

COUNCIL OF INSTITUTIONAL INVESTORS

Suite 500 • 888 17th Street, NW • Washington, DC 20006 • (202) 822-0800 • Fax (202) 822-0801 • www.cii.org

Via Email

November 9, 2007

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

Re: Concept Release on Allowing U.S. Issuers To Prepare Financial Statements in Accordance With International Financial Reporting Standards (File Number S7-20-07)

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 United States (“US”) Securities and Exchange Commission’s (“SEC” or “Commission”) Concept Release to obtain information about the extent and nature of the public’s interest in allowing US issuers to prepare financial statements in accordance with International Financial Reporting Standards (“IFRS”) as published by the International Accounting Standards Board (“IASB”) for purposes of complying with the rules and regulations of the Commission.¹

In response to the issuance of (1) the Concept Release, and (2) the SEC’s related July 11, 2007, Proposed Rule to accept from foreign private issuers their financial statements prepared in accordance with IFRS without reconciliation to US generally accepted accounting principles,² the Council has taken a number of steps to assist Council members and other institutional investors in better understanding the issues raised by those due process documents.³ Those steps have included:

- A plenary session at our 2007 fall membership meeting discussing international convergence of accounting standards. That session featured Robert Herz, Chair, Financial Accounting Standards Board (“FASB”), Thomas Jones, Vice Chair, IASB, and Mark Olson, Chair, Public Company Accounting Oversight Board.
- The establishment of an informal Council working group on accounting and auditing.

¹ Concept Release on Allowing U.S. Issuers To Prepare Financial Statements in Accordance With International Financial Reporting Standards (“IFRS”), Securities Act Release No. 8831, Exchange Act Release No. 56,217, Investment Company Act Release No. 27,924, 72 Fed. Reg. 45,600 (Aug. 14, 2007) (“Concept Release”).

² Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With IFRS 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 (Proposed July 11, 2007) (“Proposed Rule”).

³ Convergence of International Accounting Standards Receives Attention at SEC, on Capitol Hill, Alert 4 (Couns. Institutional Investors, Washington, DC), Oct. 4, 2007 (on file with the Council).

- A white paper prepared on behalf of the Council by Professor Donna L. Street, Mahrt Chair in Accounting, University of Dayton, entitled “International Convergence of Accounting Standards: What Investors Need to Know” (“White Paper”).

The White Paper, which is attached to this letter, includes a discussion of a number of important investor related issues various parties have raised in support of, and in opposition to, the Commission potentially allowing US issuers to prepare financial statements in accordance with IFRS as published by the IASB.⁴ The Council respectfully requests that the Commission carefully analyze the issues and related discussion set forth in the White Paper as part of your efforts to “better understand the nature and extent of the public’s interest” in this area.⁵

Of all of the issues referenced in the White Paper, one area of particular concern to the Council is the independence of the IASB.⁶ As background, 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.

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.⁷

⁴ Donna L. Street, International Convergence of Accounting Standards: What Investors Need to Know 24-30 (Oct. 2007) (Attachment).

⁵ Concept Release, 72 Fed. Reg. at 45,601.

⁶ Attachment, at 22-23; 30.

⁷ Council Policies, Pension Fund Issues, I. Independence of Accounting and Auditing Standard Setting (Mar. 20, 2007), available at <http://www.cii.org/policies/Policies%20on%20Other%20Governance%20Issues%2003-20-07.pdf>.

Consistent with the Council’s conclusion that high quality accounting standards can best be achieved by an independent private sector standard setting organization, we agree with the Commission that the “sustainability, governance and continued operation of the IASB are important factors for development of a set of high quality, globally accepted accounting standards . . .”⁸ Moreover, we believe that there are at least three related issues that are critical to the sustainability, governance and independence of the IASB and that those issues should be resolved as soon as possible and certainly *before* the Commission considers allowing US issuers to prepare financial statements in accordance with IFRS. Those issues are: (1) IASB funding; (2) the European Union (“EU”) endorsement process; and (3) Investor representation on the IASB.

IASB Funding

Sections 108 and 109 of the Sarbanes-Oxley Act of 2002 (“SOX”) currently require that US public companies pay accounting support fees to the US accounting standard setter—the FASB.⁹ Those sections 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.”¹⁰

Sections 108 and 109 of SOX were the result, in part, of a decision by the US Senate Committee on Banking, Housing, and Urban Affairs (“Banking Committee”) that a source of stable funding was necessary to “strengthen the independence of the FASB . . .”¹¹ 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.’¹²

⁸ Concept Release, 72 Fed. Reg. at 45,604.

⁹ Sarbanes-Oxley Act of 2002, H.R. 3763, 107th Cong. §§ 108-109 (2002), available at <http://fl1.findlaw.com/news.findlaw.com/hdocs/docs/gwbush/sarbanesoxley072302.pdf>.

¹⁰ S. Rep. No. 107-205, at 13 (2002).

¹¹ *Id.*

¹² *Id.*

With this recent history in mind, we are concerned that the independence of the IASB may be compromised by the current source of its funding.¹³ We note that the vast majority of the IASB's current funding is the result of voluntary commitments from less than 200 organizations.¹⁴ Most of those organizations are from the same two constituents—companies and accounting firms—that the Banking Committee was most troubled by.¹⁵

Our concerns about the potential impact of the IASB's current funding on its independence are real and shared by many other parties.¹⁶ As one example, in a September 19th presentation before the Economic and Monetary Affairs Committee of the European Parliament, a research fellow for a European think tank devoted to international economics stated:

Given its light framework of governance and funding, maintaining independence from dominant influences . . . is a first-order priority for the international standard setter . . .¹⁷

¹³ As an aside, we note that one commentator has indicated that “[i]t is not clear what would happen to that funding [referring to Sections 108 and 109 of the Sarbanes-Oxley Act of 2002 (“SOX”)] if companies that list in the U.S. could report their financial results using standards set by the IASB instead.” David M. Katz, IFRS or GAAP: Take Your Pick?, CFO.com, May 3, 2007, at 1, *available at* <http://www.cfo.com/article.cfm/9133180?f=related>. Similarly, Professor Lawrence A. Cunningham commented that “[i]f IASB began to set the standards [for US-listed companies], affected companies should not be required to contribute to the FASB’s budget.” Letter from Lawrence A. Cunningham, George Washington University Law School, to Securities and Exchange Commission (“SEC” or “Commission”) 2 (Aug. 10, 2007), *available at* <http://www.sec.gov/comments/s7-20-07/s72007-1.pdf>. It is surprising that neither the Proposed Rule nor the Concept Release addresses the issue of how the Commission’s potential actions permitting greater use of IFRS by U.S.-listed companies will or should impact the funding provisions of Sections 108 and 109 of SOX.

¹⁴ International Accounting Standards Board (“IASB”), Future Funding 1, <http://www.iasb.org/About+Us/About+the+Foundation/Future+Funding.htm> (last visited Nov. 7, 2007).

¹⁵ See *id.*

¹⁶ Of note, in 2002 United States Senator Carl Levin (D-Michigan) publicly released an email from David Duncan, the lead auditor of Enron Corp. (“Enron”) at Arthur Andersen. The email described Enron Chief Accountant Rick Causey’s inquiries about whether Enron’s potential contribution to the IASB would buy access and influence to the standard setting process. Senate Floor Statement of Senator Carl Levin (D-Mich) on the Introduction of Legislation to End the Double Standard for Stock Options [S. 1940] 4-5 (Feb. 13, 2002), *available at* <http://www.senate.gov/~levin/newsroom/release.cfm?id=209088>.

¹⁷ Nicolas Véron, Research Fellow at Bruegel, Presentation to the Economic and Monetary Affairs Committee of the European Parliament 3 (Sept. 19, 2007), *available at* http://veron.typepad.com/main/files/EuroParl_IFRS8_Sep07.pdf.

We welcome the recent reports from the Trustees of the International Accounting Standards Committee Foundation (“IASCF”) that they (1) “have achieved multi-year financing commitments of more than £12 million of a £16 million annual target” for the IASB;¹⁸ and (2) that the combination of national funding schemes, broad-based voluntary programs, and other sources “will bring the sources of funding from less than 200 organizations in 2006 to several thousand by 2008.”¹⁹ We, however, note that the entity that has “daily interactions” with the IASB—the FASB—raised the following serious funding concerns in their November 7th comment letter to the SEC in response to the Concept Release:

We believe the current funding levels and staffing mechanisms of the IASB are not adequate for the tasks it will face if the improved version of the IFRS becomes the single set of global accounting standards. Moreover, the current funding sources appear unstable, and they give rise to independence concerns.²⁰

We agree with the FASB and other commentators that a “funding mechanism that provides adequate resources while protecting the independence of the IASB” should be established before “moving U.S. public companies to IFRS . . .”²¹

EU Endorsement Process

Another issue critical to IASB sustainability, governance and independence is the level of involvement of the EU in the development of IFRS standards, largely 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 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.

