Council of Institutional Investors
The Voice of Corporate Governance

Via SEC Website

July 31, 2011

Ms. Elizabeth M. Murphy
Secretary
United States Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: A Securities and Exchange Commission Staff Paper, *Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers, Exploring a Possible Method of Incorporation* ("Staff Paper")[1]

Dear Ms. Murphy:

I am writing on behalf of the Council of Institutional Investors ("Council"), a nonprofit association of public, union and corporate pension funds with combined assets that exceed three trillion dollars. Member funds are major shareowners with a duty to protect the retirement assets of millions of American workers.[2]

The Council appreciates the opportunity to provide input on the Staff Paper. Our significant interest in the issue of whether and, if so, how, to incorporate International Financial Reporting Standards ("IFRS") into the financial reporting system for issuers in the United States ("US") is reflected in our long-standing membership-approved "Statement on Independence of Accounting and Auditing Standard Setters" ("Statement").[3]

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[1] Office of the Chief Accountant, United States Securities and Exchange Commission, A Securities and Exchange Commission Staff Paper, *Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issues, Exploring a Possible Method of Incorporation* 1 (May 26, 2011), http://www.sec.gov/spotlight/globalaccountingstandards/ifrs-work-plan-paper-052611.pdf [hereinafter Staff Paper].

[2] For more information about the Council of Institutional Investors ("Council") and its members, please visit the Council's website at http://www.cii.org/about.

[3] Council of Institutional Investors, Statement on Independence of Accounting and Auditing Standard Setters 1-2 (Adopted Oct. 7, 2008), http://www.cii.org/UserFiles/file/Statement%20on%20Independence%20of%20Accounting%20and%20Auditing%20Standard%20Setters.pdf [hereinafter Statement].

As you are aware, the Statement generally supports US and international accounting standard setters working cooperatively "toward a common goal of convergence to a single set of high quality standards designed to produce comparable, reliable, timely, transparent and understandable financial information that will meet the needs of institutional investors and other consumers of audited financial reports."[4] Importantly, however, the Statement generally does not support replacing US Generally Accepted Accounting Principles ("GAAP") and the Financial Accounting Standards Board ("FASB") with IFRS and the International Accounting Standards Board ("IASB"), respectively, unless and until seven criteria or milestones have been addressed.[5] Last month, the Council issued a white paper, a copy of which is attached to this letter, "designed to assist . . . in evaluating whether the . . . IASB and . . . IFRS satisfy any or all of the [seven] criteria" set forth in the Statement ("White Paper").[6]

Consistent with the Statement and White Paper we offer the following two observations on the Staff Paper:

<u>Role of the FASB in the US</u>

First, we observe that the possible incorporation approach described in the Staff Paper contemplates a dramatic change to the role of the FASB and to US accounting standard setting generally. More specifically, the approach would essentially replace the FASB with the IASB as "the principal body responsible for developing new accounting standards or modifying existing standards under U.S. GAAP."[7] While the FASB would appear to retain some authority to modify IFRS before it becomes US GAAP, the threshold for such modifications would be set so high that any such action by the FASB would be "rare and generally avoidable."[8]

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[4] *Id*. at 1.
[5] *Id* at 1-2*.; see generally* Donna L. Street, *International Convergence of Accounting Standards: What Investors Need to Know* 26-30 (Oct. 2007), http://www.cii.org/UserFiles/file/resource%20center/publications/CII%20White%20Paper%20-%20International%20Convergence%20October%202007.pdf (summarizing reasons that some parties have cited as to why investors should be concerned about permitting domestic companies to use International Financial Reporting Standards).
[6] Donna L. Street, *Criteria for an Independent Accounting Standard Setter, How Does the IASB Rate?* 1 (June 2011), http://www.cii.org/UserFiles/file/June%202011%20White%20Paper%20-%20Intl%20Accting%20Standards%20FINAL.pdf (see Attachment).
[7] Staff Paper, *supra* note 1, at 8.
[8] *Id.* at 10.

As indicated, the Statement is explicit that the "Council . . . does not support *replacing* U.S. accounting . . . standard setters with international . . . standard setters *unless and until all* [of the Council's seven criteria or milestones] . . . have been achieved."[9] The criteria were developed to provide some reasonable level of assurance that US investors would not be harmed in the short or long-term by replacing the FASB or US GAAP with the IASB or IFRS, respectively. Thus, the Council would respectfully request that the Securities and Exchange Commission ("Commission") staff fully analyze the Council's seven criteria as part of its work plan and provide investors and the public the results of that evaluation *before* making a decision to pursue the approach described in the Staff Paper or any other approach. We note that the attached White Paper provides a substantial amount of information to assist the Commission in successfully completing that analysis.

Transition Plan

The possible incorporation approach described in the Staff Paper also contemplates a transition plan for the replacement of "the content of existing U.S. GAAP with the content of IFRS."[10] An explicit objective of the plan is to "lessen the costs and burden of transition . . . ."[11] One means in which the plan attempts to reduce the costs and burden of the transition is by "maximizing the number of IFRSs incorporated prospectively."[12]

While prospective application of IFRSs into US GAAP may indeed lessen the costs and burden of the transition plan to preparers of financial reports, it has the opposite effect on investors and other users of financial reports—it *increases* their costs and burden.[13]

[9] Statement, *supra* note 3, at 1 (emphasis added).
[10] Staff Paper, *supra* note 1, at 14.
[11] *Id.* at 15.
[12] *Id.* at 20.
[13] *See, e.g.,* Letter from the Investors Technical Advisory Committee to Susan M. Cosper, FASB Technical Director 2 (May 16, 2011), http://www.fasb.org/cs/ContentServer?site=FASB&c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176158554275 ("As ITAC has long argued, retrospective application of new accounting standards [in contrast to prospective application as proposed in the Staff Paper] is essential to understanding trends in data, which of course, is fundamental to analysis.") [hereinafter ITAC Letter].

Prominent investor/accounting expert, Jack Ciesielski, explains the costs and burden to investors of prospective application of the transition plan described in the Staff Paper in the following manner:

> One recurring theme in the [Staff Paper] . . . was that prospective transition should be used whenever possible. Prospective transition can make life difficult for analysts; it can play havoc with time-series data because it introduces non-comparables into a data set. Rarely are investors and analysts provided with sufficient information to even out non-comparable information arising from the prospective method of implementing new accounting principles.[14]

We note that the costs and burden to preparers of the investor preferred "retrospective application" approach to transition are largely the result of the sometimes difficult judgments about facts and circumstances that existed in prior periods when standards were originally implemented.[15] We, however, also note that those costs and burden can generally be eliminated simply by requiring at least a three year delay in the effective date of a new accounting standard.[16] Thus, if the Commission were to decide to pursue the possible incorporation approach described in the Staff Paper, we would respectfully request that retrospective, rather than prospective, application of IFRS standards generally be required.

[14] Jack T. Ciesielski, *Is the IFRS "Condorsement" Coming? Maybe*, 20(8) Analyst's Acct. 7 (June 20, 2011) (on file with Council).
[15] ITAC Letter, *supra* note 13, at 2 (Investors Technical Advisory Committee ("ITAC") commenting that they "appreciate that companies may find [retrospective] restatement difficult, particularly when it requires judgment based on the facts and circumstances that existed in prior periods.").
[16] *Id.* (ITAC explaining that a "three-year transition period . . . would allow companies to create the data needed for [retrospective] restatement, with an eye toward the new standards . . . [and] apply contemporaneous judgment, rather than struggling to recast the past with the bias of hindsight.").

