AICPA® AUDIT COMMITTEE BRIEF
From the Audit Committee Effectiveness Center

June 2010

IFRS PRIMER FOR AUDIT COMMITTEES

History and Background

As of spring 2010, over 120 nations and reporting jurisdictions require or allow the use of IFRS by publicly traded companies, and others are planning to do so in the near future.

The movement toward adoption of a single set of high-quality, global accounting standards for use by organizations around the world continues to gather momentum. In the U.S., the movement began to take hold in 2002 when the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued the Norwalk Agreement. The IASB is a London-based, independent accounting standard setter that consists of 15 members from nine countries, including the U.S. The IASB issues accounting standards titled International Financial Reporting Standards (IFRS).

Under the Norwalk Agreement, the FASB and IASB acknowledged their commitment to developing high-quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. Ever since the agreement was signed, the two bodies have been working together toward that commitment in a process referred to as "convergence."

In 2007, the U.S. Securities and Exchange Commission (SEC) adopted rules allowing Foreign Private Issuers to prepare their financial statements in accordance with IFRS as issued by the IASB without reconciliation to U.S. Generally Accepted Accounting Principles (U.S. GAAP).

On November 14, 2008, the SEC issued a roadmap for the potential use of financial statements prepared in accordance with IFRS by U.S. issuers. The proposed roadmap included seven milestones to evaluate whether to mandate the use of IFRS by U.S. issuers, including improvements in accounting standards and IFRS education and training in the U.S.

On February 24, 2010, the SEC unanimously affirmed its belief that a single set of high-quality, globally accepted accounting standards would benefit U.S investors. It also reaffirmed its support for the continued convergence of U.S. GAAP and IFRS to narrow the differences between the two sets of standards. The FASB and the IASB's goal is to complete their major convergence projects in 2011.

The SEC has also directed its staff to execute a Work Plan that would help the SEC evaluate the impact of IFRS use by U.S. companies on the U.S. securities market. The Work Plan will take into account a number of factors, including the robust nature of IFRS, its effect on large and small U.S. companies, and the ability of people who prepare and audit financial statements to make the conversion to IFRS.

Assuming these convergence projects and the SEC staff's Work Plan are completed by 2011, the SEC will then decide whether to incorporate IFRS

Overview of IFRS 1 – *First-Time Adoption of IFRS*

- Provides detailed guidelines for first-time adoption of IFRS.
- Requires an opening IFRS statement of financial position at the date of transition to IFRS.
- Provides mandatory and optional exemptions from retroactive application of particular accounting requirements.
- Requires an entity to comply with each IFRS effective at the end of its first IFRS reporting period.
- Requires disclosures that explain how the transition from U.S. GAAP to IFRS affected the entity's reported financial position, financial performance and cash flows.

into the U.S. financial reporting system, and if so, when and how.

Reasons for Audit Committee Concern

IFRS are being used worldwide by more than 120 nations and reporting jurisdictions that either require or allow their use for the preparation of financial statements for domestic-listed companies. Convergence of U.S. GAAP with IFRS is underway. Considering the SEC's support for a single set of global accounting standards, it is reasonable to believe that the SEC may allow, or even require, adoption of IFRS by U.S. registrants in the not-too-distant future.

It is therefore important for audit committees to gain an understanding of IFRS. They should also be prepared to ask members of the company's management team specific questions to determine management's preparations for the possibility that the SEC could allow or require IFRS.

IFRS Considerations and Questions for Audit Committees

Advantages of using IFRS:

- Multinational companies may benefit from using common financial reporting systems that follow IFRS worldwide.
- IFRS may ease financial statement comparability with other companies that use IFRS worldwide.
- IFRS may facilitate cross-border investments and access to global capital markets.

Questions for audit committee consideration:

- Has the audit committee discussed the adoption of IFRS with company leadership?
- Does the audit committee believe that management understands how IFRS adoption will affect the company and its financial reporting process?
- Does the audit committee believe that management understands the full

For more information:

AICPA

"International Financial Reporting Standards (IFRS) – An AICPA Backgrounder"
http://www.ifrs.com/

Links to FASB and IASB Work Plans
http://www.ifrs.com/updates/FASB-IASB_Projects.html

IASB

Access to IFRS and Related Material
http://www.iasb.org/IFRSs/IFRS.htm

FASB

Overview of International Activities
http://www.fasb.org/intl/

SEC

Commission Statement in Support of Convergence and Global Accounting Standards
Sec.gov/rules/other/2010/33-9109.pdf

extent of the changes to the company and its financial reporting process?