¹⁸ Press Release, International Accounting Standards Committee Foundation, Trustees Announce Strategy to Enhance Governance, Report on Conclusions at Trustees’ Meeting 3 (Nov. 6, 2007), available at <http://www.iasb.org/NR/rdonlyres/D3F8A7DA-B979-462E-BF43-32F2581BEE37/0/PRonTrusteesmeet061107final.pdf>.

¹⁹ *Id.*

²⁰ Letter from Robert E. Denham, Chairman, Financial Accounting Foundation (“FAF”) & Robert H. Herz, Chairman, Financial Accounting Standards Board (“FASB”), to Nancy M. Morris, SEC 8 (Nov. 7, 2007) (emphasis added).

²¹ *Id.*; see also Parveen P. Gupta et al., The Road to IFRS?, Strategic Finance 29, 33 (Sept. 2007), available at http://www.imanet.org/publications_sfm_bi_sep2007.asp (“International standards-setting boards would have to develop a funding stream that not only preserves their independence but meets the requirements of Congress and other international legislative bodies”).

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*.²²

The EU endorsement process has resulted in several incidents that raise serious questions about whether that process impairs the independence of the IASB. For example, in 2004 the process resulted in a carve-out of several paragraphs from International Accounting Standards 39, *Financial Instruments: Recognition and Measurement*.²³

In March 2005, the EFRAG officially recommended that the EU not endorse International Financial Reporting Interpretations Committee 3, *Emission Rights* (“IFRIC 3”).²⁴ Following the EFRAG’s recommendation, the European Commission (“EC”) officially requested that the IASB defer the March 1, 2005, effective date for IFRIC 3.²⁵ In late June 2005, the IASB withdrew IFRIC 3.²⁶

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 prior to endorsing IFRS 8, *Operating Segments* (“IFRS 8”).²⁷ In response, the EC has taken action that has to-date delayed the endorsement of that standard.²⁸

Given this expansive governmental role, it is not surprising that many parties, including PricewaterhouseCoopers, have observed that the EU endorsement process greatly influences the IASB’s standard setting process.²⁹ In addition, the FASB has concluded more broadly that “endorsement mechanisms are inconsistent with . . . high-quality international accounting standards, and their continued operation could significantly threaten the benefits of transitioning U.S. companies to IFRS.”³⁰

²² 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>.

²³ *Id.* at 6.

²⁴ *Id.* at 7.

²⁵ *Id.*

²⁶ *Id.*

²⁷ 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>.

²⁸ 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.

²⁹ PricewaterhouseCoopers, ViewPoint—Convergence of IFRS and US GAAP 4 (Apr. 2007), available at [http://www.pwc.com/extweb/pwcpublications.nsf/docid/fc800243be0e3882852570500000c756/\\$File/viewpoint_convergence.pdf](http://www.pwc.com/extweb/pwcpublications.nsf/docid/fc800243be0e3882852570500000c756/$File/viewpoint_convergence.pdf).

³⁰ Letter from Denham & Herz, at 9.

Our concern in this area has only been deepened by the November 6th combined statement of European Internal Market Services Commissioner Charlie McCreevy, Financial Services Agency of Japan Commissioner Takafumi Sato, IOSCO Executive Committee Chairperson Jane Diplock, and SEC Chairman Christopher Cox.³¹ That statement included the following language:

*International Financial Reporting Standards (IFRS) are becoming more widely used throughout the world. We have a common interest of ensuring continuing user confidence in the institutions responsible for the development of global accounting standards. A **natural step in the institutional development of the IASB and the IASC Foundation would be to establish a means of accountability to those governmental authorities charged with protecting investors and regulating capital markets.** We will work together to achieve these objectives.³²*

In commenting on the statement, Floyd Norris of the *New York Times* opined:

They propose to establish a ‘new monitoring body’ that would ‘participate’ with the trustees in choosing board members. ‘The monitoring body would also be responsible for the final approval of Trustee nominees and would have the opportunity to review the Trustees’ procedures for overseeing the standard-setting process and ensuring the I.A.S.B’s proper funding.’

In other words, this new monitoring body – which evidently would be chosen by politicians – would run the show. It would also work to develop ‘objective procedures’ to assess the costs and benefits of new accounting rules. You can bet that the costs of rules companies do not like would be deemed to be too high.

You can have ‘accountability.’ Or you have have ‘independence.’ But it is an illusion to say you can have both.

The effort to get a genuinely independent accounting rule maker in this country, not dependent on companies for funding, culminated in the passage of the Sarbanes-Oxley law in 2002, which allowed the Financial Accounting Standards Board to essentially impose a tax on public companies.

The risk is that the F.A.S.B. will eventually be supplanted by an I.A.S.B. whose independence will be preserved in name only.³³

³¹ Press Release, Authorities Responsible for Capital Market Regulation Work to Enhance the Governance of the IASC Foundation (Nov. 6, 2007), available at <http://www.sec.gov/news/press/2007/2007-226.htm>.

³² *Id.* at 1 (emphasis added).

³³ Bye Bye Independence, <http://norris.blogs.nytimes.com/2007/11/06/bye-bye-independence/> 2 (Nov. 6, 2007, 7:25 PM EST) (emphasis added).

Investor Representation on the IASB

Finally, as indicated above in the Council's policy, we believe that having significant investor representation on the IASB is an important element of the IASB's sustainability, governance and independence. Since financial reports are used primarily for making decisions regarding the allocation of financial capital, investors are the key consumers of the product produced by accounting standard setters.

We note that the 14-member board of the IASB has only one current board member who could be characterized as an investment professional.³⁴ We believe that, at minimum, four members of the IASB should be drawn from the ranks of pension fund investment advisors, equity security financial analysts, equity security portfolio managers, or other users of financial reports.³⁵

The Council agrees with the recent comments of the CFA Institute Centre for Financial Market Integrity that "inadequate investor representation on the IASB . . . handicaps their ability to achieve their objectives for investors."³⁶ We are hopeful that the IASCF will promptly commit to filling future open board seats with qualified³⁷ investors or other users of financial reports so that adequate representation of the key customers of financial accounting and reporting can soon be achieved.

* * * *

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

Attachment

³⁴ In July 2007, Stephen Cooper, Managing Director and head of valuation and accounting research of UBS Investment Bank in London, was appointed to the IASB as a part-time member. IASB Home Page, <http://www.iasb.org/About+Us/About+IASB/Board+Members.htm>.

³⁵ We note that in 1992, SEC Chairman Richard C. Breeden encouraged FAF Chairman Shaun O'Malley to consider filling two open seats on the seven member FASB with individuals "from the community of users of financial statements . . ." Letter from Richard C. Breeden, Chairman, SEC, to Shaun O'Malley, President, FAF (Oct. 22, 1992) (on file with the Council). In 1993, the FAF named Anthony T. Cope, former Director of Fixed Income Credit Research and a Senior Vice President of Wellington Management Company, to the FASB. See News Release, FASB, Anthony T. Cope and James J. Leisenring to Join IASB (Jan. 25, 2001), available at <http://www.fasb.org/news/nr012501.shtml>.

³⁶ Letter from Kurt N. Schacht, Managing Director & Gerald I. White, Chair, Corporate Disclosure Policy Council, CFA Institute Centre for Financial Market Integrity, to Nancy M. Morris, Secretary, SEC 8 (Oct. 2, 2007).

³⁷ We believe "qualified" IASB investor candidates should, among other required skills, possess outstanding technical accounting expertise.



INTERNATIONAL CONVERGENCE OF ACCOUNTING STANDARDS: WHAT INVESTORS NEED TO KNOW*

Prepared by
Professor Donna L. Street
Mahrt Chair in Accounting
University of Dayton

INTERNATIONAL CONVERGENCE OF ACCOUNTING STANDARDS: WHAT INVESTORS NEED TO KNOW*

Prepared by
Professor Donna L. Street
Mahrt Chair in Accounting
University of Dayton

*This report was prepared by Professor Donna L. Street at the request of the Council of Institutional Investors (“Council”). The views and opinions expressed in this paper are solely those of the author and do not necessarily represent the views or opinions of the Staff, Board of Directors, or General Members of the Council.