The Council appreciates the opportunity to provide input in response to the Staff Paper. If you have any questions or need any additional information, please feel free to contact me at 202.261.7081 or jeff@cii.org.

Sincerely,

Jeff Mahoney
General Counsel

Attachment

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The Voi

Criteria for an Independent Accounting Standard Setter

How Does the IASB Rate?

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

June 2011

This white paper was commissioned by the Council of Institutional Investors to educate its members, policymakers and the general public about the convergence of international accounting standards. The views and opinions expressed in the paper do not necessarily represent the views or opinions of Council members, directors or staff.

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Executive Summary

In 2008, the Council of Institutional Investors (Council) adopted a policy regarding the independence of international accounting and auditing standard setters.[1] The Council's policy supports the goal of convergence to a single set of high quality accounting standards designed to produce comparable, reliable, timely, transparent and understandable financial information that will meet the needs of investors and other consumers of financial reports. Importantly, the policy also opposes replacing U.S. accounting standards and standard setters with international accounting standards and standard setters unless and until seven criteria have been achieved.

This paper explores evidence and views regarding each of the seven criteria. The paper is designed to assist Council members and other interested parties in evaluating whether the International Accounting Standards Board (IASB) and its International Financial Reporting Standards (IFRS) satisfy any or all of the criteria.[2] This evaluation is particularly timely. The U.S. Securities and Exchange Commission (SEC) has announced plans to decide in 2011 whether to require or permit U.S. companies to adopt IFRS for their financial reports.[3] This paper was completed prior to the SEC's release on May 26, 2011 of a staff report (http://www.sec.gov/spotlight/globalaccountingstandards/ifrs-work-plan-paper-052611.pdf) exploring a possible method of incorporating IFRS in the United States.

In regard to each of the Council's criteria, the evidence and views explored indicate the following:

- **Criterion #1: In the aggregate, information that results from application of [IFRS] is, at a minimum, of the same quality as the information resulting from U.S. accounting . . . standards.**

  Research regarding the comparability of IFRS and U.S. Generally Accepted Accounting Principles (GAAP) is inconclusive regarding whether applying IFRS provides, at a minimum, the same quality of information as GAAP.[4] However, a majority of U.S. and European financial executives surveyed believe the quality of IFRS is high or very high. Most also believe that the IASB and the U.S. Financial Accounting Standards Board (FASB) have made progress developing joint standards to address improvements needed prior to adoption of IFRS in all major capital markets.[5] But concerns remain regarding fundamental deficiencies in some key areas of IFRS.

- **Criterion #2: [A]pplication . . . and enforcement . . . of [IFRS] are at least as rigorous and consistent as the application and enforcement of U.S. accounting . . . standards.**

  While there is no direct evidence indicating how the application and enforcement of IFRS in the United States would compare with the application and enforcement of GAAP, research reveals a relationship between a country's institutional setting, including corporate governance and audit quality, and characteristics of a country's financial reporting.

- **Criterion #3: The [IASB] has sufficient resources — including a secure stable source of funding that is not dependent on voluntary contributions of those subject to the standards.**

  Historically, most of the IASB's funding has been from voluntary contributions, raising questions about the IASB's independence. Furthermore, the IASB ran a deficit for several years, including 2010, and is deferring certain expenditures. On a more positive note, the IFRS Foundation, the parent entity of the IASB, is focused on moving as soon as possible to a funding source that relies on public sponsorship or other intermediated mechanisms.[6] As of 2011, the United States is the only country where the IFRS Foundation will seek direct corporate contributions. The IFRS Foundation's 2011 budget, released in April, projects a break-even year and indicates that direct contributions from U.S. companies (8 percent) and international accounting firms (26 percent) represent 34 percent of total projected revenues.

- **Criterion #4: The [IASB] has a full-time standard-setting board and staff that are free of bias and possess the technical expertise necessary to fulfill their important roles.**

  Recent changes to the IASB's governing documents have elevated the importance of geographic representation as a criterion for serving on the board (previously, technical expertise was the primary criterion). The changes also permit up to three part-time members of the board. Limited resources may further stretch the IASB's staff and inhibit the board's ability to develop high quality accounting standards.

- **Criterion #5: The [IASB] has demonstrated a clear recognition that investors are the key customer of audited financial reports and, therefore, the primary role of audited financial reports should be to satisfy in a timely manner investors' information needs. This includes having significant, prominent and adequately balanced representation from qualified investors on the standard setter's staff, standard-setting board, oversight board and outside monitoring or advisory groups.**

  The IFRS Foundation and the IASB have taken several steps to increase their focus on investors. Those steps include changes to the IASB's governing documents to designate investors as a major target audience, increasing investor representation in the standard-setting process and enhancing investor outreach. Incoming IASB Chair Hans Hoogervorst said recently, "[t]he interest of the investor will always remain the main focus of accounting standard setting."[7] In addition, research suggests investors and other users need to be more proactive and enhance their participation in IASB due process. Notwithstanding the progress that has made to increase investor representation in the standard-setting process, only five of the present 20 seats on the IFRS Foundation, eight of 47 seats on the IFRS Advisory Council (IFRS Council) and three of the 15 seats on the IASB are held by individuals from the investor community.[8]

- **Criterion #6: The [IASB] has a thorough public due process that includes solicitation of investor input on proposals and careful consideration of investor views before issuing proposals or final standards.**

  IASB due process, like that of other standard setters over the years, has been challenged, particularly during the recent credit crisis and the ongoing convergence process. Some have criticized the adequacy of the IASB's due process in connection with the board's plans to complete several major projects in 2011. Moreover, evidence is mixed about whether recent amendments to the IASB's governing documents are sufficient to improve due process. Nevertheless, in 2007, an independent think tank recognized the IASB as possessing the best developed external stakeholder engagement capabilities among 30 of the world's most powerful global organizations.

- **Criterion #7: The [IASB] has a structure and process that adequately protects the standard setter's technical decisions and judgments (including the timing of the implementation of standards) from being overridden by government officials or bodies.**

  All organizations involved in standard setting face ongoing questions regarding their authority and responsibility. The IASB is no exception. To date, its technical decisions and judgments have been subject to significant pressures from governmental officials and bodies, particularly those representing the European Union (EU).

The Quest for a Single Set of High Quality Global Accounting Standards

Since the formation of the IASB in 2001, the use of IFRS has become increasingly widespread around the world. Today, more than 120 countries use IFRS or IFRS-based standards.

All major economies have adopted IFRS or IFRS-based standards, established timetables to adopt IFRS or IFRS-based standards, or have efforts underway to converge with IFRS. The G20 leaders, representing the finance ministers and central bank governors of the major advanced and emerging economies, have recently "'reemphasized the importance of achieving a single set of high quality improved global accounting standards.'"[9]

The FASB has devoted much effort to converge, or minimize differences between, GAAP and IFRS. In 2002, the FASB and IASB (collectively, the boards) issued a memorandum of understanding (MOU) formalizing their commitment to convergence. The MOU acknowledges the boards' "commitment to the development of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting."[10] The boards "pledged to use their best efforts (a) to make their existing financial reporting standards fully compatible as soon as is practicable and (b) to co-ordinate their future work programmes to ensure that once achieved, compatibility is maintained."[11]

In April 2005, pressure for a single set of high quality globally accepted accounting standards intensified when the SEC issued its "possible roadmap" for convergence.[12] The IASB and FASB responded to the challenge to enhance convergence by updating their MOU in February 2006. The new MOU reiterated their commitment to convergence and was accompanied by a revised work program.[13]

In November 2007, the SEC removed the Form 20-F reconciliation requirement for foreign registrants that use IFRS as issued by the IASB. The Form 20-F reconciliation had required foreign companies listed on U.S. exchanges to reconcile their net income and shareowners' equity as determined under their domestic financial reporting with what their net income and shareowners' equity would have been if determined using GAAP.

