

# LEGAL UPDATE

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## SEC'S PROPOSED ROADMAP TO ADOPTING INTERNATIONAL FINANCIAL REPORTING STANDARDS (REPLACING U.S. GAAP)

The Securities and Exchange Commission ("SEC") is accepting public comment through February 19, 2009 on its proposed "Roadmap"<sup>1</sup> for the mandatory adoption of international financial reporting standards ("IFRS") in place of GAAP accounting standards for all U.S. publicly-traded companies. The SEC's proposal, as set forth in its November 2008 release, would allow a select number of U.S. domestic issuers to voluntarily adopt IFRS beginning with fiscal years ending as early as December 31, 2009 and would track those companies with a set of milestones which, if achieved, could lead to the SEC's permanent adoption of IFRS for all U.S. domestic issuers beginning in 2014. The SEC will make its determination in 2011 on whether or not to require all U.S. issuers to convert to IFRS.

Currently, more than one hundred countries require or permit the use of IFRS reporting for their domestic, listed companies. In the U.S., foreign issuers already have the option of reporting their financials using IFRS as interpreted by the International Accounting Standards Board ("IASB"), the London-based body responsible for overseeing IFRS. By initially allowing select U.S. companies to report using IFRS, the SEC is creating a testing ground for the potential adoption of IFRS by all public U.S. companies.

### MILESTONES

In order to achieve that goal, the SEC has established seven milestones that it hopes to

achieve and areas that it will monitor through 2011. They are:

- improvement in accounting standards;
- improved accountability and funding of the IASC Foundation, the group that oversees IASB;
- improvement in the ability to use interactive data reporting (or XBRL) for IFRS reporting;
- improved education and training in IFRS for investors, accountants, auditors and other interested parties;
- allowing limited early use of IFRS where this would enhance comparability for investors;
- anticipated timing of future rulemaking by the SEC; and
- implementation of mandatory use of IFRS.

### INITIAL IMPLEMENTATION

Under the Roadmap, a select group of U.S. issuers would initially be permitted to use IFRS. Eligibility for IFRS reporting will be offered only to larger U.S. companies that operate in industries in which IFRS is the predominant or most widely-used standard globally. Thus, by adopting IFRS, companies operating in such industries will increase and enhance comparability for investors. In order to qualify as one of the initial companies permitted to use IFRS, an issuer, among other qualifications and procedures, would need to be one of the 20 largest companies worldwide operating in its industry and the industry must be one in which the majority of non-U.S. issuers file using IFRS.

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<sup>1</sup> See Release No. 33-8982 available at <http://www.sec.gov/rules/proposed/2008/33-8982.pdf>

## ADVANTAGES OF IFRS

While the SEC proposal initially makes IFRS reporting available only to a select group of companies, the SEC has stated its goal of adopting IFRS for all domestic issuers would provide significant benefits for investors, such as better comparability of financials with foreign-listed companies, the majority of which are either required to file using IFRS or are in a period of transitioning to IFRS reporting. One downside to the SEC's proposed IFRS adoption is that not all countries have adopted IFRS as interpreted by the IASB; this means that some implementing countries have their own means of IFRS rule interpretation, thus reducing the degree of comparability in the event of the SEC's adoption of IFRS reporting. However, the SEC's stated hope is that more and more countries will be moving toward using IFRS as reported by the IASB, rather than having their own individual interpretation bodies. The SEC has expressed that it would be more inclined to adopt IFRS across the board for U.S. filers if the majority of countries were using IFRS as interpreted by the IASB. The SEC will be tracking this issue through 2011, when it will make the determination of whether or not to adopt IFRS for all reporting companies.

IFRS has an objective-oriented, principles-based approach to interpretation, which allows for greater flexibility in IFRS reporting. This is different from U.S. GAAP which has a rules-based approach which allows for fairly narrow interpretation and implementation. Thus, there is greater room for interpretation of the IFRS rules whereas most U.S. GAAP rules have been fairly narrowly defined, allowing for less flexibility in interpretation.

## COMPLIANCE PHASE-IN PERIODS

If IFRS is adopted for all U.S. filers, large accelerated filers would be required to convert to IFRS reporting for filing years ending on or after December 15, 2014; accelerated filers would have to comply with IFRS reporting for filing years ending on or after December 15,

2015; and non-accelerated filers and smaller reporting companies would need to convert to IFRS reporting for filing years ending on or after December 15, 2016. The SEC anticipates that large accelerated filers will be better able to allocate resource costs to cover the transition and therefore the proposed transition is required sooner for accelerated filers. By establishing the transition deadlines early, the SEC has stated it hopes that will encourage earlier voluntary adoption by filers. The SEC has also stated that staggering the transition dates will allow for better resource allocation and management by auditors, consultants and other market participants, whose time and resources will be needed to assist companies in transitioning.

## ALTERNATIVE PROPOSALS

The SEC has proposed two alternative transition methods which are being considered during the comment period. Under the first proposal, new IFRS filers would be required to provide three years of audited IFRS financial statements but would only be required to provide reconciliation to U.S. GAAP in the issuer's first annual report on Form 10-K filed using IFRS. Under the second proposal, issuers would provide reconciliation of IFRS financial statements to U.S. GAAP in each annual report on Form 10-K filed using IFRS.

If you have any questions regarding the proposed Roadmap, please contact an attorney in Pryor Cashman's Securities and Corporate Finance Group.

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Ed has represented clients at every stage of development, with such clients ranging from start-up ventures to publicly traded corporations engaged in a wide range of industries, including pharmaceutical, advertising and media, entertainment, energy, manufacturing software and health services, among many others.

Prior to joining Pryor Cashman in 2000, Ed practiced law with a New Jersey firm where, in addition to his current areas of focus, he represented corporate borrowers and financial institutions in bank lending transactions and counseled clients in technology-related transactions.

Before he became an attorney, Ed served as an active-duty officer in the United States Army and held finance-related positions at several large corporations.

Ed is a 1998 graduate of the State University of New York at Buffalo Law School, where he also earned a Certificate of Concentration in Financing Transactions. Ed has a B.S. in Economics from Siena College and an M.B.A. from Bryant University, where he had a concentration in finance.



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Before embarking on her legal career, Megan spent nearly two years living and working in Beijing, China, where she served as the English-language editor at Women of China magazine, a publication of the All China Women's Federation, while pursuing Chinese language studies.