

# COUNCIL OF INSTITUTIONAL INVESTORS

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## Via Email

September 24, 2007

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

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

Dear Ms. Morris:

I am writing on behalf of the Council of Institutional Investors (“Council”), an association of more than 130 public, corporate and union pension funds with combined assets of over \$3 trillion. As a leading voice for long-term, patient capital, the Council welcomes the opportunity to provide comments on the Securities and Exchange Commission’s (“SEC” or “Commission”) proposed amendments to Form 20-F and conforming changes to Regulation S-X.<sup>1</sup> The effect of those proposed changes would be to permit the SEC to accept financial statements prepared in accordance with the English language version of International Financial Reporting Standards (“IFRS”) as published by the International Accounting Standards Board (“IASB”) without reconciliation to U.S. generally accepted accounting principles (“GAAP”) when contained in the filings of foreign private issuers with the Commission (“Proposed Rule”).

On March 20, 2007, the Council’s general members unanimously approved the following policy regarding the independence of accounting and auditing standard setting:

Audited financial statements and their related disclosures are a critical source of information to institutional investors making investment decisions. The well-being of the financial markets—and the investors who entrust their financial present and future to those markets—depends directly on the quality of the information audited financial statements and disclosures provide. The quality of that information, in turn, depends directly on the quality of the standards that . . . preparers use to recognize and measure their economic activities and events . . . . The result should be accurate, transparent, and understandable financial reporting.

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<sup>1</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. 1301, 72 Fed. Reg. 37,962 (Proposed July 11, 2007), *available at* <http://www.sec.gov/rules/proposed/2007/33-8818fr.pdf> (“Proposed Rule”).

The responsibility to issue and develop accounting . . . standards should reside with independent private sector organizations with an appropriate level of government input and oversight. Those organizations should possess adequate resources and the technical expertise necessary to fulfill this important role. Those organizations should also include significant representation from investors and other users of audited financial reports on the organizations' boards and advisory groups. Finally, those organizations should employ a thorough public due process that includes solicitation of public input on proposals and consideration of user views before issuing final standards. The United States Congress, the Securities and Exchange Commission ("SEC"), and other federal agencies and departments should respect and support the independence of the designated accounting and auditing standard setting organizations and refrain from interfering with or overriding the decisions and judgments of those bodies.<sup>2</sup>

Consistent with our conclusion that high quality accounting standards can best be established by an independent private sector standard setting organization, we generally support the Commission's views expressed in the Proposed Rule that any potential elimination of the U.S. GAAP reconciliation requirement should (1) "apply only to a foreign private issuer that files its financial statements in full compliance with the English language version of IFRS *as published by the IASB*;"<sup>3</sup> and (2) be "premised on the IASB's sustainability, *governance* and continued operation in a stand-alone manner as a standard setter . . . ." <sup>4</sup> We, however, believe that there are at least two related issues critical to the independence of the IASB that the Proposed Rules fail to adequately address: (1) IASB funding; and (2) the European Union ("EU") endorsement process.

### IASB Funding

Section 109 of the Sarbanes-Oxley Act of 2002 requires that public companies pay accounting support fees to the U.S. GAAP standard setter—the Financial Accounting Standards Board ("FASB").<sup>5</sup> Section 109 eliminated the need for the Financial Accounting Foundation, the parent entity of the FASB, "to seek contributions from accounting firms and companies whose financial statements must conform to FASB's rules."<sup>6</sup>

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<sup>2</sup> Council Policies, Pension Fund Issues, I. Independence of Accounting and Auditing Standard Setting (Mar. 20, 2007), available at <http://www.cii.org/policies/softdollars.htm>.

<sup>3</sup> Proposed Rule, 72 Fed. Reg. at 37,970 (emphasis added).

<sup>4</sup> Proposed Rule, 72 Fed. Reg. at 37,969 (emphasis added).

<sup>5</sup> Sarbanes-Oxley Act of 2002, H.R. 3763, 107<sup>th</sup> Cong. § 109(e) (2002).

<sup>6</sup> S. Rep. No. 107-205, at 13 (2002).

Section 109 was the result of a decision by the U.S. Senate Committee on Banking, Housing, and Urban Affairs (“Banking Committee”) that stable funding was necessary to “strengthen the independence of the FASB . . . .”<sup>7</sup> More specifically, the Banking Committee found that

Witnesses overwhelmingly agreed that . . . the FASB required guaranteed sources of funding, in order to protect their independence. . . . With respect to the FASB, Michael Sutton, a former SEC Chief Accountant, testified to the Committee that “[t]o restore confidence in our standards setters, we should take immediate steps to secure independent funding for the FASB—funding that does not depend on contributions from constituents that have a stake in the outcome of the process.”<sup>8</sup>

With this recent history in mind, we are concerned that the independence of the IASB may be compromised by the source of its funding. We note that the vast majority of the IASB’s current funding is the result of voluntary commitments that apparently terminate in 2007 and are from the same two constituents—companies and accounting firms—that the Banking Committee was most troubled by.<sup>9</sup>

We obviously agree with the conclusion of the International Accounting Standards Committee Foundation (“IASCF”), the parent entity of the IASB, that the current system of funding the IASB is not “sustainable.”<sup>10</sup> We view as potentially positive the development that the IASCF has agreed on the “[c]haracteristics” of a “new scheme for 2008” that would, if successful, provide “broad-based” funding “not contingent on any particular action that would infringe on the independence” of the IASB.<sup>11</sup> We note that the Proposed Rule indicates that the IASCF “Trustees continue to make progress in obtaining stable funding that satisfies those elements.”<sup>12</sup> We, however, are unaware of any publicly available information that supports a premise that our concerns about the funding issue will be resolved anytime soon.

