SEC Publishes a Work Plan to Study Potential Adoption of IFRS for U.S. Issuers; Potential Transition to IFRS Delayed Until 2015-2016

SUMMARY
The SEC has published a statement (the “2010 Statement”) updating its evaluation of whether U.S. issuers should prepare financial statements in accordance with International Financial Reporting Standards. In the 2010 Statement, the SEC reaffirms its belief that a single set of high-quality globally accepted accounting standards will benefit U.S. investors and that IFRS is best positioned to serve as this set of standards. The 2010 Statement, however, concludes that the SEC needs more information before making this decision and approves a comprehensive work plan setting forth specific areas and factors for the SEC Staff to study.

Consistent with the SEC’s proposed IFRS Roadmap issued in November 2008, the SEC anticipates determining whether to proceed with a transition to IFRS by 2011. In contrast to the IFRS Roadmap, which anticipated that IFRS reporting could be required as early as 2014, the 2010 Statement contemplates that IFRS reporting would not be required before 2015 or 2016. The precise transition period, including any potential phase-in based on accelerated filer status, will be determined at a later date. Also, according to the 2010 Statement, the SEC is no longer currently considering voluntary early adoption for large filers, and has withdrawn proposed early adoption rules published in November 2008.

IMPLICATIONS
Following this latest update from the SEC, any transition to IFRS is further away than was anticipated in November 2008. The SEC acknowledged in the 2010 Statement that a change from U.S. GAAP to IFRS could require significant transition time and effort for issuers, investors and others. Several steps in the work plan approved in connection with the 2010 Statement (the “Work Plan”) are designed to provide the
SEC Work Plan for Consideration of IFRS Adoption

March 2, 2010

SEC with information regarding the effect of these changes. According to the 2010 Statement, the process set forth in the Work Plan will enable the SEC to provide a sufficient period of time for issuers and other affected parties to efficiently and effectively implement any transition to IFRS.

Although the 2010 Statement delays potential transition to IFRS for U.S. issuers, issuers should, as discussed in our memorandum on the proposed IFRS Roadmap published in November 2008 (the “Proposed Roadmap”),1 continue to consider the possibility that U.S. GAAP may be replaced by IFRS when negotiating new credit facilities, indentures and other long-term contracts that use financial measures. In addition, U.S. issuers should consider other consequences of a change to IFRS, including changes in accounting treatment of existing or proposed contractual arrangements, business combinations and equity investees, among others. Given the delay in potential implementation, however, issuers may wish to wait until the SEC’s 2011 determination before expending significant resources in preparing for a transition to IFRS.

Furthermore, although the 2010 Statement and the Work Plan do not expressly request comments, in executing the Work Plan, the SEC Staff will gather information using a variety of methods, including seeking comment from, holding discussions with, and analyzing information from constituents, including investors, issuers, auditors, attorneys, other regulators, standard setters and academics. To that end, companies should begin to consider their positions on the various concerns expressed in the Work Plan and evaluate whether they would like to participate in any comment or information-gathering processes that the SEC may offer in the future.

BACKGROUND

As outlined in the 2010 Statement, the SEC has long promoted a single set of high-quality globally accepted accounting standards and in recent years has taken several steps towards full recognition of IFRS. In 2007, the SEC adopted rules allowing foreign private issuers to include financial statements prepared in accordance with IFRS, as issued by the International Accounting Standards Board (the “IASB”), in SEC filings without reconciliation to U.S. GAAP and also issued a Concept Release on whether U.S. issuers should be permitted to prepare financial statements in accordance with IFRS.2 As discussed above, in November 2008, the SEC published a Proposed Roadmap to evaluate the further role of IFRS in the U.S. capital markets and sought comment on a number of suggested milestones that

---


SEC Work Plan for Consideration of IFRS Adoption
March 2, 2010
the SEC might consider. According to the 2010 Statement, the Work Plan was created to address areas of concern in comments received by the SEC on the Proposed Roadmap.