During November 2008, the SEC proposed a roadmap that established a timetable for requiring all U.S. registrants to use IFRS by 2016 (SEC roadmap).[14] Cognizant of the importance convergence would play in the SEC's decision regarding whether to allow or require domestic registrants to use IFRS, during joint meetings in April 2008 and November 2009, the IASB and FASB again affirmed their commitment to developing common, high quality standards, and agreed to revised target dates for completing the MOU projects.[15]

Among other things, the credit crisis and a change in the U.S. administration delayed consideration of the SEC roadmap. Then in February 2010, the SEC issued a work plan to consider areas and factors relevant to a determination in 2011 as to whether, when and how the financial reporting system for U.S. issuers should be transitioned to a system incorporating IFRS.[16] The plan addresses, among other issues, sufficient development and application of IFRS for the U.S. domestic reporting system and the independence of standard setting for the benefit of investors.

In a June 2, 2010 letter, the chairs of the IASB and FASB highlighted their understanding of "the relevance of the June 2011 target to G20 members adopting IFRS in 2011 or 2012 and for other countries, including Japan and the United States, who consider continued improvement and convergence to be an important consideration in deciding the role of IFRS in their capital markets."[17, 18] The joint letter also noted stakeholder concerns about their ability to provide quality input on the large number of major joint exposure drafts planned for publication in 2010. In response, the IASB and FASB announced a modified strategy maintaining targeted completion dates of June 2011 or earlier for projects where the need for improvement is the most urgent. Other projects were assigned a later completion date because they address areas that the IASB and FASB believe have a lower priority or where additional research and analysis is required.

On Oct. 29, 2010, the SEC issued a progress report regarding the use of IFRS in the United States.[19] The report addresses, among other things, auditability and enforceability of IFRS; whether the IASB's funding and governance structure support the independent development of accounting standards for the ultimate benefit of investors including oversight of the IFRS Foundation; composition of the IFRS Foundation and the IASB; funding of the IFRS Foundation; and the IASB standard-setting process. The SEC's evaluation of the standard-setting process will include consideration of the extent to which the IASB promotes the pre-eminence of investor views; an assessment of the IASB's ability to resolve emerging issues in a timely and effective manner without compromising due process; and an assessment of the adequacy of the IASB's independence and objectivity during recent standard-setting efforts. The issues under consideration by the SEC overlap substantially with the Council's policy.

The SEC progress report also addresses the manner in which countries have incorporated IFRS. Some use full IFRS as promulgated by the IASB. Others use IFRS after a national incorporation process, which could lead to the use of IFRS as issued by the IASB or a local variation/adaptation. The SEC staff noted that based on its research, a very small minority of the largest jurisdictions currently incorporates full IFRS as promulgated by the IASB.

On April 14, 2011, the chairs of the IASB and the FASB agreed to push back the June 2011 targeted completion date for issuing final standards on four of their major joint projects. The announcement indicated that more time was needed to evaluate the feedback received on those projects and that the "quality of the standards remains of the utmost importance."[20]

Criterion #1:

In the aggregate, information that results from application of [IFRS] is, at a minimum, of the same quality as the information resulting from U.S. accounting . . . standards.

Findings supporting a conclusion that criterion #1 has been met

- A majority of surveyed U.S. and European financial executives believes the quality of IFRS is high or very high.
- The IASB and the FASB have made progress developing joint standards to address improvements needed prior to adoption of some version of IFRS in all major capital markets.

Findings supporting a conclusion that criterion #1 has not been met

- Concerns remain regarding fundamental deficiencies in some key areas of IFRS.

Inconclusive findings regarding criterion #1

- Research on the comparability of IFRS and GAAP is inconclusive regarding whether the application of IFRS provides, at a minimum, the same quality of information as the application of GAAP.

In a November 2010 document requesting input to guide their strategy review of the IASB, the IFRS Foundation trustees enumerate challenges facing the IASB.[21] One challenge involves the quality and implementation of IFRS. The trustees acknowledge that the IASB must continue to demonstrate the quality and relevance of its standards to ensure global acceptance.

A review of the academic literature by Frost, Henry and Lin[22] reveals that there exists little research directly addressing whether U.S. investors, issuers and markets would benefit from implementation of IFRS in the United States. Comparative evidence on GAAP versus IFRS reporting by U.S. issuers is not available because U.S. issuers to date have only been permitted to use GAAP. Frost et al. note that because capital markets, financial reporting regulation and other environmental and issuer characteristics differ around the world, findings from non-U.S. based research are not necessarily transferable to the U.S. environment.

Recognizing those potential limitations, the discussion that follows considers research on IFRS adoption by non-U.S. companies on the comparability of IFRS and GAAP, a survey of corporate finance experts' views of the quality of IFRS and progress toward eliminating fundamental deficiencies in IFRS.

Comparability and Accounting Quality of IFRS Compared with GAAP

The academic literature review by Frost et al.[23] concludes that research has produced mixed evidence regarding the comparability of IFRS and GAAP.[24] Two examples of that research follow:

- First, the findings of a study by Henry, Lin and Yang[25] suggest that, for European companies using IFRS and cross-listed on exchanges in the United States, the convergence efforts of the IASB and FASB have on average increased the similarity of results reported under IFRS and GAAP. More specifically, their findings indicate that from 2004 to 2006, the average number of differences between IFRS and GAAP, as reflected in SEC 20-F filings, declined.
- Second, a study I co-authored with Gray and Linthicum[26] examines the 20-F reconciliations of the population of U.S. listed European companies filing IFRS statements with the SEC in 2005. We found that IFRS income for those companies was generally significantly higher than the corresponding GAAP income. Conversely, for seasoned IFRS users (i.e., those voluntarily adopting IFRS prior to 2005), IFRS and GAAP income was comparable between 2001 and 2006, with the exception that IFRS income was significantly greater in 2005.

Frost et al. note that research on continuing convergence efforts will be limited as a result of the SEC's elimination of the 20-F reconciliation requirement in 2007. Future research needs to be based on qualitative assessments of differences in IFRS and GAAP standards rather than quantitative assessments of differences.

A more recent study being conducted by Barth, Landsman, Lang and Williams[27] includes a review of the academic literature comparing accounting amounts based on, and the economic implications of, non-U.S. companies applying IFRS instead of domestic standards. The authors conclude that the existing literature, in general, provides evidence that IFRS and GAAP earnings are comparable. Their findings, however, do not bear directly on the question of comparability of GAAP-based amounts applied by U.S. companies and IFRS-based amounts applied by non-U.S. companies for at least four reasons:

- First, the studies reviewed in the existing literature do not include U.S. companies, and non-U.S. cross-listed companies examined in the studies do not face the same incentives, auditing, regulation and litigation environment U.S. companies face.[28]
- Second, the properties of accounting amounts examined in the studies resulting from 20-F reconciliations of earnings and equity to GAAP are not the same as those resulting from full application of GAAP.[29]
- Third, because of the existence of the SEC reconciliation requirement during the periods examined in the studies, the non-U.S. cross-listed companies likely made GAAP-consistent choices under international standards to minimize reconciling items.[30]
- Finally, the studies' comparisons of GAAP and IFRS-based amounts implicitly control for factors other than accounting standards. In contrast, the SEC's concerns about comparability of IFRS and GAAP include the effects of all factors affecting accounting amounts (e.g., managerial incentives, auditing, and regulatory and litigation environments).