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<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> International Accounting Standards Board, Future Funding 1, <http://www.iasb.org/About+Us/About+the+Foundation/Future+Funding.htm> (last visited Sept. 23, 2007).

<sup>10</sup> *Id.*

<sup>11</sup> *Id.* at 1-2.

<sup>12</sup> Proposed Rule, 72 Fed. Reg. at 37,964-65.

### EU Endorsement Process

The Proposed Rule contains over a half dozen paragraphs discussing the IASB structure and process. In our view, however, that discussion is incomplete because it does not take into account the EU influence on the development of IFRS standards as a result of the EU endorsement process. The following is a summary description of that process:

First, the European Financial Reporting Advisory Group (EFRAG) technically assesses each new standard and interpretation approved by the IASB and submits the assessment to the [European Commission or] EC. EFRAG is an independent private body whose task is to provide the EC “advice on the technical soundness of new standards.” EFRAG’s members are academics, analysts, auditors, industry representatives, and users. To approve or disapprove an accounting standard, two-thirds of the members of EFRAG’s Technical Expert Group must agree.

In July 2006, the EC created the Standards Advice Review Group (SARG) to review EFRAG’s opinions to ensure their objectivity and proper balance. The EC will appoint up to seven members to SARG. Members will be independent accounting experts and high-level representatives from EU national accounting standards setters. SARG will be expected to deliver its advice within three weeks of EFRAG responses.

The EC then submits a proposed standard to the European Parliament and the Accounting Regulatory Committee (ARC). The ARC is chaired by the EC and composed of representatives of the EU member states. This represents the political aspect of the endorsement process. If a majority of the member states favors a proposed standard, it is approved by the ARC.

After approval by the ARC and the European Parliament, the EC formally decides on the use of new IASB standards and interpretations within the EU. Therefore, the final—and some would say most important—part of the endorsement process requires the EC to adopt new IFRSs and publish them in the *Official Journal of the EU*.<sup>13</sup>

The absence of any discussion of the EU endorsement process is problematic since the process has resulted in several incidents that raise serious concerns about whether the process is undermining the independence of the IASB. In 2004, the process resulted in a carve-out of several paragraphs from International Accounting Standards 39, *Financial Instruments: Recognition and Measurement* (“IAS 39”).<sup>14</sup> In addition to impairing the independence of the IASB by overriding the results of the IASB’s public due process, many believe that the EU’s carve-out of IASB 39 (and the threat of future EU carve-outs) has hindered the efforts of the IASB and FASB to converge the accounting for financial instruments, if not the overall convergence effort.<sup>15</sup>

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<sup>13</sup> Robert K. Larson & Donna L. Street, *The Roadmap to Global Accounting Convergence—Europe Introduces ‘Speed Bumps’*, CPA J. 5-6 (2006), available at <http://www.nysscpa.org/cpajournal/2006/1006/essentials/p36.htm>.

<sup>14</sup> *Id.* at 6.

<sup>15</sup> *See id.*

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In March 2005, the European Financial Reporting Advisory Group (“EFRAG”) officially recommended that the EU not endorse International Financial Reporting Interpretations Committee 3, *Emission Rights* (“IFRIC 3”).<sup>16</sup> Following the EFRAG’s recommendation, the European Commission (“EC”) officially requested that the IASB defer the March 1, 2005, effective date for IFRIC 3.<sup>17</sup> In late June 2005, the IASB withdrew IFRIC 3.<sup>18</sup>

In April 2007, the Economic and Monetary Affairs Committee of the European Parliament proposed a Parliamentary resolution calling on the EC to conduct a thorough impact assessment of IFRS 8, *Operating Segments* (“IFRS 8”), prior to endorsing it.<sup>19</sup> In response, the EC has taken actions that have to-date delayed the endorsement process for IFRS 8.<sup>20</sup>

As indicated, the Council generally agrees with the Commission that any potential acceptance of financial statements prepared in accordance with the English language version of IFRS as published by the IASB without reconciliation to U.S. GAAP should be premised on the IASB’s sustainability, governance, and continued operation in a stand-alone manner. Given, however, our significant concerns about the impact of the EU endorsement process and the IASB’s funding on the independence of the IASB going forward, we would respectfully request that the SEC thoroughly assess those two issues and publicly report its findings, conclusions, and recommendations *prior to* issuing any final rule that would eliminate the Commission’s longstanding reconciliation requirement.<sup>21</sup>

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We appreciate the opportunity to express our views on this matter. Please feel free to contact me with any questions.

Sincerely,



Jeff Mahoney  
General Counsel

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<sup>16</sup> *Id.* at 7.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> European Parliament, Motion for a Resolution 3 (Apr. 18, 2007), *available at* <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+MOTION+B6-2007-0157+0+DOC+PDF+V0//EN>

<sup>20</sup> See European Commission, Endorsement of IFRS 8 *Operating Segment*—Analysis of potential Impacts (API) 2 (May 30, 2007), *available at* [http://ec.europa.eu/internal\\_market/accounting/docs/ifrs8-consultation-final.pdf](http://ec.europa.eu/internal_market/accounting/docs/ifrs8-consultation-final.pdf).

<sup>21</sup> Of note, other issues raised by the Proposed Rule that are likely important to many investors are contained in a paper prepared on behalf of the Council by Professor Donna L. Street, Mahrt Chair in Accounting, University of Dayton. We expect that Professor Street’s paper will soon be completed and made available on the Council’s website at <http://www.cii.org>.