Also in the past several years, and in conjunction with the SEC’s consideration of a transition to IFRS, the Financial Accounting Standards Board (“FASB”) and the IASB have worked towards convergence of U.S. GAAP and IFRS. In response to questions at the September 2009 meeting of the Group of Twenty nations as to the possibility that differing global accounting standards contributed to the current economic downturn, the FASB and the IASB reaffirmed their commitment to complete the convergence project by June 2011. The 2010 Statement indicates that following successful completion of the Work Plan and the FASB-IASB convergence projects, the SEC will determine whether to implement a transition to IFRS.

THE WORK PLAN

General
The Work Plan sets forth specific areas and factors for the SEC Staff to analyze regarding a potential transition of the current financial reporting system for U.S. issuers to a system incorporating IFRS. Specifically, the Work Plan addresses six general areas highlighted by commenters on the Proposed Roadmap, which are described in greater detail below.

According to the Work Plan, although each of the six areas of concern is important to the determination of whether to adopt IFRS, no one area is determinative, nor is a particular answer required as a prerequisite to a positive determination on the transition to IFRS. As noted by Commissioner Casey during the Open Meeting on the approval of the 2010 Statement and the Work Plan, “[t]he work plan does not raise any new obstacles or establish a checklist prior to the use of IFRS. It sets forth key steps and processes [the SEC] staff will take to provide necessary information to the [SEC] and to evaluate key transitional issues in transitioning to IFRS in order to drive the process.” Indeed, the Work Plan largely echoes many of the considerations outlined in the Proposed Roadmap.

Factors and Considerations Outlined in the Work Plan
The Work Plan identifies six general areas of concern expressed by commenters on the Proposed Roadmap, and sets forth a detailed description of these concerns, the process of gathering and analyzing the information necessary to address such concerns, and a plan for identifying potential areas where more information may be needed or additional action should be taken prior to the adoption of IFRS. The 2010 Statement indicates that the first two areas identified below would be the most relevant to a determination whether to proceed with IFRS, and that the four remaining areas would be most relevant in addressing transitional matters.

3 See our 2008 Memorandum for a detailed discussion of the Proposed Roadmap.
Determining whether IFRS is sufficiently developed and consistent in application for use as the single set of accounting standards in the U.S. reporting system. The 2010 Statement observes that “[a] necessary element for a set of global accounting standards to meet [the SEC’s mission] is that they must be high quality . . . .” In order to evaluate whether IFRS is of “high-quality and sufficiently comprehensive,” the Work Plan calls for an evaluation of the comprehensiveness of IFRS, the auditability and enforceability of IFRS, and the comparability of IFRS financial statements within and across jurisdictions:

- **Comprehensiveness.** As noted in the Proposed Roadmap, IFRS is not as fully developed as U.S. GAAP in certain areas. The 2010 Statement highlights IFRS’ lack of guidance in certain topical areas, such as common control transactions, recapitalization transactions, reorganizations and acquisitions of minority interests, as well as IFRS’ lack of guidance for certain industries, including utilities, insurance and investment companies. The SEC Staff intends to continue to study IFRS’ overall comprehensiveness.

- **Auditability and Enforceability.** As noted in the 2010 Statement, the less detailed and prescriptive nature of IFRS may raise questions as to the auditability and enforceability of IFRS. Commenters noted that the greater flexibility of IFRS may create a risk of opportunistic accounting, presenting challenges in a financial statement audit or enforcement of reporting rules. Increased subjectivity may also lead to unfair criticism of financial statement preparers by auditors, regulators and investors, and potentially expose issuers to claims from shareholders and others seeking to challenge the issuer’s application of IFRS.

- **Comparability.** The less detailed nature of IFRS, as well as formal and informal jurisdictional variations that have developed over time, may limit the comparability of financial statements prepared under IFRS, which would compromise one of the SEC’s key goals in considering IFRS.

The Work Plan calls for the SEC Staff to analyze factors that may impact the issues described above, and to identify potential changes to IFRS to address these concerns.

