

# Investors Technical Advisory Committee

401 Merritt 7, P.O. Box 5116, Norwalk, Connecticut 06856-5116 | 203 956-5320  
Fax: 203 849-9714

## Via Email

August 31, 2007

Ms. Nancy M. Morris  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: File Number S7-13-07. Proposed Rule: Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP (Proposed Rule).

Dear Ms. Morris,

The Investors Technical Advisory Committee (ITAC or Committee) comprises 12 individuals from the investment profession possessing strong technical accounting knowledge.<sup>1</sup> The purpose of the ITAC is to provide independent technical advice, from the investors' perspective, to the Financial Accounting Standards Board (FASB) and its staff. At its June 12, 2007 meeting, the ITAC concluded that, given the importance of the Proposed Rule to the FASB's standard setting activities, the Committee should submit a comment letter in response. This letter represents the views of the ITAC and does not necessarily represent the views of its individual members, the organizations by which they are employed, or the views of the FASB or its staff.

We support the goal of convergence to a single set of high quality financial reporting standards by the International Accounting Standards Board (IASB) and the FASB. With world-wide market information becoming more accessible (and inexpensive to access) by all classes of investors, all investors would benefit from having just one high quality financial reporting language spoken in corporate communications.

We commend the U.S. Securities and Exchange Commission (SEC or Commission) for trying to move existing reporting in the direction of convergence by issuing the Proposed Rule. We are particularly pleased that the proposal to eliminate the reconciliation extends only to financial statements that are prepared strictly on the basis of International Financial Reporting Standards (IFRS) as issued by the IASB and excludes any statements prepared using "country versions" of the standards. We, however, do not believe that there is sufficient current symmetry between the IFRS literature and U.S. Generally Accepted Accounting Principles (GAAP) to warrant the elimination of the required reconciliation. There remain many highly material differences in the results produced by the two systems.<sup>2</sup> In the absence of the required reconciliation, those important differences generally could not be quantified or even reasonably estimated.

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<sup>1</sup> For more information about the Investors Technical Advisory Committee (ITAC), including a list of the current members and the organizations in which they are employed, see [http://www.fasb.org/investors\\_technical\\_advisory\\_committee/](http://www.fasb.org/investors_technical_advisory_committee/).

<sup>2</sup> As one recent example of the numerous and highly material differences in the results of the two systems, the Form 20-F filed by Kabel Deutschland Vertrieb und Service GmbH & Co. KG (Kabel) with the U.S. Securities and Exchange Commission on July 31, 2007, contains over ten pages of disclosures reconciling its use of International Financial Reporting Standards (IFRS) to U.S. Generally Accepted Accounting Principles (GAAP). Kabel, Financial Statements (Form 20-F), at F-134-45, *available at* [http://www.sec.gov/Archives/edgar/data/1359737/000110465907057443/a07-17295\\_120f.htm](http://www.sec.gov/Archives/edgar/data/1359737/000110465907057443/a07-17295_120f.htm). Those disclosures reveal that Kabel's net loss for its year ending March 31, 2007, was 430,038 T€ in accordance with IFRS as compared to 44,933 T€ in accordance with U.S. GAAP. *Id.* at F-135.

While we would agree that progress has been made towards convergence of the two systems, it is not yet at the point where most reconciliations in SEC filings are labeled “Not Applicable.” If such a result were to occur, it would indicate the achievement of convergence – or at least a substantial harmonization, with the exception of items bearing inconsequential significance to investors.

We note that the Proposed Rule’s elimination of the reconciliation provision “is based on ... the robustness of a process that lends itself to continued progress of the IASB and the FASB towards convergence over time through, among other things, the joint development of future standards.”<sup>3</sup> While we agree with the Commission that there is fairly “robust processes” present in the workings of the FASB and IASB,<sup>4</sup> we disagree that its presence means that the convergence finish line has been crossed – or is even within imminent reach. Having a process in place to achieve convergence is not the same as having achieved convergence. Moreover, we are concerned that removing the reconciliation requirement might result in further delay to reaching a genuinely converged conceptual framework.

We would prefer to see concrete evidence that the two sets of standards are substantially equivalent before the reconciliation is eliminated. We suggest that the Commission undertake an evaluation of the IFRS/U.S. GAAP differences commonly found in the reconciliations, and periodically publicly disseminate and report upon such an inventory. We also suggest the development of a separate inventory of all of the differences between the two sets of standards. The reconciliation requirement should be dropped only when the inventory of all identified differences has been satisfactorily resolved. If this milestone is reached reconciliation would clearly not be warranted.

