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SEC Proposes Roadmap for the Adoption of IFRS for U.S. Issuers

Overview

On November 14, 2008, the SEC published for comment a proposed roadmap for the adoption by U.S. issuers of International Financial Reporting Standards (“IFRS”), as issued by the International Accounting Standards Board (“IASB”).¹ The SEC believes that the adoption of IFRS could enhance the ability of investors to compare the financial information of U.S. and non-U.S. companies.

In the proposal, the SEC sets forth several milestones that, if achieved, could lead to the replacement of generally accepted accounting principles in the U.S. (“U.S. GAAP”) with IFRS as the required accounting standards for domestic issuers.

Timetable for Adoption of IFRS

- **Voluntary Adoption**

2010 Domestic issuers that satisfy certain requirements² could voluntarily adopt IFRS.

- **Mandatory Adoption**

2011 The SEC will decide whether to require domestic issuers to use IFRS, based on various factors outlined in the proposed rules. If the SEC decides to make IFRS mandatory, it will be implemented in stages as follows:

2014 Large accelerated filers will have to use IFRS for financial reporting for any fiscal period ending on or after 12/15/2014.

2015 Accelerated filers will have to use IFRS for financial reporting for any fiscal period ending on or after 12/15/2015.

2016 Non-accelerated filers will have to use IFRS for financial reporting for any fiscal period ending on or after 12/15/2016.

¹ The SEC’s proposal is available at <http://www.sec.gov/rules/proposed/2008/33-8982.pdf>. To implement the transition to IFRS, the SEC has also proposed conforming rules and amendments to SEC Regulations S-X and S-K, as well as other parts of the Securities Exchange Act of 1934 and the Securities Act of 1933.

² These domestic issuers must be among the 20 largest companies worldwide (based on market capitalization) in industries where IFRS is the most commonly applied accounting standard. An eligible issuer would have to (1) submit a request detailing its eligibility for early adoption to the Division of Corporation Finance’s Office of the Chief Accountant and (2) receive a letter of no objection from the SEC in return. Currently, the SEC estimates that 110 issuers, or 12% of the total U.S. market capitalization as of December 2007, would be eligible for early adoption of IFRS.

Considerations for Domestic Issuers

In evaluating the SEC's proposed roadmap for the adoption of IFRS, domestic issuers should perform a comprehensive review of the impact that a change from U.S. GAAP to IFRS might have on their business and operations. A few key considerations are discussed below:

- **Training**

The transition from U.S. GAAP to IFRS will require training for those involved in the financial reporting process. Auditors, accountants, officers, audit committees and others involved in the preparation of financial statements will need to become familiar with IFRS. The internal training and procedural changes required for a shift to IFRS will result in additional costs to the transitioning issuer. Eligible issuers considering early adoption of IFRS may want to consider these costs before deciding to do so.

- **Internal Controls & Compliance**

A conversion to IFRS, whether voluntary or mandatory, will require an issuer to make sweeping adjustments to its internal reporting systems, procedures and controls to ensure that financial information is accurately captured and reported. Furthermore, during the transition period, such controls must enable the collection of financial information for both IFRS and U.S. GAAP reporting.

- **Limited Guidance**

IFRS is more principles-based and not as robust as U.S. GAAP and does not provide issuers with the same degree of detailed guidance for the preparation of financial statements. It will require management to exercise more judgment. Also, because IFRS is less comprehensive, its consistent application and interpretation is not guaranteed, which may compromise the comparability of financial information among like U.S. and non-U.S. issuers.

- **Debt Covenants & Existing Contracts**

An issuer's credit facilities, indentures or other contracts may include covenants tied to U.S. GAAP measures. Should IFRS be adopted, issuers will need to evaluate these instruments and amend any provisions that refer to U.S. GAAP or financial metrics that might be affected by different accounting treatment under IFRS. A transitioning issuer will also need to consider the extent to which existing contracts refer to or rely on U.S. GAAP, and whether the accounting treatment of such contracts will change under IFRS.

- **Tax Consequences**

Due to the interaction between income tax and accounting standards, the adoption of IFRS may impact an issuer's income tax. U.S. GAAP generally endorses the Last-in, First-out ("LIFO") method of inventory accounting; IFRS does not permit the use of the LIFO method, instead requiring the application of the First-in, First-out ("FIFO") method of accounting for inventory. The U.S. Internal Revenue Code defers to the inventory accounting method used for financial reporting as the method to be used for tax purposes, which has traditionally been the LIFO method. Thus, the transition from U.S. GAAP to IFRS will require that an issuer change from LIFO to FIFO inventory accounting, potentially resulting in a change to the issuer's taxable income.

- **Contingencies**

As the threshold for the recognition of legal contingencies under IFRS is lower than the threshold under U.S. GAAP, issuers may be required to reflect such contingencies sooner in their financial statements.

- **Compensation Arrangements**

Bonuses and sales commissions are often tied to financial statement results. Should an issuer adopt IFRS, these compensation arrangements may need to be adjusted.

- **Investor Relations**

Investors may be unfamiliar with IFRS and its differences from U.S. GAAP. As such, transitioning issuers should consider reaching out to investors and explaining the potential impact of IFRS on their financial statements.

- **Equity Investees & IPOs**

Where an IFRS-reporting issuer has an equity method investment in a company that prepares its financial statements in accordance with U.S. GAAP, the issuer would still need IFRS-based information to

accurately record and report the investment.

Obtaining this information may prove to be difficult and/or costly. In addition, should IFRS be adopted, a private company going public that uses U.S. GAAP will need to provide IFRS financial statements for its initial registration statement with the SEC.

- **Voluntary Conversion**

Issuers eligible for the early adoption of IFRS by 2010 face some unique considerations. For the first year IFRS is used to prepare financial statements, the issuer will need to provide audited IFRS statements for the preceding 3 years. This will require advance planning, training and data collection. Also, should the SEC elect not to proceed with the adoption of IFRS in 2011, the SEC may require early adopting issuers to revert to U.S. GAAP.

Comments on the IFRS roadmap must be submitted to the SEC by February 19, 2009. Information on submitting comments to the SEC can be found on the SEC's website at www.sec.gov/rules/submitcomments.htm.

Our client alerts are for general informational purposes and should not be regarded as legal advice. If you would like additional information or have any questions, please contact:

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