Ensuring that accounting standards are established by an independent standard-setter and for the benefit of investors. The 2010 Statement notes 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.” The IASB is the standard-setting body of the IFRS Foundation (formerly called the IASC Foundation). Governance of the IFRS Foundation rests with 22 Trustees who are responsible for oversight and funding. The IFRS Foundation’s constitution also establishes a relationship with a “Monitoring Board” composed of public capital markets authorities (including the SEC) charged with the adoption or recognition of accounting standards used in their respective jurisdictions. As noted in the Proposed Roadmap, in considering whether to adopt IFRS, the SEC will consider the extent to which the IFRS Foundation has a secure and stable funding mechanism that promotes the foundation’s independence. To further evaluate the accountability and funding of the IFRS Foundation, the Work Plan identifies four areas for the SEC Staff to analyze:

- oversight of the IFRS Foundation, including whether the Monitoring Board is functioning as designed;
composition of the IFRS Foundation and the IASB;

funding of the IFRS Foundation, including the extent to which its funding mechanism promotes independence of the IASB, as well as potential mechanisms to provide the U.S.-based contribution; and

the IASB standard-setting process, focusing on the extent to which the process promotes pre-eminence of investor views, timeliness in completing projects (while satisfying appropriate public notice and comment requirements) and objectivity.

Investor understanding and education regarding IFRS, and how it differs from U.S. GAAP. The Work Plan acknowledges that a set of globally accepted accounting standards is beneficial to investors in their investment decision-making process only if investors understand and have confidence in the basis for the reported results. Although IFRS currently differs from U.S. GAAP in a number of areas and thus a transition to IFRS may require significant investor education, the Work Plan notes that many U.S. investors already possess some understanding of IFRS due to global industry focus, cross-border investment decisions and investments in foreign issuers. Furthermore, the Work Plan recognizes that the FASB-IASB convergence project should reduce the differences between IFRS and U.S. GAAP. The Work Plan identifies certain areas to research and analyze with respect to investor understanding and education to ensure that investors have a sufficient understanding of IFRS prior to potential implementation.

Understanding other regulatory impacts of a change in accounting standards. In the 2010 Statement, the SEC acknowledges that the adoption of IFRS for U.S. issuers could have far-reaching effects outside the securities laws context. The Work Plan describes several examples:

• Industry Regulators. As noted in the Proposed Roadmap, U.S. issuers commonly provide financial information to a wide variety of other parties, including other regulatory authorities, and these other regulators frequently rely on U.S. GAAP as a basis for their regulatory reporting regimes. Accordingly, a change to IFRS may impact issuers’ regulatory reporting and compliance. For example, as noted by a number of commenters on the Proposed Roadmap, if regulators continue to require U.S. GAAP reporting following a transition to IFRS, issuers may be required to prepare financial statements under both U.S. GAAP and IFRS. The Work Plan outlines areas for SEC Staff consideration, including evaluation of the impact of a change in SEC reporting on industry regulators.

• Federal and State Tax Impacts. As noted in the Proposed Roadmap, certain interactions exist between federal and state tax laws and U.S. GAAP. The Work Plan calls for an analysis of the impact of the adoption of IFRS on federal and state tax regulation.

• Statutory Dividend and Stock Repurchase Restrictions. The Work Plan notes that some states provide that dividends or amounts in respect of stock repurchases may only be paid from retained earnings or from current earnings despite an accumulated deficit. Adoption of IFRS could affect a company’s ability to take such corporate actions or require an issuer to keep two sets of records. The Work Plan calls for consideration of these concerns in connection with the potential transition to IFRS.

• Audit Regulation and Standard Setting. The Work Plan observes that the SEC must evaluate how the adoption of IFRS would affect the Public Company Accounting Oversight Board (“PCAOB”), including evaluating which PCAOB auditing standards may require amendment to better align with IFRS as well as the time that may be required to make any necessary changes.
to current auditing standards. As mentioned in the Proposed Roadmap, one specific area of concern is the recognition of legal contingencies. The IFRS threshold (more likely than not that an obligation exists) is lower than the U.S. GAAP threshold, and commenters have questioned an auditor’s ability to corroborate the information through audit inquiry letters obtained from an issuer’s attorneys.

- **Broker-Dealer and Investment Company Reporting.** The Proposed Roadmap excluded from IFRS implementation investment companies registered under the Investment Company Act of 1940 and certain other regulated entities that are required to file or furnish certain types of financial reports, such as broker-dealers. In response to comments about these exclusions, the SEC Staff will gather information to assess whether all U.S. issuers, including investment companies and broker-dealers, should be required to adopt IFRS.