Of note, some of the academic literature reviewed by Barth et al. focuses on comparisons using German companies that were permitted to apply either IFRS (or depending on the period of study, International Accounting Standards (IAS))[31] or GAAP prior to 2005. For example, studies by Leuz and Verrecchia[32] and Leuz[33] find that comparisons of measures of information asymmetry provide little evidence of differences in bid/ask spreads, trading volume and stock price volatility for companies applying GAAP relative to those applying international standards. In contrast, a study by Bartov, Goldberg and Kim[34] provides evidence that earnings response coefficients are highest for companies applying GAAP, followed by companies applying international standards, and then companies applying German standards.

Barth et al.[35] indicate that because many of the studies they reviewed examine the properties of IFRS-based accounting amounts of companies in a single country with unique institutional features, it is not clear to what extent any conclusions drawn from the literature are applicable to comparisons between international standards and U.S. companies more generally. In any event, Barth et al. provides some evidence that non-U.S. companies have greater accounting system and value relevance comparability with U.S. companies when they apply IFRS than when they previously applied domestic standards. Moreover, comparability is higher for non-U.S. companies that adopted IFRS mandatorily after 2005 and for non-U.S. companies headquartered in countries with a common law legal origin.

Survey Assessing the Quality of IFRS

In 2008 Burthe and Mattli[36] conducted a survey of 749 corporate finance experts (primarily chief financial officers and chief accounting officers) employed by major listed companies in the United States, Germany, France and the United Kingdom (U.K.). Burthe and Mattli found that a majority of the surveyed U.S. (84 percent) and European (68 percent) financial executives believe the quality of the IASB's IFRSs and revised IASs are high or very high.

IASB and FASB Staff Analysis of MOU Progress

At an April 2008 joint meeting of the IASB and FASB, a group of board and staff members presented an assessment of MOU progress. The focus was to "outline the improvements to existing IFRS needed to facilitate mandatory adoption of IFRS in all major capital markets."[37] Two categories of MOU projects were identified:

- Significant, fundamental deficiencies in existing IFRS that need to be prioritized for completion by mid-2011 (i.e., revenue recognition, fair value measurement, consolidation policy and de-recognition).
- Worthwhile improvements where both IFRS and U.S. standards are currently similar (i.e., financial statement presentation, post-retirement benefits, leasing, financial instruments and liabilities and equity).

In the area of worthwhile improvements, based on the IASB's May 2011 timetable, the board plans to ballot final standards during 2011 on financial instruments, addressing impairment, general hedge accounting and asset and liability offsetting and a joint standard with the FASB on leasing. An exposure draft on macro hedge accounting is also expected to be released in 2011.

The IASB also plans during 2011 to issue final standards based on phase 1 of its post-retirement benefits project and, as part of phase B of the joint financial statement presentation project, a standard addressing presentation of other comprehensive income. Completion of the remaining portions of phase B of the financial statement presentation project to replace IAS 1, *Presentation of Financial Statements,* and IAS 7*, Statement of Cash Flows*, has been delayed until after 2011.

As of May 2011, three new IFRS standards have been issued addressing, at least in part, three of the four areas of IFRS identified in 2008 as having fundamental deficiencies.

Fair Value Measurement

In May 2011, the IASB and FASB issued common fair value measurement and disclosure requirements. IFRS 13, *Fair Value Measurement*, does not increase the usage of fair value measurements but focuses on improving consistency and reducing complexity by providing, for the first time, a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. Coinciding with the issuance of IFRS 13, the FASB issued an updated Topic 820, clarifying existing GAAP guidance to align with IFRS 13.

Consolidation Policy

Also in May 2011, the IASB issued a standard on consolidation policy. IFRS 10, *Consolidated Financial Statements*, builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company.

The FASB considered stakeholder input on the requirements of IFRS 10 and decided not to pursue a change to GAAP consistent with those requirements. The FASB's decision raises questions as to whether the fundamental deficiency in IFRS consolidation policy identified in 2008 has been resolved by IFRS 10.

De-recognition

Previously, in October 2010, the IASB amended IFRS 7, improving de-recognition disclosure requirements as part of its comprehensive review of off-balance sheet activities. The amendment, however, does not address the concerns raised in 2008 about IFRS requirements for determining when a financial asset or financial liability must be removed from the statement of financial position. The IASB Web site indicates that in 2012, the FASB will conclude its post-implementation review of the changes it made to its de-recognition requirements: "The boards will then consider the nature and scope of any further improvement and convergence efforts on de-recognition accounting."[38]

Revenue Recognition

The IASB has not yet issued a standard to address the fundamental deficiency in IFRS requirements for revenue recognition identified in 2008. Since 2002, however, the IASB and FASB have been working on a joint revenue recognition project. The boards are expected to vote on a joint standard on improving revenue recognition in the third quarter of 2011.[39]

Criterion #2:

[A]pplication . . . and enforcement . . . of [IFRS] are at least as rigorous and consistent as the application and enforcement of U.S. accounting . . . standards.

Inconclusive findings regarding criterion #2

- There is no direct evidence comparing the application and enforcement of IFRS in the United States with the application and enforcement of GAAP. However, research indicates a relationship between a country's institutional setting, including corporate governance and audit quality, and characteristics of a country's financial reporting. Hence, capital market regulation and enforcement of standards determine the quality of a country's financial reporting at least as strongly as the quality of the accounting standards utilized.

Whether IFRS enhances transparency and comparability depends on how the standards are implemented in practice. As indicated, the IFRS Foundation trustees have identified quality and implementation of IFRS as a primary challenge facing the IASB.[40] The trustees' acknowledge that as IFRS is adopted universally, there is a risk that implementation and adoption practices will diverge.

In an apparent effort to reduce the risk that global practices related to the implementation and adoption of IFRS will result in inconsistent application of IFRS, the IFRS Foundation trustees' recently proposed a number of action steps, including the following:

- The IASB will work with a network of securities regulators, audit regulators, standard setters and other stakeholders to identify divergence in practice.
- Where such divergence could be resolved through an improvement in the standard or an interpretation, the IASB or the IFRS Interpretations Committee will act accordingly.
- The IFRS Foundation, through its education and content services, should undertake activities aimed at promoting consistent application.
- The IASB, in partnership with relevant authorities, will identify jurisdictions where IFRS are being modified and encourage transparent reporting of such divergence.[41]

The trustees acknowledged that the success of the proposed action steps in ensuring consistency in applying IFRS "depends upon enforcement and regulatory activities, rigorous audits and sound corporate financial reporting and governance, areas outside the mandate of the Foundation."[42]

The following discussion summarizes research and other relevant information about the importance of rigorous regulation and enforcement, strong corporate governance, and the financial statement audit to the quality of financial reporting resulting from the application of IFRS.