INTERNATIONAL CONVERGENCE OF ACCOUNTING STANDARDS: WHAT INVESTORS NEED TO KNOW

TABLE OF CONTENTS

1. What is the international convergence of accounting standards?	3
2. What is the SEC currently proposing?	5
What is currently required for a non-domestic SEC registrant?	5
What would the SEC proposal and concept release change?	6
3. Why is convergence important to investors?	6
4. What are the main reasons that some parties have cited as to why investors should support the elimination of the reconciliation requirement?	6
#1 Eliminating the reconciliation is key to maintaining the premier status of U.S. markets.	6
#2 IFRS are robust, ‘principles-based’ standards suitable for the U.S. market and are preferred by some investors over U.S. GAAP.	8
#3 Removal of the reconciliation should not result in the loss of any investor or market protections afforded by underwriters, securities counsel, or auditors.	9
#4 Reconciliation delays the release of information to U.S. investors.	10
#5 With the reconciliation in place, U.S. investors may be missing out on important investment opportunities.	10
5. What are the main reasons that some parties have cited as to why investors should be concerned about the elimination of the reconciliation requirement?	11
#1 Significant differences between IFRS and U.S. GAAP remain.	11
#2 The 20-F reconciliation includes valuable information that would be lost after its elimination.	13
#3 IFRS are not being faithfully and consistently applied throughout the world.	15

#4 Removing the reconciliation should be delayed until foreign issuers, audit firms, and other constituents have more experience with preparing IFRS statements.	18
#5 U.S. accountants and auditors are not adequately versed in IFRS.	19
#6 Convergence, particularly the work of the IASB and FASB, will most likely be impeded if the reconciliation is dropped prematurely.	20
6. What are the main reasons that some parties have cited as to why investors should support permitting U.S. companies to use IFRS?	24
#1 For U.S. companies in certain industries, IFRS would enhance comparability with competitors.	24
#2 IFRS presents several opportunities to U.S. companies that operate globally.	24
#3 Elimination of the reconciliation should be paired with allowing U.S. registrants to use IFRS.	25
7. What are the main reasons that some parties have cited as to why investors should be concerned about permitting U.S. companies to use IFRS?	26
#1 Allowing U.S. companies to use IFRS may be followed by elimination of U.S. GAAP	26
#2 Requiring U.S. companies to use IFRS will limit the influence of FASB, SEC, and other U.S. organizations in shaping the accounting standards used by U.S. and other companies accessing the U.S. markets.	27
#3 IFRS does not provide a comprehensive set of standards suitable for the U.S. market.	28
#4 There is limited experience in preparing IFRS statements in the U.S. market.	29
#5 Enhanced lobbying will limit the IASB's ability to maintain IFRS' status as 'principles-based.'	29
References / Endnotes	31

INTERNATIONAL CONVERGENCE OF ACCOUNTING STANDARDS: WHAT INVESTORS NEED TO KNOW

1. WHAT IS THE INTERNATIONAL CONVERGENCE OF ACCOUNTING STANDARDS?

While discussion and consideration has been centered around the admirable goal of ‘harmonizing’ accounting standards for decades, the process initially proceeded at a very slow pace and represented a challenging undertaking. More recently, however, the focus has shifted to ‘convergence,’ and in the last decade or so, tremendous progress has been made. Today’s goal is to converge, or minimize the differences between, the two sets of globally recognized accounting standards that co-exist in the world’s capital markets: U.S. GAAP and International Financial Reporting Standards (IFRS).

U.S. GAAP is developed primarily by the Financial Accounting Standards Board (FASB), while IFRS are issued by the London-based International Accounting Standards Board (IASB). The use of IFRS has become increasingly widespread throughout the world with about 100 countries now requiring or allowing the use of these standards. Additional countries are in the process of replacing their national standards with IFRS. For example, from 2005 onward, companies headquartered in the European Union (EU), with securities listed on an EU regulated market, are required to report their consolidated financial statements using ‘EU-endorsed’ IFRS. This requirement affects about 7,000 EU companies. Other countries including Australia and New Zealand (N.Z.), have adopted similar requirements mandating the use of IFRS, while countries including Canada and Israel plan to adopt IFRS as their national standards in the near future. Furthermore, major emerging and transition economies such as Brazil, China, India, and

Russia are adopting or considering IFRS, not U.S. GAAP, in an effort to become integrated in the world's capital markets and to attract the investment needed to finance development.

Recognizing the need to address not only domestic comparability, but also international comparability of financial information, the FASB updated its strategic plan in the 1990s. Working with the then International Accounting Standards Committee (IASC – the predecessor of the IASB) as well as national standard setters from Australia, Canada, N.Z., and the United Kingdom (U.K.), the FASB made notable progress in converging existing standards. For example, the FASB and Canadian Accounting Standards Board issued identical standards on segment reporting and accounting for business combinations, and the FASB and IASC issued similar standards on earnings per share.

Following the formation of the IASB, the IASB and FASB in 2002 issued a Memorandum of Understanding (MOU) formalizing the two accounting standard setting bodies' commitment to converging their standards. Then, in April 2005, the call for a single set of high quality globally accepted accounting standards intensified when the Securities Exchange Commission (SEC) issued its Roadmap for Convergence. The IASB and FASB responded to the Roadmap's challenge to enhance convergence by issuing an updated MOU in February 2006. The new MOU reiterated the Boards' commitment to converging their standards and was accompanied by a revised work program for 2006-2008 aimed at achieving this goal.

2. WHAT IS THE SEC CURRENTLY PROPOSING?

What is currently required for a non-domestic SEC registrant?

Under current SEC rules, foreign companies listed in the U.S. must comply with the information requirements set forth in Form 20-F by the SEC. Accordingly, the financial statements furnished by foreign private issuers disclose essentially equivalent information to statements complying with U.S. GAAP. This information may be presented in two ways. The foreign company may prepare either complete U.S. GAAP statements or statements based on its domestic GAAP or IFRS, but include a reconciliation of reported net income and shareholders' equity to U.S. GAAP.

In their '20-F reconciliation,' companies following the latter option, begin with national GAAP/IFRS net income (shareholders' equity) and then list each material difference with U.S. GAAP and indicate its numerical impact on income (equity). The reconciliation ends with total income (equity) according to U.S. GAAP. A verbal description of each material difference listed in the reconciliation is also provided to concisely explain how the national GAAP/IFRS utilized by the company differs from U.S. GAAP. Furthermore, the SEC requires foreign registrants filing under national GAAP or IFRS to provide certain U.S. GAAP disclosures.

A foreign private issuer must file its annual report, including financial statements reconciled to U.S. GAAP as appropriate, with the SEC six months after its year end. Alternatively, U.S. headquartered companies file with the SEC within 60 to 90 days following their year end.

What would the SEC proposal and concept release change?

The SEC Roadmap for Convergence details the steps that should occur before the elimination of the 20-F net income and shareholders' equity reconciliations for foreign issuers reporting under IFRS. One of the key steps noted is the evidence of sufficient progress in converging IFRS and U.S. GAAP. A SEC^a proposal and request for comment regarding elimination of the reconciliation for foreign registrants reporting under IFRS 'as issued by the IASB' followed in July 2007. Then, in August 2007, the Commission issued a concept release posing questions aimed at determining whether U.S. headquartered registrants should also be provided with the option to report under IFRS.^b

3. WHY IS CONVERGENCE IMPORTANT TO INVESTORS?

Among other things, the SEC Roadmap for Convergence highlights the importance of convergence. Converged standards would:

- enhance comparability and enable investors to compare 'apples to apples' as opposed to 'apples to oranges'
- reduce regulatory compliance costs without undermining investor protection or impairing market information and make it significantly less costly for non-domestic companies to access U.S. markets
- promote global financial market competitiveness while improving the information available to investors.

These and other dimensions of convergence are discussed in the following sections.

4. WHAT ARE THE MAIN REASONS THAT SOME PARTIES HAVE CITED AS TO WHY INVESTORS SHOULD SUPPORT THE ELIMINATION OF THE RECONCILIATION REQUIREMENT?

#1 Eliminating the reconciliation is key to maintaining the premier status of U.S. markets. Doing away with the reconciliation would remove unnecessary costs and remove a barrier for foreign issuers wishing to access U.S. markets.

