), the reduced differences should translate into fewer costs associated with transition. Furthermore, the costs of implementing the new converged standards (such as those for revenue and leases) will be borne by US preparers regardless of whether the US moves to IFRS or retains US GAAP. In addition, a recent study commissioned by the IFRS Foundation that found considerable benefits arising from the adoption of IFRS, was omitted from the SEC Staff Report.5

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How we see it

Much has been achieved over the last ten years with the issue of several converged standards, such as segment reporting, fair value measurement and business combinations. We welcome the fact that the Boards are continuing to work jointly on the revenue recognition and leasing projects, and urge both Boards to ensure that further divergence be kept to a minimum.

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