Regulation and Enforcement of Compliance with IFRS

A growing body of research indicates that capital market regulation and enforcement of standards determine the quality of financial reporting at least as strongly as the quality of the standards themselves (Ball, Robin and Wu;[43] Daske, Hail, Leuz and Verdi;[44] Leuz, Nanda and Wysocki,[45] and DeFond, Hu, Hung and Li[46]). A paper by Ball argues: "Implementation is the Achilles heel of IFRS. There are overwhelming political and economic reasons to expect IFRS enforcement to be uneven around the world, including within Europe."[47]

In Ball's view, IFRS implementation issues raise concerns "that investors will be mislead [sic] into believing that there is more uniformity in practice than actually is the case and that, even to sophisticated investors, international differences in reporting quality now will be hidden under the rug of seemingly uniform standards."[48]

While several researchers have analyzed the relationship between countries' institutional settings and characteristics of financial reporting, only a few studies are beginning to address this relationship for companies applying IFRS. As one example, a study by Daske et al.[49] analyzes the economic effects of mandatory IFRS adoption in Europe and other parts of the world linking the effects to institutional environments. The study shows that first-time IFRS adoption is associated with an increase of market liquidity and valuations. However, cost of capital appears to have decreased only in countries with strict enforcement regimes.

In addition, a study by Francis, Khurana, Martin and Pereira[50] focuses on voluntary IFRS adoption by private companies and finds that adoption is influenced by company- and country-level factors. Company-level incentives are relatively more important in countries with high economic development and strong institutions. In less developed countries, country factors are more important.

Finally, a study I co-authored with Glaum, Schmidt and Vogel[51] examines the year 2005 financial statements of companies comprising the premier stock market indices of 17 European countries. The study focuses on disclosures for business combinations and impairment testing and finds evidence of substantial non-compliance. To ensure that the findings do not reflect transitory implementation problems pertaining only to first year IFRS application, the study also analyzes data for a select group of companies for 2007. The findings are very similar to those for 2005, indicating non-compliance is not a temporary phenomenon. The study also finds that compliance is determined jointly by company- and country-level variables, thereby providing evidence that accounting traditions and other country-specific factors continue to play an important role in compliance with IFRS.

Corporate Governance

While it is unclear how corporate governance practices will affect the rigor of IFRS' application in the United States, research provides evidence that corporate governance is especially important to high quality application of IFRS. A study by Chen and Zhang[52] finds that adoption of IFRS by Chinese B-share companies (i.e., companies listed on Chinese exchanges that trade in U.S. dollars) does not necessarily lead to IFRS-type accounting practices. For the period 1999–2004, they find that the decline in earnings differences under Chinese GAAP and IFRS is associated with the implementation of (1) a 2001 Chinese government compulsory accounting compliance policy and (2) the oversight activities of audit committees rather than the reduction of differences between the two sets of accounting standards. Chen and Zhang find that convergence of accounting practices may be affected by not only the lack of sufficient understanding of IFRS by local accounting professionals but also management's opportunistic behavior during the application of different standards. This finding provides evidence that corporate governance affects the convergence of accounting practices.

Importance of the Audit

Research indicates that rigorous application and enforcement of the use of IFRS in the United States would be critical to the quality of IFRS reporting. Hence, an unanswered question is whether the Public Company Accounting Oversight Board (PCAOB) and the SEC will be up to the task of enforcing audit quality. For example, a PCAOB report issued in September 2010 indicates that audit deficiencies may be linked to areas where issuers are required to exercise significant judgment in the application of GAAP.[53] If not addressed, audit risks could potentially multiply under IFRS (i.e., in the absence of detailed implementation guidance) where there is often a greater need for exercising professional judgment in contrast to GAAP.

Commenting more broadly on the difficulties of establishing a global system of financial reporting, Wyatt,[54] a former accounting standard setter and audit firm partner, observed, "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." Wyatt proposes five dimensions to achieving "effective" convergence: effective accounting standards, relevant education and understanding, effective regulatory regimes, a suitable political environment and effective auditing standards.[55]

Criterion #3:

The [IASB] has sufficient resources — including a secure stable source of funding that is not dependent on voluntary contributions of those subject to the standards.

Findings supporting a conclusion that criterion #3 has not been met

- Historically most of the IASB's funding has been from voluntary contributions, giving rise to questions concerning the board's independence.
- The IFRS Foundation ran a deficit for several years, including 2010, and is deferring certain expenditures.

Inconclusive findings regarding criterion #3

- The IFRS Foundation strategy calls for moving to a funding system that relies on public sponsorship or other intermediated mechanisms as soon as possible. The United States is the only country where the IFRS Foundation has said it will seek direct contributions from companies. The 2011 budget indicates that direct contributions from U.S. companies (8 percent) and international accounting firms (26 percent) represent only 34 percent of total projected revenues.
- The IFRS Foundation's 2011 budget projects a break-even year.

The following discussion provides information about the IFRS Foundation's historic dependence on voluntary contributions and the foundation's 2010 operating results and 2011 budget.

Historic Dependence on Voluntary Contributions

In 2002, a major change introduced by the Sarbanes-Oxley Act was a requirement that the FASB be financially independent; the law requires U.S. public companies to fund its annual budget. Historically the IASB had no similar protection and was funded almost completely by voluntary contributions leading key constituents to voice concerns about the board's independence.[56]

A funding solution that safeguards the independence of the standards setter is imperative in view of recent political pressure on the IASB in Europe and from financial institutions on topics including accounting for derivatives and other financial instruments.[57] According to SEC Chairman Mary Schapiro, the goal is that IASB funding become mandatory in each jurisdiction. Funding should not be subject to: "'We do not like this, so we will reduce our contribution.'"[58]

American Institute of Certified Public Accountants (AICPA) President & CEO Barry Melancon[59] has stated:

> [I]t is imperative the foundation find a permanent funding solution for the International Accounting Standards Board's activities. A permanent funding solution would ensure that the IASB has appropriate resources to carry out its mission and would lead to world-wide confidence in the IASB's role as an independent standard setter. . . .

Melancon also reaffirmed the AICPA's support for use of IFRS in the United States and stated, "[t]he AICPA will encourage the SEC to use part of the current levy on U.S. public companies for accounting standard setting activities as a permanent funding source for the IASB."[60]

The SEC staff is currently considering IASB funding approaches including those used by other jurisdictions; mechanisms utilized to fund the FASB; and other possible alternatives, as provided by relevant legal statutes, such as the Sarbanes-Oxley Act.[61] The SEC staff analysis will help determine the appropriate method to provide the U.S. based contribution. Several alternatives under consideration, such as creating a separate fee or authorizing the SEC to use appropriated funds to contribute to the IFRS Foundation and the IASB, would likely require Congressional action.[62]

Operating Results for 2010 and 2011 Budget

In October 2010, the IFRS Foundation announced a forecasted operating deficit for 2010 of £1.78 million.[63] The trustees projected that the outlook would worsen during 2011 with a projected operating deficit of £3.3 million. In contrast to plans announced in 2009 to expand the technical staffing of the IASB and its engagement with stakeholders, the IFRS Foundation's preliminary 2011 budget, included a number of cuts or deferred expenditures including deferring until 2012 hiring a 16th IASB member, phased hiring to fill staff vacancies and new positions, and reducing the use of consultants.

Following the release of the preliminary 2011 budget, members of the Monitoring Board, a group of international regulators overseeing the IFRS Foundation, stressed the need for stable funding for the IASB. The Monitoring Board raised concerns that the IFRS Foundation was reporting an "unstable and unsustainable" budget position for 2011.[64, 65]

In April 2011, the IFRS Foundation reported to the Monitoring Board on the foundation's 2010 results and presented an updated budget for 2011. The report included a deficit for 2010 totaling £2.01 million (an operating deficit of £1.3 million). The report also included an updated 2011 budget projecting a break-even year based on assumptions including significant increases in financing with the addition of new funding regimes in Africa, the Americas, Europe and Asia-Oceania.