About 1,150 of the 13,000 SEC registrants are foreign issuers. Combined with the costs associated with complying with the requirements of other regulations, including

Sarbanes-Oxley, some allege the 20-F reconciliation requirement makes a U.S. listing costly for foreigners and is viewed as onerous by them. Thus, the current U.S. regulatory environment has prompted some foreign companies to exit U.S. markets. Moreover, few new foreign listings are materializing as other sources of capital increasingly provide alternatives to the U.S. markets. With IFRS widely accepted throughout the world, the attitude of some has become: Why bother to reconcile IFRS with U.S. GAAP?

In response to this alleged crisis, a study commissioned by political leaders in New York suggests the city (NYC) may lose its status as the world financial center within ten years unless a major shift in regulation and policy occurs. *Sustaining New York's and the US' Global Financial Service Leadership*^c is based on analyses of market conditions in the U.S. and abroad and draws from interviews with more than 50 leaders representing the financial services industry, consumer groups, and other stakeholders. The findings indicate that NYC financial markets are becoming stifled by stringent regulations and high litigation risks. Among the high-priority goals set forth in the report as a ‘national agenda’ is the recognition of IFRS without reconciliation for foreign SEC registrants and the promotion of global convergence of accounting (and auditing) standards.

At a Roadmap Roundtable hosted by the SEC on March 6, 2007, some observers noted that the companies, investors, rating agencies, accounting firms, and others spoke ‘in one voice’ encouraging the SEC to eliminate the reconciliation to U.S. GAAP provision as soon as possible.^d Roundtable participants indicated that the main benefit of this elimination would be a significant reduction of costs for some companies. They believe the reconciliation imposes costs in terms of ease, timing, and ability of foreign

private issuers to come to the U.S. markets. During the Roundtable, the CFO of AXA indicated preparing the annual 20-F reconciliation for his company cost approximately \$25 million.

The NYC report reiterates that doing away with the reconciliation without delay would eliminate unnecessary costs and remove a barrier for foreign issuers. This action, it is alleged, would clearly communicate to the global financial services community that the U.S. respects and honors approaches developed outside its borders. Eliminating the reconciliation in conjunction with accelerating convergence of accounting (and auditing) standards would unleash the potential to improve U.S. markets and facilitate access to them by non-domestic companies using IFRS. The NYC report's authors also indicate that following the report's recommendation of eliminating the reconciliation without delay would yield substantial benefits with few discernable offsetting costs.

Furthermore, accelerating the convergence of two sets of high quality accounting standards will make it significantly less costly for non-domestic companies to access U.S. markets, and, in so doing, improve the international competitiveness of the U.S. as a financial center. Finally, the NYC report's authors believe that the ensuing reduction in regulatory compliance costs can be achieved without undermining investor protection or market information.

#2 IFRS are robust, ‘principles-based’ standards suitable for the U.S. market and are preferred by some investors over U.S. GAAP.

According to the NYC report, interviews conducted with business leaders reveal the need to accelerate convergence as well as the need to remove the unintended consequences of the ‘rules-based’ approach of U.S. GAAP, which can produce financial

reporting that differs from economic reality. Surveyed business executives believe the need to reconcile to the ‘principles-based’ IFRS, which is accepted by almost every other major country other than the U.S., is unnecessary given the quality of IFRS and its widespread adoption.

Some members of the Roadmap Roundtable investors’ panel indicated they were not really using the reconciliation and to some extent preferred IFRS to U.S. GAAP. Some stated that they had essentially already moved to analytic models that do not incorporate the reconciliation. For many industries and peer groups, IFRS is the most common accounting standard, so to understand that industry or sector, analysts must know IFRS. Indeed, institutional investors sometimes ‘reconcile’ U.S. GAAP to IFRS to facilitate comparisons and make investment decisions. According to Dzinkowski, of the 165 foreign companies rated by Moody’s, only 13 have analysts within the U.S while the others are covered by foreign analysts, who neither need nor want reconciliation.^e Many interested parties rely on foreign comparables, information that is not provided by U.S. GAAP.

#3 Removal of the reconciliation should not result in the loss of any investor or market protections afforded by underwriters, securities counsel, or auditors.

Some Roadmap Roundtable participants do not expect removal of the reconciliation to impact investors or change the way securities are priced. As noted above, for due diligence, credit rating and other purposes, most capital market players are comfortable relying on IFRS alone when engaging in transactions with foreign private issuers. Thus, Roundtable participants believe that the removal of the reconciliation should not result in the loss of any investor or market protections afforded to them by

underwriters, securities counsel (and other similarly situated parties) or auditors. While the reconciliation may keep foreign issuers out of U.S. markets, some allege it is not facilitating the offering work done by other participants in the capital raising process.

#4 Reconciliation delays the release of information to U.S. investors.

A Roadmap Roundtable panel representing the investor community indicated that the timeliness of information is critical. Thus, to the extent that the reconciliation slows the availability of information to U.S. investors, it operates counter to their interests. Presently, foreign private issuers are not required to file Form 20-F with the SEC until six months after their fiscal year end. Filing deadlines for U.S. issuers, alternatively, range from 60 to 90 days. Since reconciling can be a time-consuming endeavor, the requirement to provide the reconciliation is frequently held out as one of the justifications for the extra filing time allowed foreign private issuers. In their quest for timely information, some Roundtable participants indicated that large institutional investors and analysts, and perhaps credit rating agencies, turn to foreign private issuer's home markets.

#5 With the reconciliation in place, U.S. investors may be missing out on important investment opportunities.

A critical concern by some at the Roadmap Roundtable was that the reconciliation is keeping foreign private issuers from bringing transactions to the U.S. markets. As a result, U.S. investors are denied possibilities they might otherwise have to invest in foreign capital. Thus, the reconciliation may be detrimental to not only foreign private issuers, who cannot tap the liquidity and depth of the U.S. markets, but also for U.S. investors, as they have fewer options in terms of the investment decisions they might

select. Ultimately, the results of the reconciliation may make the U.S. markets disadvantaged as well.

This arguably holds true not only for institutional investors but also for some retail investors who are highly interested in securities of foreign companies that are not available in the U.S. markets. If these retail investors choose to go overseas to attain more investment opportunities, they do so without the coverage of the U.S. federal securities laws. Thus, the reconciliation may be imposing an indirect cost that appears difficult to justify.

5. WHAT ARE THE MAIN REASONS THAT SOME PARTIES HAVE CITED AS TO WHY INVESTORS SHOULD BE CONCERNED ABOUT THE ELIMINATION OF THE RECONCILIATION REQUIREMENT?

#1 Significant differences between IFRS and U.S. GAAP remain. IFRS and U.S. GAAP are not comparable.

In a recent interview, IASB Chair Tweedie^f predicts that by ‘2011–12, U.S. and international accounting should be pretty much the same - with 150 countries using IFRS and several others using U.S. GAAP. That adds up to about 170 countries accounting in much the same way.’ However, despite Tweedie’s optimism, research indicates the convergence of U.S. GAAP and IFRS is at an early stage.

A few studies have examined the materiality of differences between International Accounting Standards (IAS)/IFRS and U.S. GAAP as reflected in 20-F reconciliation adjustments, but findings from the initial studies should be viewed cautiously as IAS/IFRS numbers have historically not been widely reported in terms of, and thus reconciled to, U.S. GAAP. Street, Nichols, and Gray^g and Blanco and Osma^h examined the net income 20-F reconciliations of a small number of companies using IAS to access

U.S. markets prior to 2001. Both studies suggest that IAS and U.S. GAAP were converging. However, more recent research on larger samples suggests a different story.

With the widespread adoption of IFRS by the EU member states, Australia, and others, the significance of 20-F adjustments by larger numbers of ‘IFRS-based’ SEC registrants is under investigation. Street, Gray, and Linthicumⁱ find that adoption of IFRS in 2005 resulted in divergence, as opposed to convergence, with U.S. GAAP for 135 European companies listed in the U.S filing ‘IFRS-based’ financial statements. During the pre-IFRS period of 2002-2004, European and U.S. GAAP net income measures were generally comparable (not significantly different). However, following the switch to IFRS in 2005, IFRS net income was significantly higher than U.S. GAAP net income. Furthermore, the gap between 2004 IFRS and U.S. GAAP net income significantly exceeded the difference between European GAAP and U.S. GAAP net income. These findings are in line with Gray and Morris^j who find that the move to IFRS in 2005 resulted in significantly higher net profits under IFRS as compared to Australian GAAP.

A recent survey by Citigroup yields similar results, thereby supporting the conclusion that ‘the glut of differences between the two sets of standards causes major swings.’^k For 73 European SEC registrants, the 2005 and 2006 20-F reconciliations contain 426 reconciling differences with most of the reconciling items attributable to the treatment of tax, pensions, goodwill and intangible assets, and financial instruments. Eighty-two percent of the companies had higher net income under IFRS, with IFRS net income, on average, being 23 percent higher than U.S. GAAP net income (based on the mean). The median IFRS net income was about six percent higher under IFRS.