- **Public versus Private Companies.** The Proposed Roadmap focused only on companies that file registration statements and reports with the SEC. Although private company reporting is largely outside the purview of the SEC, the Work Plan will consider how IFRS adoption could burden private companies considering an initial public offering, how IFRS adoption could impact business combinations between public companies using IFRS and private companies using U.S. GAAP, and whether any actions should be taken to accommodate any resulting implications on private companies.

**Understanding the impact to companies.** The Work Plan acknowledges that several commenters expressed concern that the cost, effort and time involved with a move to IFRS would be considerable. To that end, the Work Plan seeks to evaluate the types and magnitude of changes that issuers would need to make in a number of areas, including:

- **Modifications to Accounting Systems, Controls and Procedures.** The SEC Staff will address not only the accounting system modifications necessary for a full conversion to IFRS, but also modifications needed during the transition periods, and in the event that companies may need to report under two accounting systems (for example, if other regulators continue to require reporting under U.S. GAAP).

- **Contractual Arrangements.** As noted in the Proposed Roadmap, contracts often have provisions based off of U.S. GAAP reporting, such as financial covenants in debt instruments and performance metrics in lease contracts and employee compensation plans. Pursuant to the Work Plan, the SEC Staff will assess the types and pervasiveness of such contractual arrangements that would be implicated, and will gather information to determine the estimated time and resources required to address concerns regarding such contracts.

- **Corporate Governance.** Adoption of IFRS may reduce the number of individuals who could serve as “audit committee financial experts” under Sarbanes-Oxley, and who meet the financial literacy standards of the listing rules for U.S. securities exchanges. The SEC Staff will explore these and other corporate governance concerns and identify and evaluate possible approaches to address these concerns.

- **Accounting for Litigation Contingencies.** Commenters have raised concerns that the lower standard under IFRS regarding the treatment of litigation-related loss contingencies could erode the attorney-client privilege. Under the Work Plan, the SEC Staff will discuss concerns in this area with issuers, the legal profession and investors.

- **Smaller Issuers versus Larger Issuers.** The Proposed Roadmap contemplated a staggered implementation of IFRS based on issuer size over three years. Although no information is provided in the 2010 Statement or the Work Plan regarding how IFRS may be implemented if adopted, the Work Plan will seek to evaluate the cost and logistical impact on smaller issuers as compared with larger issuers.
Determining whether the parties who prepare and audit financial statements are sufficiently prepared, through education and experience, to make the conversion to IFRS. As part of the Work Plan, the SEC Staff will evaluate the current level of IFRS expertise and the extent of the education and training that will be required for investors, issuers, attorneys, auditors, regulators and educators in order to make a successful transition to IFRS.

Ongoing Role of FASB
In the 2010 Statement, the SEC states that it believes the FASB will continue to play a “critical and substantive role in achieving the goal of global accounting standards,” and that FASB’s role as the accounting standard-setter for U.S. capital markets will “remain critical after adoption of global standards.” Under the Work Plan, the SEC Staff will analyze approaches to the FASB’s ongoing role after potential IFRS adoption.

POTENTIAL IMPLEMENTATION METHODS AND SCHEDULE
The 2010 Statement provides that, following successful completion of the Work Plan and assuming completion of the FASB-IASB convergence projects under the current expected timetable, the SEC will be in a position in 2011 to determine whether to incorporate IFRS into the U.S. domestic reporting system. In response to comments on the Proposed Roadmap that U.S. issuers would need approximately four to five years to successfully implement a change to IFRS, the 2010 Statement states that, assuming the SEC determines to transition to IFRS, the SEC believes that the first time U.S. issuers would report under such a system would be approximately 2015 or 2016. The SEC Staff will further evaluate this timeline under the Work Plan. According to the 2010 Statement, the SEC will publish periodic progress reports on the Work Plan beginning no later than October 2010.