- Does the audit committee have an oversight plan for monitoring IFRS implementation and progress?
- What impact does IFRS adoption have on internal control and financial statement disclosures?
- How will audit committee members become financially literate in IFRS and learn the key differences between IFRS and U.S. GAAP?
- How will the audit committee understand and question management's IFRS accounting-policy choices? IFRS contains less detail than U.S. GAAP and their application may require more professional judgment. The company will therefore need time to evaluate its choices for accounting policies. Also, depending on the accounting-policy choices, some processes and/or systems, such as fixed assets, share-based systems and inventory, may be affected.
- How will the audit committee inform the board of directors, compensation committee and others of the impact of the company's transition to IFRS?
- How will the audit committee know if management's education goals for shareholders and analysts are being met?

Questions for audit committee and management review:

- Are any of the company's foreign subsidiaries or joint ventures currently using IFRS?
- Has the company performed a readiness assessment of IFRS adoption?
- What are the challenges, risks and costs/benefits of IFRS adoption?
- What is the IFRS knowledge level within the company?
- What type and level of IFRS education will the company's employees need?
- What is the company's plan for educating stakeholders (e.g., investors, analysts, lenders and creditors) so that they understand accounting policy and financial statement changes? How will the company address the restatement of comparative periods and its possible impact on investors?
- Is management monitoring the FASB and IASB convergence efforts?
- What steps is the company taking now to prepare for IFRS adoption if an option is granted?
- Does the company have a transition plan that includes financial assessment, key conversion activities, a timetable, required resources, and project- and change-management training?
- If IFRS is adopted, how will it affect the company's business practices (e.g., changes to IT and other internal systems, risk monitoring and controls, relationships with external companies, contractual arrangements, outsourcing arrangements, inventory accounting, budgeting and forecasting, key performance indicators, compensation, joint ventures and alliances, subsidiaries, and legal issues, among other practices)?
- What are the changes to accounting and other policies? What is the potential financial impact of those changes? Is there an accounting impact

on the defined pension plan? Are there any off-balance sheet items that would be brought on to the balance sheet or vice versa? How will it affect disclosure?

- Are there any process or contract changes resulting from differences in hedge accounting guidelines?
- What are the tax implications of IFRS adoption (e.g., pre-tax income, differences in tax accounting on a company's effective tax rate, company's cash taxes in U.S. and foreign jurisdictions, and tax-reporting processes, among other implications)?
- How would IFRS adoption affect treasury (e.g., debt agreements, financial covenants and dividend policy, among other areas)?
- How is management making system changes or implementing new systems today that may be affected by the possible use of IFRS in the future?
- Are there particular IFRS accounting issues for the industry in which the company operates?
- Will external advisors be used to help with the transition to IFRS, and what will be their qualifications and roles?
- What is the company's approach for identifying and resolving transition-related issues, and communicating information to the audit committee?
- What is the company's plan for communicating IFRS transition-related information to stakeholders?
- Has a formal IFRS risk assessment been documented? Has it been integrated with existing risk-assessment information?

Next Steps

If the SEC makes a determination in 2011 to incorporate IFRS into the U.S. financial reporting system, the SEC believes the first time U.S. entities would be required to report under such a system would be no earlier than 2015.

While this might appear to be a long lead time, the SEC requirement for presenting two years of comparative prior-year financial statements means that calendar-year filers need to have much of their conversion work completed by their January 1, 2013 opening balance sheet date. In addition, the SEC stated that while it is not pursuing an early adoption option, it could reconsider this position later.

Audit committees need to anticipate the possibility that the SEC could allow, or even mandate, the use of IFRS. They also need to discuss with company leadership the extent to which the company is prepared for the transition and ensure that it has an effective implementation plan for moving to IFRS if or when required.

2510-347