While the survey covers only two years, Citigroup concludes that the median is dropping, thereby indicating some differences are being removed. Yet, book value for 70 percent of the companies surveyed is lower under IFRS. On average, IFRS returns on equity are much higher. Citigroup stressed that in breakdowns of book value and equity returns, U.K. companies topped the tables of European companies showing the biggest divergences. For example, BSkyB (84.1 percent), GlaxoSmithkline (72.9 percent), Imperial Tobacco (61.5 percent), and National Grid (55.8 percent) had book values significantly lower than the U.S. GAAP equivalent. In terms of the largest differences for return on equity, nine of the top 15 were U.K. based. For example, BSkyB, which headed the list, had a 382 percent increase in return on equity under IFRS.

Citigroup, thus, concludes that the ‘differences could well result in investors and/or analysts arriving at different conclusions about the financial position and performance of business depending on the GAAP used.’ Citigroup further indicates that it appears that ‘if U.S. companies were given the option to use IFRS rather than U.S. GAAP then this would provide a boost to book earnings and returns.’

#2 The 20-F reconciliation includes valuable information that would be lost after its elimination.

In *The Roadmap to Convergence: U.S. GAAP at the Crossroads* S&P’s Bukspan and Joas¹ present an alternative view to the Roadmap Roundtable participants’ perspective and state that it is premature to drop the reconciliation before U.S. GAAP and IFRS are fully converged. According to these authors, the 20-F reconciliation guides analysts between different accounting conventions and provides a better appreciation of how accounting differences are evident under varying reporting regimes. In the absence of convergence, the reconciliation serves as a ‘useful tool for aiding comparisons among

global peers, particularly as IFRS is still in its infancy in terms of its application and interpretation.’ Without the reconciliation, analysts and other financial statement users would have to rely more on disclosures, thereby calling into question the robustness of current IFRS requirements.

Bukspan and Joas reference an earlier S&P study that highlights ‘significant variations in the quality and types of IFRS disclosures’ and concludes that many of the disclosures are boilerplate and, thus, lacking in the analytical information needed to gain a full appreciation of the underlying assumptions and risks. This S&P report’s conclusion is consistent with reports issued by SEC staff (see www.sec.gov/divisions/corpfin/ifrs_staffobservations.htm) as well as the U.K. Financial Reporting Review Panel (see <http://www.frc.org.uk/images/uploaded/documents/IFRS%20Implementation%20-20preliminary.pdf>) based on their regulatory reviews of IFRS accounts. According to Bukspan and Joas, the overall SEC staff report emphasizes the need for robust and consistent disclosures that analysts view as ‘essential in fostering a transparent, principles-based reporting environment.’

Bukspan and Joas also contend that the SEC review of 100 IFRS reports filed for fiscal year 2005 draws attention to other reasons to improve IFRS disclosure requirements before eliminating the reconciliation. They refer to problems associated with ‘scant guidance’ on financial statement presentation; different accounting treatments for merger recapitalizations, reorganizations, acquisitions of minority interests, and insurance contracts; auditors signing-off on home country-based IFRS (as opposed to IFRS as issued by the IASB); and SEC requests for additional disclosures related to

revenue recognition, intangible assets and goodwill, policies for evaluating impairments, leases, and contingent liabilities.

#3 IFRS are not being faithfully and consistently applied throughout the world.

The SEC request for comment and proposal poses the question of whether there is sufficient comparability among companies using IFRS ‘as published by the IASB’ to allow investors and others to use and understand financial statements prepared in accordance with IFRS without a reconciliation. This question is somewhat challenging to address in that, as acknowledged by the Commission, for most of the approximately 200 companies filing fiscal year 2005 20-F’s ‘based on IFRS,’ the auditor did not opine on IFRS ‘as issued by the IASB.’ The studies referred to in the following paragraphs are, accordingly, based on accounts opined on as ‘IFRS-based’ (i.e. IFRS as endorsed by the EU, etc.) as well as IFRS ‘as issued by the IASB.’ No distinction was made in the sample selection by the authors.

Reviews of fiscal year 2005 IFRS statements by academics and regulators indicate that the answer to the SEC question may be ‘no.’ While generally promising, these reviews indicate problems with emerging ‘flavors of IFRS,’ thereby suggesting that a substantial learning curve exists for many 1st-time IFRS adopters.

Academic research indicates the degree of compliance with IAS/IFRS by early, ‘voluntary’ adopters was mixed and somewhat selective.^{mnop} Street and Bryant find that, for early adopters, the extent of compliance with IAS was greater for companies with U.S. listings than for companies without U.S. listings. Similarly, Street and Gray find greater levels of compliance with IAS-required disclosures for companies with non-regional listings (including most notably U.S. listings), companies referring exclusively

to the use of IAS in their accounting policy notes, and companies audited by, what was at the time, a Big 5+2 accounting firm. These early studies support the SEC position that consideration should only be given to dropping the reconciliation for companies using IFRS ‘as issued by the IASB.’ This position is further endorsed in a comment letter to the SEC prepared by the FASB’s Investors Technical Advisory Committee.

It is important to stress that Glaum and Street^q identified significant non-compliance by companies listed on Germany’s now defunct Neuer Market not only for IAS accounts but also for U.S. GAAP accounts. Their study, therefore, indicates the key issue is enforcement of standards and not the quality of the accounting standards used. Companies listed on the Neuer Market were required to prepare either IAS or U.S. GAAP accounts. Thus, the use of internationally recognized standards was mandatory as opposed to voluntary, yet compliance, on average, was problematic.

Following the required adoption of IFRS in the EU and elsewhere in 2005, researchers began to examine larger samples of IFRS accounts. Their findings again reveal implementation problems. For example, Glaum, Street, and Vogel^r conducted an assessment of the 2005 merger and acquisition disclosures of companies comprising the premium segments of 17 major European exchanges (see www.pwc.de/en/ma-ifrs-survey2005). Their analysis uncovers several areas in need of notable improvement. Thus, these authors conclude that the understandability and information content of IFRS merger and acquisition disclosures needs to improve to enhance transparency and comparability. The findings of Glaum, Street, and Vogel are in line with those of regulatory reviews of 2005 IFRS accounts by, among others, the SEC (see www.sec.gov/divisions/corpfin/ifrs_staffobservations.htm) and U.K. Financial Reporting

Review Panel (see <http://www.frc.org.uk/images/uploaded/documents/IFRS%20Implementation%20-20preliminary.pdf>).

In a study of 2005 disclosures provided by companies comprising the premier segments of 20 European exchanges, Faßhauer, Glaum, & Street^s uncover a number of cases where companies omit certain relevant IAS 19 pension disclosures. They also identify a troubling number of boilerplate disclosures and vague, shallow disclosures. Their findings regarding boilerplate and vague disclosures are in line with concerns expressed by the U.K. Financial Reporting Review Panel based on its review of IAS 19 disclosures provided in 2005 accounts by a small sample of U.K. companies (see <http://www.frc.co.uk/images/uploaded/documents/010806%20-%20final%20report.pdf>).

The regulatory reviews of IFRS accounts noted above are uncovering examples of non-compliance in addition to raising questions regarding the quality of the disclosures provided. A notable area of concern is whether various banks complied with IAS 39, in determining loan impairment. SEC discussions on this topic are ongoing (see http://www.sec.gov/divisions/corpfin/ifrs_staffobservations.htm), and CESR has posted information regarding several regulatory rulings regarding the issue on its website (see http://www.cesr-u.org/index.php?page=home_details&id=209).

A review of the accounts of 284 companies by the U.K. Financial Reporting Review Panel resulted in 49 companies being obliged to undertake alterations to financial reporting policies. In February 2007, the U.K. Financial Services Authority issued *Financial Risk Outlook 2007*^t highlighting potential risks stemming from, among other things, the move to IFRS. Inconsistent national application was noted as a major risk to the continued success of IFRS. Specifically, the U.K. report states:

With regard to inconsistency, the true benefit of IFRS can only be realised through enabling a better comparison of similar entities across national boundaries, which, in turn, will provide enhanced transparency for markets and a more efficient global capital market. We also acknowledge that, under a principles-based accounting framework, there may be relevant economic and legal differences between countries such that similar transactions might legitimately be reported in different ways. However, should local custom or national interest operate to threaten the consistent application of IFRS, much of this anticipated benefit could be lost.