The differences among accounting standards are not our only concern. We are not yet certain that there is consistent auditing and enforcement of the application of IFRS. We understand that the international accounting firms currently assign highly experienced U.S. GAAP-trained practitioners to review the SEC filings of foreign private issuers and the accuracy of the reconciliation as a matter of due course. Given the fragmentation of international auditing standards and disciplines and the inconsistent state of the application of IFRS,<sup>5</sup> we view this process as critical in ensuring consistent application of accounting and auditing disciplines among international peers and the completeness of financial disclosures provided to U.S. investors. We, therefore, also suggest that the Commission undertake an evaluation of the differences in the auditing and enforcement disciplines of IFRS versus the auditing and enforcement of U.S. GAAP and how those differences may affect the comparability and credibility of the resulting financial reports before concluding that the reconciliation may be omitted.

We believe elimination of the reconciliation at this time will actually *hinder* the convergence process. The reconciliation provides a visible reminder that convergence has not yet been achieved, and provides direction for standard setters in setting their priorities for convergence projects. More importantly, as long as there are two standard setters, the reconciliation injects a dynamic tension into the convergence process. We are concerned that without a reconciliation requirement the IASB, and those who participate and oversee its process, might not act with a sense of urgency on convergence issues.

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<sup>3</sup> Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP, Securities Act Release No. 8818, Exchange Act Release No. 55,998, International Series Release No. 1302, 72 Fed. Reg. 37,962, 37,967 (proposed July 11, 2007).

<sup>4</sup> *Id.*

<sup>5</sup> See Staff Observations in the Review of IFRS Financial Statements 2 (July 2, 2007), *available at* [http://www.sec.gov/divisions/corpfin/ifrs\\_staffobservations.htm](http://www.sec.gov/divisions/corpfin/ifrs_staffobservations.htm) (indicating inconsistent application of IFRS in a number of areas including statement of cash flows, common control mergers, recapitalizations, reorganizations, acquisitions, and minority interests).

We note that convergence might also be hindered by other current Commission activities relating to financial accounting and reporting. For example, the Commission recently issued a staff Concept Release that asks whether U.S. issuers should be permitted to use IFRS for purposes of complying with the Commission's rules and regulations."<sup>6</sup> If the goal of convergence is a single set of high quality accounting standards, would permitting U.S. companies the option to use IFRS or U.S. GAAP further the attainment of that goal?

In our view the reconciliation remains a critical repository, providing visibility to investors of the material variations between the accounting systems that are otherwise generally not determinable. Given the aforementioned trends, we believe it is clearly premature to consider its removal because the data in the reconciliation has even greater significance to investors during a period of frequent underlying changes to the respective GAAPs.<sup>7</sup>

While we respect the work of the IASB and its staff, we are concerned that the substance of the Proposed Rule is to recognize the IASB as a standard setter for purposes of the U.S. public capital markets, on virtually the same level as the FASB. We note that the funding mechanism for the IASB could have a negative effect on the quality and timeliness of the standards it produces and may jeopardize its independence. The FASB has been funded by public fees since 2003 as required by the Sarbanes-Oxley Act of 2002, and hence, is an adequately funded independent standard-setter free of the potential influences that might occur in seeking contributions from constituents to fund its operations. The IASB does not enjoy the same degree of independence: Its operations are funded by donor contributions, and its trustees are currently searching for a funding program for 2008.<sup>8</sup>

While the reconciliation requirement currently fosters cooperation on the part of the standard setters by the healthy creative tension it provides, we believe its elimination would replace that creative tension with greater control over the convergence process by European governments. As the Proposed Rule notes, since 2005 the European Union (EU) has required companies incorporated in its Member States with securities trading on an EU regulated market to report their consolidated financial statements using endorsed IFRS.<sup>9</sup> The crucial concept is "endorsed IFRS," pursuant to which the European Parliament must approve any standards issued by the IASB. That has the potential to inject a political, Euro-centric bias into standards set by the IASB, which already has, as noted, a funding system that is susceptible to influence. As a consequence, genuine convergence may be deterred, the promulgation of improved converged standards may be unnecessarily delayed, and further divergence may result as future standards are created. We believe that it would not be in the best interests of the investing public at large if the SEC were to effectively put IASB standards on the same footing as FASB standards through the elimination of the reconciliation given those circumstances; the FASB would be at a disadvantage in trying to produce high-quality standards for investors while trying to "push" those standards through another system that is more susceptible to political pressures that have the potential to represent local economic or political sentiments, which often can run counter to the interests of investors.