Under the Proposed Roadmap, in November 2008, the SEC proposed to allow certain large U.S. issuers to voluntarily adopt IFRS beginning with filings for fiscal years ending on or after December 15, 2009. Although the 2010 Statement notes that the SEC is not foreclosing the future possibility that issuers may be permitted to choose between IFRS and U.S. GAAP, or that some manner of early use or adoption would be available, it makes clear that the SEC is no longer actively pursuing rulemaking to provide for voluntary early adoption at this time. The SEC has also withdrawn its November 2008 proposed rules for limited early use of IFRS by certain U.S. issuers.

* * *

Copyright © Sullivan & Cromwell LLP 2010

SEC Work Plan for Consideration of IFRS Adoption
March 2, 2010
ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance and corporate transactions, significant litigation and corporate investigations, and complex regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 700 lawyers on four continents, with four offices in the U.S., including its headquarters in New York, three offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed below, or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future related publications from Jennifer Rish (+1-212-558-3715; rishj@sullcrom.com) or Alison Alifano (+1-212-558-4896; alifanoa@sullcrom.com) in our New York office.

CONTACTS

New York

<table>
<thead>
<tr>
<th>Name</th>
<th>Phone Number</th>
<th>Email Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>Robert E. Buckholz, Jr.</td>
<td>+1-212-558-3876</td>
<td><a href="mailto:buckholzr@sullcrom.com">buckholzr@sullcrom.com</a></td>
</tr>
<tr>
<td>Jay Clayton</td>
<td>+1-212-558-3445</td>
<td><a href="mailto:claytonwj@sullcrom.com">claytonwj@sullcrom.com</a></td>
</tr>
<tr>
<td>Robert W. Downes</td>
<td>+1-212-558-4312</td>
<td><a href="mailto:downesr@sullcrom.com">downesr@sullcrom.com</a></td>
</tr>
<tr>
<td>William G. Farrar</td>
<td>+1-212-558-4940</td>
<td><a href="mailto:farrarw@sullcrom.com">farrarw@sullcrom.com</a></td>
</tr>
<tr>
<td>David B. Harms</td>
<td>+1-212-558-3882</td>
<td><a href="mailto:harmsd@sullcrom.com">harmsd@sullcrom.com</a></td>
</tr>
<tr>
<td>Robert W. Reeder III</td>
<td>+1-212-558-3755</td>
<td><a href="mailto:reederr@sullcrom.com">reederr@sullcrom.com</a></td>
</tr>
<tr>
<td>Andrew D. Soussloff</td>
<td>+1-212-558-3681</td>
<td><a href="mailto:soussloffa@sullcrom.com">soussloffa@sullcrom.com</a></td>
</tr>
</tbody>
</table>

Washington, D.C.

<table>
<thead>
<tr>
<th>Name</th>
<th>Phone Number</th>
<th>Email Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>Robert S. Risoleo</td>
<td>+1-202-956-7510</td>
<td><a href="mailto:risoleor@sullcrom.com">risoleor@sullcrom.com</a></td>
</tr>
</tbody>
</table>

Los Angeles

<table>
<thead>
<tr>
<th>Name</th>
<th>Phone Number</th>
<th>Email Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>Patrick S. Brown</td>
<td>+1-310-712-6603</td>
<td><a href="mailto:brownp@sullcrom.com">brownp@sullcrom.com</a></td>
</tr>
<tr>
<td>Alison S. Ressler</td>
<td>+1-310-712-6630</td>
<td><a href="mailto:resslera@sullcrom.com">resslera@sullcrom.com</a></td>
</tr>
<tr>
<td>Rita-Anne O’Neill</td>
<td>+1-310-712-6698</td>
<td><a href="mailto:oneillr@sullcrom.com">oneillr@sullcrom.com</a></td>
</tr>
</tbody>
</table>

Palo Alto

<table>
<thead>
<tr>
<th>Name</th>
<th>Phone Number</th>
<th>Email Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scott D. Miller</td>
<td>+1-650-461-5620</td>
<td><a href="mailto:millersc@sullcrom.com">millersc@sullcrom.com</a></td>
</tr>
<tr>
<td>Sarah P. Payne</td>
<td>+1-650-461-5669</td>
<td><a href="mailto:paynesa@sullcrom.com">paynesa@sullcrom.com</a></td>
</tr>
</tbody>
</table>