There is a great deal of work being undertaken internationally to ensure that IFRS is implemented in a way that is both consistent and responsive to local economic differences. However, judging whether or not this balance is being successfully achieved will only be possible after one or two more years have passed.

#4 Removing the reconciliation should be delayed until foreign issuers, audit firms, and other constituents have more experience with preparing IFRS statements.

IFRS implementation problems may be linked to, among other things, an inconsistent and fragmented international auditing environment. Buksman and Joas state that harmonizing international auditing standards and ensuring consistent compliance with these standards are key to developing confidence in any accounting framework. In the same vein, SEC Director of Corporation Finance, White^u indicates that ‘The auditing point is another very critical one ... that clearly must be considered in any comprehensive conversation about convergence and ending reconciliation.’

Wyatt^v posits that ‘maybe we are not so close to having a single set of accounting standards around the world. And, maybe we are even further from having an acceptable international financial reporting regime that would add credibility to financial statements that investors rely upon for their investment decisions.’ He calls for ‘patience by all parties to permit the overall environment to become appropriate for a successful transition to the utilization of truly international accounting standards.’ Wyatt’s five

facets to achieving ‘effective’ convergence include effective accounting standards combined with relevant education and understanding, effective regulatory regimes, a suitable political environment, and as stressed in both the NYC report and by Buksman and Joas, effective auditing standards.

Wyatt explains that while considerable progress has been made by the International Federation of Accountants (IFAC) in developing International Standards of Auditing (ISA), the application of these standards is affected by cultural and environmental forces that vary across countries. Reconciling these differences will not be easy. The existence of a solid set of generally accepted auditing standards will not, therefore, necessarily result in consistent application of those standards globally. It remains an open question as to how regulators in different countries will address variations in audit practice that have led to inconsistent application and implementation of IFRS.

#5 U.S. accountants and auditors are not adequately versed in IFRS.

Wyatt explains that, regardless of the quality of IFRS, effective implementation cannot be achieved until accounting practitioners, both in public and private practice, in countries all around the world, achieve a degree of understanding of those principles that enable their application in practice. Since we currently do not have a set of accounting standards on which broad agreement has been reached, we do not have the textbooks necessary to convey those standards to students and other interested parties. In the U.S., Wyatt notes that universities do not have courses devised to assist in this educational process. While the development of the necessary educational materials and course

curricula should not require a lengthy time period, the process is highly unlikely to commence until IFRS are further along in their development stage.

Wyatt estimates that the various requirements of the educational process will not get underway globally in any concerted fashion until the IASB determines that it has an effective set of standards and securities regulators around the world deem these standards to be acceptable. At that point, we are probably looking at a three to seven year changeover from current educational processes to the introduction of new curricula. While the large accounting firms and publicly-owned companies may be able to re-educate their employees in a somewhat shorter time period, the process for an international company will require planning and dedication to retraining.

In a bulletin describing the move to IFRS in Canada, the Canadian Accounting Standards Board stresses that such a transition from national GAAP to IFRS requires education, not only for auditors and in the universities, but also for public companies, their investors, lenders, and advisors. The need for a comparable transition period prior to acceptance of IFRS in the U.S. should not be overlooked by the SEC or taken lightly.

#6 Convergence, particularly the work of the IASB and FASB, will most likely be impeded if the reconciliation is dropped prematurely.

Street and Linthicum^w consider whether it is conceivable that eliminating the reconciliation now would stall convergence efforts of the IASB and FASB, especially since the EU's incentive to achieve convergence and comparability with U.S. GAAP, as well as its support for the continued improvement of IFRS, may disappear with the reconciliation. While stressing the importance of convergence, the SEC is adamant that the IASB and FASB should not focus on eliminating differences between accounting standards needing significant improvement. Instead the Boards should cooperate and

develop new requirements in areas where both sets of standards require improvement. SEC Deputy Chief Accountant Erhardt^x has specified that the Boards should ‘tackle the toughest, most intractable and problematic standard setting issues’ such as financial instruments, performance reporting, revenue recognition, pensions, leases, and consolidation policy. The IASB and FASB accepted this challenge in the 2006 update of their Memorandum of Understanding by revising their joint work program with the goal of making significant progress in the development of new joint standards to address the areas highlighted by Erhardt.

While the efforts of the IASB and FASB to address the SEC’s desire to ‘advance the frontiers of accounting’ are clearly in the best interest of investors, Street and Linthicum point out that one can question whether the Boards’ work program is in favor with the EU. For example, EU Commissioner for the Internal Market and Services McCreevey^{y,z} stated that convergence cannot be allowed to destabilize the IFRS platform in Europe and, cautioned that convergence is not an invitation for standard setters to advance the ‘theoretical frontiers’ of accounting. ‘Revolutionary’ new standards will not be acceptable as the ‘IFRS train’ has just ‘left the station.’ While the SEC has not suggested a timetable for addressing the issues noted by Erhardt, the implication is that IFRS and U.S. GAAP must improve. It is feasible that McCreevey’s stable platform may hinder the improvement desired by the SEC as his message to the IASB contradicts the SEC position.

It is important to acknowledge that the IASB responded to concerns expressed by European and other IFRS adoptors that the Board was moving too fast in the development of new standards. To assist ‘adoption of IFRS and reinforce consultation,’

in 2006, the IASB announced that no new standards will be effective until 2009, thereby providing four years of stability in the IFRS platform for companies adopting IFRS in 2005. The IASB stresses that establishment of this approach does not preclude issuance of new standards before that date. IASB Chair Tweedie explains that the policy is directed at assisting those involved with IFRS implementation throughout the world, while concurrently enabling the IASB to make progress on its contribution toward eliminating the need for 20-F reconciliation requirements by 2009. From the perspective of the U.S. investor, a key issue, however, remains. If the reconciliation is dropped, will EU and other non-U.S. registrants adequately implement the new international standards that become effective in 2009? Or, will there again be implementation and compliance issues in line with those identified based on reviews of 2005 accounts?

Another concern pointed out by Larson and Street is the onerous and ever expanding EU endorsement process.^{aa} The NYC report states that elimination of the reconciliation without delay would communicate to the global financial services community that the U.S. respects and honors approaches developed outside its borders. However, as discussed by Street and Linthicum, the EU endorsement process suggests a similar view may not be shared in Europe. Even with the reconciliation in place and some U.S. GAAP disclosures required for foreign registrants (including segment reporting requirements), the IASB's decision to adopt U.S. segment reporting requirements in IFRS 8 sparked opposition. In April 2007, the Economic and Monetary Affairs Committee of the European Parliament^{bb} proposed a Parliamentary resolution calling on the EC to conduct a thorough assessment of the impact prior to endorsing IFRS 8. Among the concerns expressed was that adoption of IFRS 8 'would import into EU

law an alien standard without having conducted any impact assessment.’ In response, the EC announced that a vote on IFRS 8 would be delayed.

Another example of the EU endorsement process hindering convergence is IAS 39. Despite a SEC warning that ‘watering down’ IAS 39 could hinder convergence,^{cc} the EU went forward with a ‘carve out’ of IAS 39. With the EC willing to block convergence efforts by modifying IFRS for use in Europe with the reconciliation in place, how much bolder will the Commission become post-reconciliation?

The EU’s endorsement process to determine whether each IASB standard will be approved for use in the EU will likely continue to produce variations between IFRS ‘endorsed by the EU’ and IFRS ‘as issued by the IASB.’ While the SEC is adamant that the reconciliation will be dropped only for companies using IFRS ‘as issued by the IASB,’ careful consideration should be given to the conflicting objectives of the SEC and EU prior to eliminating the reconciliation. As a major IASB constituent, the impact of EU lobbying on the development of IFRS should not be underestimated.

At the Roadmap Roundtable, investors also connected convergence with reconciliation. They generally support removing the reconciliation, except in the case where its elimination would cause convergence to cease. It is, therefore, worthy for one to consider what would be the incentive for convergence once the reconciliation takes place. Given the existence of differing global views, one should also ponder whether the IFRS of the future will be ‘principles-based.’

6. WHAT ARE THE MAIN REASONS THAT SOME PARTIES HAVE CITED AS TO WHY INVESTORS SHOULD SUPPORT PERMITTING U.S. COMPANIES TO USE IFRS?

#1 For U.S. companies in certain industries, IFRS would enhance comparability with competitors.