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<sup>6</sup> Concept Release on Allowing U.S. Issuers To Prepare Financial Statements in Accordance with International Financial Reporting Standards; Proposed Rule, Securities Act Release No. 8831, Exchange Act Release No. 56,217, Investment Company Act Release No. 27,924, 72 Fed. Reg. 45,600, 45,600 (Aug. 14, 2007) available at <http://www.sec.gov/rules/concept/2007/33-8831fr.pdf>.

<sup>7</sup> Some ITAC members fear that without the reconciliation requirement in place the practice of disclosure of a "pro forma" reconciliation in company earnings releases will emerge that that will neither be complete nor subject to an external independent audit.

<sup>8</sup> See International Accounting Standards Board, Future Funding, available at <http://www.iasb.org/About+Us/About+the+Foundation/Future+Funding.htm>.

<sup>9</sup> See 72 Fed. Reg. at 37,965.

Another feature of the reconciliation is that it provides investors with awareness of international standards. Some investors receive their education about IFRS via “on the job training” – through the study of financial statements and learning from them the accounting differences of different jurisdictions. Removal of the reconciliation during the still relatively early stages of convergence would withdraw valuable information from investors.

The Proposed Rule espouses the Commission’s belief that elimination of the reconciliation may spur a wider adoption of IFRS. We agree with that assessment, but we do not agree with the statement that “[t]he resulting reduction of the multiplicity of accounting standards that presently exist is expected to benefit investors by allowing them to spend less time and allocate fewer resources to learning, or keeping up with developments in, myriad GAAPs of varying quality in favor of a single, high-quality set of globally accepted standards.”<sup>10</sup> We believe the opposite will occur: If the reconciliation vanishes at the present state of IFRS evolution (standards setting, interpretation, and compliance aspects) and convergence, investors will have to work harder to gain an understanding of IFRS reporting, including attempting to compensate for the major gaps in IFRS at present, such as accounting for insurance liabilities and extractive industries. Instead of having IFRS reporting equated to something familiar to them – US GAAP reporting – they will have to build their knowledge more directly. IFRS reporting is not widely taught in the American education system currently; there is little broad knowledge of its application among investors. Thus, investors’ investment in self-education will become much more costly without the reconciliation’s presence.

We also note that the Commission’s staff is still gaining familiarity<sup>11</sup> with the proper application of IFRS, when the elimination of the reconciliation could trigger a substantial increase in the number of IFRS-denominated filings. We question how the Commission could effectively carry out its mission of investor protection if faced with a large influx of new IFRS filers while still trying to develop in-house expertise. All accounting talent has been in scarce supply in the last few years, and we are not aware of an overabundance of IFRS expertise in the marketplace. We doubt that the Commission could quickly acquire satisfactory new talent.

We also are troubled that the elimination of the reconciliation could trigger a weakening of the existing quality control practices of the “Big Four” accounting firms that audit foreign company filers that use IFRS. As noted, it is our understanding that the firms’ practices typically involve a review of the U.S. GAAP/IFRS reconciliation by the firms’ experts from both U.S. GAAP and IFRS disciplines. It is also our understanding that those reviews have frequently identified IFRS application problems *before* the issuance of the financial statements to the public. We believe that such reviews are of the utmost importance while foreign filers are in the early years of applying IFRS, and that such practices provide a benefit to investors which would likely vanish if the reconciliation requirement were eliminated.

We also do not believe that the reconciliation should be waived for classes of registrants, such as companies that exceed (or are below) a certain market capitalization or total asset threshold, especially when the SEC staff review found that even several of the largest IFRS filers are not able to properly report under IFRS without displaying many highly material deficiencies.<sup>12</sup> We believe that the reconciliation provides important information about all companies, and to partially eliminate it could introduce informational shortfalls that could prevent investors from adequately assessing a company’s performance and performing peer comparisons.

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<sup>10</sup> *Id.* at 37,984.

<sup>11</sup> *Id.* at 37,968.

<sup>12</sup> *See* Staff Observations in the Review of IFRS Financial Statements, *supra*, at 1-2.

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In closing, we urge the Commission to drop or revise the Proposed Rule and focus its efforts on supporting and defending the private sector process that the FASB and IASB have established to resolve the reconciling differences by working jointly to improve the overall quality of financial accounting and reporting standards. To eliminate the reconciliation at this time would amount to nothing more than achieving convergence by decree, rather than by achieving it in fact. It would effectively demote U.S. GAAP to a lower common denominator – a poor public policy.

If you have any questions, please feel free to contact the undersigned or any ITAC member.

Sincerely,

A handwritten signature in black ink, reading "Jack Ciesielski". The signature is written in a cursive style with a large, looping initial "J".

Jack Ciesielski

Member

Investors Technical Advisory Committee