For 2011, the trustees anticipate total revenues of £23.19 million from the following sources:

- Publicly sponsored/nationally administered financing regimes — 48 percent
- Direct voluntary contributions excluding accounting firms — 8 percent
- International accounting firms — 26 percent
- Central banks and international institutions — 1 percent
- Waived trustee fees — 0.5 percent
- Publications and related activities — 15.5 percent
- Interest income and honoraria — 1 percent

The IFRS Foundation acknowledges that its anticipated funding for 2011 fails "to keep pace with the growing demands placed on the organization."[66] The trustees indicated it was their belief that the "budget may need to grow to approximately £40-45 million . . . annually over a period of time."[67] They also proposed development of a global funding system that would include the following features:

- **A long-term commitment.** Funding should not be dependent on annual appropriations and not contingent on fulfilling any conditions that would compromise the independence of the standard-setting process.
- **Public sponsorship (either direct or implicit governmental or regulatory support).** This "public" element will remove any perception of undue interference by private sector interest groups through the financing process.
- **Flexibility.** Funding should take into account (1) agreed increases in the budget and (2) that national jurisdictions are likely to arrange the financing regimes to suit their legal frameworks and cultural background.
- **Proportionality.** Funding should be shared by the major economies of the world, proportionately, based on gross domestic product (GDP).
- **Public accountability.** Trustees should disclose annually how they plan to use the funds raised and seek the Monitoring Board's approval of the annual budget.[68]

Criterion #4:

The [IASB] has a full-time standard-setting board and staff that are free of bias and possess the technical expertise necessary to fulfill their important roles.

Findings supporting a conclusion that criterion #4 has not been met

- Recent changes to the IASB's governing documents have elevated the significance of geographic representation when selecting board members. Technical expertise is arguably no longer the primary qualification for board membership. A notable result is that incoming IASB Chair Hoogervorst, while highly knowledgeable about financial reporting, is not an accountant.
- Going forward, the lack of resources, as described in the discussion of criterion #3, may further stretch the IASB's staff, particularly if the IASB decides to no longer work on joint projects with the FASB.

Inconclusive findings regarding criterion #4

- All existing IASB members are full time. Moreover, based on recent changes to the IASB's governing documents, the IASB will continue to be comprised primarily of full-time members. However, up to three of the 16 members may serve part time.

The following discussion highlights recent changes to the IASB governing documents regarding requirements for IASB members, and provides information about the IASB's current staff resources.

Recent Changes to the IFRS Foundation Constitution

Tied to concerns expressed by the EU and others, recent amendments to the IFRS Foundation's constitution led to increasing the membership of the IASB from 14 to 16 (by 2012) in an effort to increase geographic diversity. Under the revised constitution, up to three (previously two) IASB members may be part time. Some view this later change as an opportunity to increase the number serving on the IASB with recent practical expertise. For example, current IASB member Stephen Cooper was appointed as a part-time member in August 2007, while serving as managing director and head of valuation and accounting research at UBS Investment Bank. In January 2009, Cooper's appointment was changed to full time.

Other recent amendments to the IFRS Foundation's constitution include the apparent demotion of technical expertise as the main criteria for IASB membership. This change may potentially be a concern to the SEC and investors. This issue of technical expertise of international accounting standard setters has a long history. As background, in the months leading up to the formation of the IASB in 2001, the EU and SEC participated in a debate regarding geographic representation versus technical expertise. The final agreement was that technical expertise would serve as the utmost qualification for board membership.[69]

A paper by Walton[70] notes that selection of the expert model (SEC view) over the geographic representation model (EU view) suggests that a key strategic issue was that financial statements prepared utilizing international standards should be accepted on stock exchanges worldwide. In line with this objective, the primary target was the U.S. capital markets, and the expert model was selected. One of my research papers[71] describes the outcome of the debate in the following manner:

> [O]nly one global standard setting model was acceptable to both the world's leading national accounting standard setters and the world's major capital market. A quality international accounting standard setter had to be characterized by traits including an independent decision-making structure, adequate due process, and sufficient technical capabilities. Geographic representation, while important, should be viewed as a secondary consideration.

A paper by Zeff[72] describes the continuing debate about board membership following the formation of the IASB:

> By 2004, there was already pressure, almost entirely from Europe, to alter the primary criterion for IASB membership. In 2005, the IASCF trustees changed the 'main qualifications' for Board membership to be 'professional competence and practical experience' . . . . The desired membership of the Board was to represent 'the best available combination of technical expertise and diversity of international business and market experience.' To critics of the original Constitution, technical expertise as the primary qualification was evidently seen as meaning that abstract theory and technical refinement would take precedence over the practical wisdom of highly experienced professionals. In an annex to the revised Constitution, 'demonstrated technical competency and knowledge of financial accounting and reporting' is now listed as one of six criteria for Board membership. Yet there is no question that technical expertise was significantly demoted as a criterion.

Under the current IFRS Foundation constitution,[73] the IASB by July 1, 2012 will normally be comprised of four members from each of Asia/Oceania, Europe and North America; one member from Africa; one member from South America; and two members appointed from any area, subject to overall geographical balance.

A notable result of the de-emphasis of technical expertise as a qualification for IASB members was the Oct. 12, 2010 announcement by the IFRS Foundation trustees of the appointment of Hans Hoogervorst to be the next chairman of the IASB beginning in July 2011. Hoogervorst, currently the chairman of the Netherlands Authority for the Financial Markets, is not an accountant. It has been reported that Hoogervorst's appointment was coupled with the appointment of U.K. Accounting Standards Board Chairman Ian Mackintosh as IASB vice-chair so that "Mackintosh will compensate for Hoogervorst's lack of accounting experience."[74]

Staff Resources

The IFRS Foundation had an average of 114 employees (including IASB members and staff) during 2009 (101 in 2008).[75] In contrast to earlier intentions to expand the IASB's technical staff, the IFRS Foundation's 2011 budget provides for a number of cuts or deferred expenditures. Those include deferring the hiring of additional staff to fill vacancies and new positions, as well as the reduced use of consultants.

Further complicating the current IASB staffing issues, a significant amount of intellectual capital and staffing is provided to the IASB by national standard setters and others as "contributed services." As I indicated in one of my research papers,[76] some observers are concerned that following the adoption of IFRS, some countries may determine that the cost of maintaining a national standard setter can no longer be justified. While others may retain their national standard setter, funding could be greatly reduced due to what may be viewed as the more limited role of the national standard setter of the future.

My paper argues that "to maintain influence and continue making a significant contribution to the development of global accounting standards, it is crucial that the world's largest economies continue to support their national standard setting bodies. Otherwise, the primary outlet for their national voice at the IASB will be silenced." Furthermore, if national standard setters such as the FASB, the Canadian Accounting Standards Board and others were to shut down following IFRS adoption in their respective countries, or curtail their contributed services to the IASB, the board's work program could progress more slowly.

Another related complication is that the IASB has faced growing criticism from the European Commission (EC) and the Federation of European Accountants for its close working relationship with the FASB. In August 2009, IASB Chair Sir David Tweedie explained to a U.S. audience that other countries were tired of waiting for the SEC to decide whether to approve a roadmap for transitioning to IFRS.[77] Tweedie noted that the United States needed to commit by 2011, warning that, in his opinion, the special MOU with the FASB could not go on forever. If the scenario described by Tweedie were to materialize, the IASB board and staff may have trouble completing their work plan post-2011, absent contributed services from the FASB.