Deloitte's Gannon, Sogoloff, and Madla^{dd} state that U.S. companies, if permitted, may consider IFRS if their significant competitors report under IFRS (i.e. companies in the banking, insurance, motor vehicle manufacturing, pharmaceutical, and telecommunications industries). According to these authors, comparability in reporting would level the playing field, thereby providing investors an 'apples-to-apples' perspective when comparing results.

#2 IFRS presents several opportunities to U.S. companies that operate globally.

Gannon, Sogoloff, and Madla further explain that IFRS offers U.S. companies, particularly those operating globally, several potential opportunities, including:

- Standardization of Accounting and Financial Reporting Policies – A consistent set of accounting policies and financial statements in each country where local reporting is required improves comparability of financial information and tax planning.
- Centralization of Processes – By moving toward company-wide IFRS use, a company could reduce reliance on local accounting resources for statutory reporting purposes, develop standardized training programs, and eliminate divergent accounting systems.
- Improved Controls – Standardized reporting would allow companies to assign one worldwide owner for statutory reporting, yielding better control over the quality and issuance of financial statements in other locations.
- Better Cash Management – Dividends that can be paid from subsidiaries may be based on local financial statements. Allowing use of a consistent standard across countries can help improve cash flow planning.

#3 Elimination of the reconciliation should be paired with allowing U.S. registrants to use IFRS. Otherwise, some U.S. companies, particularly those in certain industries, may be at a competitive disadvantage.

According to BDO's Johnson, unless allowed the same option to use IFRS, dropping the reconciliation could put U.S. companies at a competitive disadvantage.^{ee} For example, IFRS and U.S. GAAP revenue recognition rules differ for the tech industry. Under IFRS, a company can report revenue growth faster than a U.S. company. This is due to the 'principles-based' nature of IFRS, which provides more flexibility in regard to when companies recognize revenue. This is especially important for emerging tech companies because customers, investors, and analysts view revenue recognition as the easiest way to comprehend such a company's worth. Thus, even though two companies could have the same product and similar financial health, customers may view them differently because of the U.S. GAAP company's delay in revenue recognition. Therefore, given the option, U.S.-based tech companies may consider moving to IFRS to avoid competitive disadvantage.

Following a similar line of thinking, at the Roadmap Roundtable, Phillip Jones, Director of External Reporting and Accounting Policies and Procedures at Dupont, referred to his company's willingness to see the reconciliation end. However, from a competitive point, Jones suggests that U.S. issuers should be afforded the same opportunity to report in IFRS.

The SEC's White^{ff} shares that he has heard the same from a number of finance and accounting executives at large, multinational corporations in the U.S. These multinationals are already using IFRS for various reasons, whether at their international subsidiaries or for reporting purposes with various regulators in other jurisdictions. They

hold that reporting under IFRS in their SEC filings could improve disclosure and reporting processes overall in terms of transparency and internal consistency.

7. WHAT ARE THE MAIN REASONS THAT SOME PARTIES HAVE CITED AS TO WHY INVESTORS SHOULD BE CONCERNED ABOUT PERMITTING U.S. COMPANIES TO USE IFRS?

#1 Allowing U.S. companies to use IFRS may be followed by elimination of U.S. GAAP. This contradicts with the general sentiment in the U.S. that we should maintain control of establishing accounting standards utilized by U.S. companies.

Bukspan and Joas state that the SEC's willingness to explore giving U.S. companies a choice between IFRS and U.S. GAAP may 'be interpreted as a not-so-gentle nudge toward a looming exit for U.S. GAAP, and could bring a sea of change for the future role of U.S. GAAP and of the FASB.' Indeed at the Roadmap Roundtable, former SEC Chief Accountant Nicolaisen shared his belief that eventually U.S. registrants should be required to report under IFRS.^{gg} At the Annual Conference of the International Organization of Securities Commissions, SEC Commissioner Campos^{hh} further explored the possibility of not only allowing, but requiring, U.S. companies to use IFRS. Campos stated that over the long-term, it is difficult to argue that one set of accounting standards is anything other than an ultimate target.

In May 2007, a poll was taken at the Financial Services Executives Forum in NYC, which was attended by several hundred CFOs and other finance professionals. The results reveal that a vast majority are willing to accept an IFRS-based standard or a converged set of standards. However, when asked if they are prepared to give up control of establishing accounting standards, 68 percent responded no and another seven percent was unsure. Bukspan and Joas believe the latter likely reflects the U.S. sentiment in general, given the historical strength of the U.S. capital markets relative to global

markets. Despite the shortcomings of U.S. GAAP, these authors believe that the U.S. market may not be prepared to embrace a completely new set of standards that are in an evolutionary stage, yet to be tested, and to which the market will have to get accustomed.

Based on responses by 142 members of the American Association of Individual Investors to their survey, McEnroe and Sullivanⁱⁱ report that the attitudes of individual investors are in line with studies highlighting potential negative consequences linked to the elimination of the reconciliation. Their study finds that U.S. individual investors are very much in favor of foreign listings on U.S. exchanges. However, individual investors endorse current rules requiring either the use of U.S. GAAP or the reconciliation. A large majority of the individual investors believe the U.S. should maintain control of accounting standards used for U.S. listings. A smaller majority believe there should be a global set of accounting principles for all stock exchanges.

#2 Requiring U.S. companies to use IFRS will limit the influence of the FASB, SEC, and other U.S. organizations in shaping the accounting standards used by U.S. and other companies accessing the U.S. markets.

Tarca^{jj} describes the impact of adoption of IFRS in Australia, which historically has followed a standard setting model similar to the U.S. Her major points provide a preview of what the future would likely hold for the U.S. if IFRS were adopted.

- The Australian Accounting Standards Board no longer develops standards from inception. The Board cannot independently determine the content of standards, but is constrained to ensure that Australian standards are not inconsistent with IFRS. The Board does not have control over its work program, which is aligned with that of the IASB, so that matters under consideration by the IASB are also considered by the Australian Board.
- Lobbying efforts of the corporate sector must be directed more at the IASB than the Australian Board. Australian companies have less influence in international standard setting than they had in national standard setting.
- The Federal Government is more removed from the standard setting process now that Australian standards are based on IFRS. Given the Government's support for

harmonization with IFRS, it is unlikely to intervene in the standard setting process to allow Australian standards to be incompatible with IFRS.

As noted previously, U.S. investors, in general, apparently are not prepared to give up control of establishing accounting standards as has occurred in Australia.

Tarca's point on lobbying is consistent with Wyatt's view that, upon acceptance of IFRS, lobbying is redirected from the national standard setter to the IASB. According to Wyatt, with lobbying from 'multiple governments with differing priorities and multiple business communities with various interests to protect' pressures on the IASB will eventually exceed those ever faced by any national standard setter and make development of 'principles-based' standards a massive challenge.

#3 IFRS does not provide a comprehensive set of standards suitable for the U.S. market.

Bukspan and Joas describe IFRS as a 'work in progress' that does not cover some areas of accounting (see also Street and Linthicum). When an IFRS standard does not address a matter, IAS 8 requires companies to look to the most recent pronouncements of other standard setters. In a review of 2005 IFRS accounts, the SEC staff identified substantial variation in accounting for insurance contracts and in reporting of extractive industry exploration and evaluation activities in the absence of an extensive IFRS standard for these activities. If the reconciliation is eliminated and, more importantly, if U.S. registrants are allowed to use IFRS, the SEC should clarify what rules to follow in the absence of an IFRS. Otherwise, comparability will likely be greatly impeded.

#4 There is limited experience in preparing IFRS statements in the U.S. market. Thus, important implementation concerns should be addressed prior to allowing U.S. companies to use IFRS.

Most U.S. accountants and auditors are not trained in IFRS. Thus, as explained by Wyatt, a move to IFRS would necessitate substantial continuing professional education for those in practice as well as extensive changes in the curricula of universities. Furthermore, a move to IFRS at a rapid pace would require, among other things, investments in systems, personnel, new reporting formats, and modification to the internal control system over financial reporting.^{kk} Significant costs could result from renegotiating contracts, lending agreements and debt covenants, and compensation agreements tied to U.S. GAAP. Tax advisors, as well as regulators, would need to comprehend the implications of moving to IFRS. Following the like-sized efforts associated with implementation of Sarbanes-Oxley, such a move would likely not be welcome.

As noted by the Canadian Accounting Standards Board, in the short-term, Boards of Directors of public companies would need to ensure that a member of management, or an advisor, is responsible for reporting on a regular basis on the implications of IFRS adoption.^{ll} Effort up-front would be necessary to mitigate longer-term costs and impact.

#5 Enhanced lobbying will limit the IASB's ability to maintain IFRS' status as 'principles-based.' Thus, acceptance of IFRS will not represent the desired move from the 'rules-based' approach of U.S. GAAP.

Both the NYC report and Bukspan and Joas highlight the need for convergence towards 'principles-based' as opposed to 'rules-based' accounting standards. Wyatt explains that the FASB's departure from the underlying concepts set forth in the Board's Conceptual Framework has in many instances been the result of political interference,

either from disagreement with SEC thinking, or more frequently, effective lobbying by the business community signaling to the FASB that the direction of a FASB proposal would cause harm to the U.S. economy. The result is often issuance of a U.S. standard that departs from the Conceptual Framework and that accordingly is more' rules-based' than 'principles-based.'

According to Wyatt, no one understanding accounting standard setting can possibly think the IASB will be immune from the political forces that have caused the FASB so much anguish and have lead to the issuance of bad U.S. standards. He states that 'multiple governments with differing priorities and multiple business communities with various interests to protect will generate even greater pressures on the IASB than the FASB has faced.' Thus, according to Wyatt, the 'principles-based' versus 'rules-based' issue represents a red herring. Future international standards will likely look more like FASB standards than 'principles-based' standards. While 'principles-based' standards are an admirable goal, the evolution of standards, be they U.S. GAAP or IFRS, will likely continue to be influenced by forces unrelated to accounting concepts. While 'rules-based' standards will continue to be issued, Wyatt is hopeful that they will be issued on a diminished basis.

In line with Wyatt's thinking, a PwC report^{mm} states that, the IASB and FASB 'fail to acknowledge other key forces that influence standard setting in the EU – specifically, the ... endorsement process at the European Commission level. Thus, the belief that IFRS are the route to global 'principles-based' standards may be flawed.

-
- ^a SEC (2007). *Acceptance from Foreign Private Issuers of Financial Statements Prepared with International Financial Reporting Standards without Reconciliation to U.S. GAAP*, Proposed Rule. July 3. Available at: <http://www.sec.gov/rules/proposed/2007/33-8818fr.pdf>.
- ^b SEC (2007). *Concept Release On Allowing U.S. Issuers To Prepare Financial Statements In Accordance With International Financial Reporting Standards* (Corrected). August 7. Available at: <http://www.sec.gov/rules/concept/2007/33-8831.pdf>.
- ^c *Sustaining New York's and the US' Global Financial Service Leadership* (2007). Commissioned by Mayor Michael Bloomberg and Senator Charles Schumer.
- ^d White, J. (2007). 'Seeing down the road: IFRS and the U.S. capital markets,' speech at NYSE/Brooklyn Law School Breakfast Roundtable, March 23.
- ^e Dzinkowski, R. (2007). 'Likely no more U.S. GAAP reconciliation for foreign companies,' *Strategic Finance*, June, 47-49.
- ^f Tweedie, D. (2007). 'Simplifying global accounting,' July, available at <http://www.aicpa.org/pubs/jofa/jul2007/tweedie.htm>.
- ^g Street, D. L., Nichols, N.B, and S. J. Gray. (2000). 'Assessing the acceptability of International Accounting Standards in the U.S: An empirical study of the materiality of U.S. GAAP reconciliations by non-U.S. companies complying with IASC standards'. *The International Journal of Accounting*, 35(1): 27-63.
- ^h Blanco, J.L.U., and Osma, B.G. (2004). 'The comparability of international accounting standards and US GAAP: An empirical study of Form 20-F reconciliations'. *International Journal of Accounting, Auditing and Performance Evaluation*, 1(1): 5-36.
- ⁱ Street, D., Gray, S., and Linthicum, C. (2007). 'Global accounting convergence: Do European accounts under IFRS and U.S. GAAP provide comparable net income and shareholders' equity information?' Working Paper, University of Dayton.
- ^j Gray, S. and Morris, R. (2007). 'Australia's adoption of International Financial Reporting Standards: The impact on net profits and equity' Working Paper, The University of Sydney.
- ^k Jetuah, D. (2007). 'Citigroup lays out IFRS-US GAAP gulf,' *Accountancy Age*, 30 August.
- ^l Bukspan, N. and Joas, R. (2007). *Roadmap to Convergence: U.S. GAAP at the Crossroads*. Standard & Poor's Commentary Report, July 16.
- ^m Cairns, D. (1999). The FT International Accounting Standards Survey, (London: Financial Times).
- ⁿ Street, D., Gray, S., and Bryant, S. (1999). 'Acceptance and observance of International Accounting Standards: An empirical study of companies claiming to comply with IAS,' *The International Journal of Accounting*, 35(1): 27-63.
- ^o Street, D. and Bryant, S. (2000). 'Disclosure level and compliance with IASs: A comparison of companies with and without U.S. listings and filings,' *The International Journal of Accounting*, 35(3): 305-329.
- ^p Street, D. and Gray, S. (2001). *Observance of International Accounting Standards: Factors Explaining Non-compliance by Companies Referring to the Use of IAS*, ACCA Research Monograph.
- ^q Glaum, M., Street , D.L. (2003), 'Compliance with disclosure requirements at Germany's New Market: IAS versus US GAAP,' *Journal of International Financial Management and Accounting*, 4:1, 64-100.
- ^r Glaum, M., Street, D.L. and Vogel, S. (2007) *Making Acquisitions Transparent: An Evaluation of M&A Related IFRS Disclosures by European Companies in 2005*. Sponsored by PwC, accessible at www.pwc.com/Extweb/pwcpublications.nsf/docid/1619091BABCFF3428025712D00234186.
- ^s Faßhauer, J. Glaum, M. and Street, D.L. (2007). 'Adoption of IAS 19R by Europe's premier listed companies: The corridor approach versus full recognition,' working paper University of Dayton.
- ^t UK Financial Services Authority. (2007). *Financial Risk Outlook 2007*.
- ^u Ibid d.
- ^v Wyatt, A. (2007). Address at AAA International Accounting Section Lunch, Chicago, August.
- ^w Ibid i.

-
- ^x Erhardt, J.A. (2005). "Remarks before convergence: The future of international financial reporting worldwide conference U.S. Securities and Exchange Commission," Speech by SEC staff, June 24, London, England, accessible at <http://www.sec.gov/news/speech/spch062405jae.htm>.
- ^y McCreevey, C. (2005). Address to the Global Public Policy Symposium, October, London.
- ^z McCreevey, C.(2007). Capital markets and European competitiveness, speech at European Financial Forum, Brussels, May 2.
- ^{aa} Larson, R.K., and D.L. Street. (2006). The 'Roadmap' to global accounting convergence: Europe introduces 'speed bumps', *CPA Journal*, 2006, 36-43.
- ^{bb} Economic and Monetary Affairs Committee of the European Parliament. (2007). Resolution RE\663584EN.doc, accessible at <http://www.iasplus.com/europe/0704resolutionifrs8.pdf>.
- ^{cc} *Financial Times*. (2004). 'US warns Europe on accounting rules,' February 2.
- ^{dd} Gannon, D.J., Sogoloff, R. and Madla, R. (2007). 'The shift toward IFRSs and its impact on U.S. companies' *Heads Up*, Deloitte newsletter August 17, 14(16):1.
- ^{ee} Johnson, S. (2007). 'Auditor: Convergence could spur revenue wreck, Will U.S. tech companies lose out if foreign issuers can use international accounting standards to report here?' *Today in Finance* at CFO.com, August 30, assessable at http://www.cfo.com/article.cfm/9721751/c_9723616?f=home_todayinfinance.
- ^{ff} Ibid d.
- ^{gg} Ibid d.
- ^{hh} Campos, R.C. (2007). Speech by SEC Commissioner: Remarks before the IOSCO conference. April 12, Mumbai, India, accessible at <http://www.sec.gov/news/speech/2007/spch041207rcc.htm>.
- ⁱⁱ McEnroe, J.E. and Sullivan, M. (2006). 'Individual investors' attitudes towards listing requirements for foreign entities on U.S. stock exchanges and the promulgation of international accounting standards,' *Journal of International Accounting, Auditing, and Taxation*, 15 (2006) 215-225.
- ^{jj} Tarca, A. (2005). 'Update on standard setting environment,' In *Accounting Theory Update*, editor Jayne Godfrey, John Wiley & Sons Australia Limited.
- ^{kk} Ibid e.
- ^{ll} AcSB. (2006) 'Accounting Standards in Canada: New Directions,' Accounting Standards Board Strategic Plan.
- ^{mm} PwC. (2007). *Convergence of IFRS and US GAAP*, April.