Perhaps in recognition of the IASB's need for resources from national standard setters including the FASB, in April 2011 the IFRS Foundation trustees proposed that "the IASB should encourage the maintenance of a network of national and other accounting standard-setting bodies as an integral part of the global standard-setting process."[78]

Criterion #5:

The [IASB] has demonstrated a clear recognition that investors are the key customer of audited financial reports and, therefore, the primary role of audited financial reports should be to satisfy in a timely manner investors' information needs. This includes having significant, prominent and adequately balanced representation from qualified investors on the standard setter's staff, standard-setting board, oversight board and outside monitoring or advisory groups.

Findings supporting a conclusion that criterion #5 has been met

- The IASB governing documents include the specific designation of investors as a major target audience for the IASB. Incoming IASB Chair Hoogervorst has stated, "[t]he interest of the investor will always remain the main focus of accounting standard setting."[79]
- The IASB has made progress in increasing investor representation in the standard setting process.

Inconclusive findings regarding criterion #5

- While considerable progress has been made in increasing investor representation in the IASB's standard setting process, some observers continue to be concerned that the vast majority of individuals participating on the IFRS Foundation (15 of 20), the IASB (12 of 15) and the IFRS Council (39 of 47) are not from the investor community. On the other hand, the issue of the utmost importance is that those serving on these bodies are in tune with and actively pursue investor needs.

The following discussion highlights existing provisions of the IASB's governing documents that focus on investors, information about the current level of investor involvement in IFRS standard setting, the IASB's ongoing efforts to improve investor participation, and some research and an article about the challenges the IASB faces in those efforts. The discussion concludes by summarizing the IFRS Foundation's consideration of whether IFRS standard setting should place a greater focus on the needs of financial stability and what that might mean for investors.

Investor Focus of IFRS Foundation Constitution

The objectives of the IFRS Foundation, as reflected in its constitution, include:

> [T]o develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles. These standards should require high quality, transparent and comparable information in financial statements and other financial reporting to help investors, other participants in the world's capital markets and other users of financial information make economic decisions.[80]

Recently, the IFRS Foundation's constitution was modified to add a specific designation of investors as a major target audience for financial statements.[81] It is, however, important to note that in a 2008 report to the SEC by the Advisory Committee to Improve Financial Reporting, the committee recommended that investor perspectives should be given 'pre-eminence by' (as opposed to being a major target audience of) all parties involved in standards setting.[82]

Investor Representation on IFRS Foundation Trustees, IASB, etc.

The IFRS Foundation's 2009 annual report indicates that during 2009 the trustees took steps to encourage greater involvement of the global investor community, a primary beneficiary of financial reporting standards.[83] Those steps, updated for events occurring since 2009, include the following:

- Four (five as of 2011) trustees have current or recent experience with companies making investments,[84] and five (six as of 2011) trustees have served as securities regulators. According to the current IFRS Foundation constitution, the trustees shall be comprised of 22 individuals; as of April 2011, 20 individuals served as trustees.
- Following the appointment of Finnegan and McConnell, the IASB has three members with extensive international experience as financial analysts.[85] According to the constitution, the IASB shall be comprised of 16 individuals by 2012; as of April 2011, the IASB was comprised of 15 individuals.
- The IFRS Council has been reconstituted with a vice-chair from the investor community.[86] Eight major investor organizations are represented,[87] and have regular meetings with the trustees to discuss strategic and governance matters. In addition to the chair and two vice chairs, as of February 2011, individuals representing 47 organizations held a seat on the IFRS Council.
- The IASB has appointed a staff manager investor liaison and continues to undertake initiatives specifically targeted at the investor community.

Investor Outreach

IASB Chair Tweedie describes the IASB's investor outreach effort in the following manner: "We have taken additional steps to engage with investors. We have appointed an Investor Relations Manager to work with the investor and analyst communities. At meetings of the IFRS Advisory Council we have special sessions to meet Council members from the investor community."[88] Other investor outreach activities include: working with an Analyst Representative Group that provides input on technical activities;[89] the IFRS Foundation Web site now includes a dedicated investor section called Investor Resources[90] providing a portal for communication between the IASB and investors; each project on the IASB's agenda has a dedicated outreach champion that develops and implements an investor focused outreach strategy to ensure that the views of the user community are adequately captured during the development of new IFRSs; and to manage contact with investors and other users efficiently and effectively, the IASB staff has developed an internal database to capture and maintain the contact details of individuals with whom the board and staff interact with on the outreach front.

Investors, Other Users Should Increase Participation in IASB Due Process

According to Former IFRS Foundation Chair Gerrit Zalm, standard setters have always found it challenging to involve investors and other users.[91] This position is supported by academic research.

For example, research by Jorissen, Lybaert, Orens and van der Tas[92] examines the nature of European constituents' participation in the IASB's due process and finds evidence of limited participation by users.[93] The authors encourage the IASB to identify ways to stimulate users to participate more actively in the IASB's due process. As noted above, the IASB is cognizant of the importance of active participation by investors in the board's due process.

An article by Bruce, a financial journalist, explains that, while investors are often described as the primary users of financial statements, few have the time or inclination to get involved in the development of IFRS.[94] However, efforts by the IASB and investors are beginning to improve the situation.

Bruce[95] also notes that investor needs are not uniform. Investors have multiple motivations, pursue different strategies and operate in different markets.

Bruce cites IASB member Cooper as explaining that, instead of asking investors a full range of questions on an exposure draft, going forward the IASB will ask investors more about specific issues, the key issues from the investor perspective.[96] Cooper continues, "[w]e can modify our message to analysts." IFRS Foundation trustee Antonio Vegezzi adds, "[w]e need to hear criticism from investors if they are in disagreement with us."[97] Bruce opines that the key is to keep up the momentum of bringing standard setters and users closer in a dialogue that should make the process more effective. He also cautions that there will always be some friction; "people have to be realistic."[98]

Bruce[99] also summarizes the current situation facing the IASB, stating that the G20 nations have made it clear they want better information better communicated to investors. The SEC also continues to emphasize the needs of investors and is adamant that a key issue in acceptance of IFRS in the United States will be its usefulness to U.S. investors. Thus, the need for effective and timely outreach from the IASB and better, more coordinated, input from investors has never been greater. On this point, Bruce again quotes trustee Vegezzi: "As a result of the changes we have made, investors now have the front seat. I hope the investors see this. We want to be proactive."

Greater Focus on Regulators Could Threaten Investor Supremacy

As part of its ongoing strategy review, the IFRS Foundation is considering the extent to which financial reporting standards should be adapted to meet the needs of financial stability.[100] *Financial Times* journalist Jones poses the question as to whether a greater focus on financial stability by the IASB could potentially threaten the transparency expected by capital markets. Jones comments on the pressure regulators have placed on the IASB and FASB, to "rewrite screeds of accounting rules in order to serve artificial deadlines set by politicians and regulators in the wake of the financial crisis."[101] Jones suggests that succumbing to such pressure may jeopardize the long-term needs of investors.

Incoming IASB Chair Hoogervorst, addressed the concerns raised by Jones and many other parties in a February 2011 speech noting that investor needs will remain the main focus of accounting standard setting. Hoogervorst believes that stability should be a consequence of greater transparency, rather than a primary goal of standard setters. He explained:

> What accounting standard setters can also not do is to pretend that things are stable which are not. And, quite frankly, this is where their relationship with prudential regulators sometimes becomes testy. Accounting standard setters are sometimes suspicious that they are being asked to put a veneer of stability on instruments which are inherently volatile in value.[102]

Consistent with Hoogervorst's views, in an April 2011 "Report of the IFRS Foundation Trustees' Strategy Review," the trustees reaffirmed "the current constitutional focus on the development of financial reporting standards aimed at capital allocation decisions," and appear to have rejected an approach that would have placed greater emphasis on financial stability or other public policy objectives.[103]

Criterion #6:

The [IASB] has a thorough public due process that includes solicitation of investor input on proposals and careful consideration of investor views before issuing proposals or final standards.

Findings supporting a conclusion that criterion #6 has been met

- In 2007, One World Trust (an independent think tank) assessed the IASB as possessing the best developed external stakeholder engagement capabilities among 30 of the world's most powerful global organizations and a high performer in both transparency and evaluation.

Findings supporting a conclusion that criterion #6 has not been met

- IASB due process, like that of the FASB, has been challenged, particularly during the recent credit crisis. Many believe its current timeline for completing a number of major projects in 2011 is insufficient to obtain and carefully consider input before issuing final standards.

Inconclusive findings regarding criterion #6

- Evidence is mixed about whether the recent amendments to the IASB's governing documents will improve the IASB's due process.

The following discussion provides some background on past and current challenges to the IASB's due process, recent changes to the IASB's governing documents intended to improve due process, the controversy surrounding the due process in connection with the ongoing convergence projects, and the results of a 2007 third-party assessment of the IASB.

As indicated, the IFRS Foundation is currently conducting a strategy review that includes a review of the IASB's due process.[104] The IASB's due process is described in the IFRS Foundation constitution[105] and the IASB Due Process Handbook.[106] Some highlights include:

> The IASB meets and makes decisions in public. Issues are added to the IASB's work agenda only after consultation with the IFRS Advisory Council and the Trustees. The IASB also consults other groups, such as national accounting standard-setters, on its agenda and work programme. The IASB must publish exposure drafts (and often preliminary discussion papers) with the opportunity for public comment before reaching final conclusions. On major projects, the IASB establishes working (or advisory) groups reflecting the different stakeholders.[107]

Due Process Challenged During the Credit Crisis

One of my papers[108] provides an overview of the IASB's response to the credit crisis. Among other things, the paper describes threats from the EU to the IASB's independence and the resulting October 2008 "emergency" amendment to IAS 39, *Financial Instruments: Recognition and Measurement*. A brief review of this recent history may be instructive.

In June 2008, French President Nicolas Sarkozy sent a letter to the EC proposing to modify or suspend IAS 39 mark to market accounting requirements for some financial assets of banks.[109] During an Oct. 1, 2008 press conference, EC President José Manuel Barroso commented on the financial crisis and appeared supportive of Sarkozy's proposal.[110]

Prior to a summit called by the EU and Sarkozy to establish a common European position on regulation, the Chartered Financial Analysts (CFA) Institute conducted a poll of its EU-based members.[111] The findings indicated that 79 percent did not support suspension of fair value standards under IFRS and 85 percent believed suspension of fair value standards would further decrease confidence in the European banking system. In a letter to Sarkozy, CFA stressed that any weakening of accounting rules would not improve market stability and would further undermine investor confidence.

On Oct. 1, 2008, CFA Institute, the Council of Institutional Investors and the Center for Audit Quality[112] issued the following joint statement to a U.S. audience: "In the interest of investor confidence and the health of our capital markets and overall economy, we urge the SEC to resist calls from those with a questionable commitment to transparency and to reject any proposal that would suspend fair value accounting."[113]

With certain European banks claiming GAAP provided their competitors with reclassification alternatives that IFRS did not allow and growing political pressure, IASB members made their distaste clear.[114] However, the board acknowledged that the credit crisis represented an extreme situation, and IASB Chair Tweedie eventually agreed that if IAS 39 had to be modified, the change would best be made by an accounting standard setter and not politicians.[115]

With the approval of the IFRS Foundation trustees, and cognizant that due process was not followed,[116] on Oct. 13, 2008, amendments to IAS 39 and IFRS 7, *Financial Instruments: Disclosures*, were issued.

Changes to IASB Due Process Following Constitutional Reviews

Recent modifications have been made to the IFRS Foundation Constitution to safeguard due process and ensure that investors and other IASB constituents have ample time to adequately consider IASB proposals and provide informed feedback to the board. Following a review completed in June 2005, the constitution was amended to, among other things, ensure that the IASB follow appropriate due process procedures, provide time and channels for consultation and give reasons if it does not follow any of the non-mandatory consultative procedures.[117] Additionally, the IFRS Foundation formed a Due Process Oversight Committee.[118]

On Feb. 1, 2009, the constitution was further amended.[119] The changes, among other things, included a requirement for an accelerated due process and the introduction of an emergency procedure. Thus, the constitution now includes a provision for an accelerated due process but only in the most exceptional circumstances and only after approval by at least 75 percent of the IFRS Foundation trustees.[120]

In April 2011, the IFRS Foundation trustees proposed further changes to the IASB's due process as part of their strategy review.[121] Those proposed changes include a clarification to the trustees' oversight of the IASB's due process that would provide that the Due Process Oversight Committee should review and discuss due process compliance regularly throughout the standard setting process and at the end of the process before a standard is finalized.[122]

Due Process and the Convergence Projects

With the SEC poised to vote in 2011 on whether to move ahead with a mandate on IFRS adoption in the United States, the IASB and FASB began accelerating efforts in 2009 to make substantial progress toward convergence of IFRS and GAAP by June 2011.[123] Faced with the resulting challenge of commenting on an unprecedented number of due process documents, IASB and FASB constituents have been voicing concerns regarding their ability to provide quality feedback to the boards. In June 2010, the IASB and FASB responded by announcing a six month delay in the completion of certain convergence projects to allow for greater public comment.[124]

In a June 24, 2010 letter to the G20, the IASB and FASB chairs explained that the boards recognize the challenges that arise from seeking effective global stakeholder engagement on a large number of projects.[125] With stakeholders voicing concerns about their ability to provide high quality input on the large number of major exposure drafts, the boards developed a modified work plan limiting to four the number of significant or complex exposure drafts issued in any one quarter.

The June 2010 decision to modify the timetable of the MOU work plan did not cause an end to the concerns. As an example, at the July 13, 2010 meeting of the FASB's Investors Technical Advisory Committee (ITAC), some ITAC members continued to view the work plan as ambitious.[126] The ITAC also expressed concerns that the financial statement presentation project, which the ITAC has long supported, had been identified by the IASB and FASB as a lower priority project.

Many other parties, including accounting firm PricewaterhouseCoopers,[127] responded to the IASB and FASB's modified timeline sharing their concerns:

> Our experience with the standard setting process suggests that staff and board members need sufficient time to thoughtfully consider constituent input; to analyze, evaluate, and consider alternatives; and to deliberate with other board members in order to issue standards that have duly considered all important ramifications and unintended consequences.
>
> Recognizing the inherent need to balance speed to completion and efforts aimed at enhancing quality, we believe the targeted time periods in the boards' recent release are not sufficient.

On April 14, 2011, the chairs of the IASB and the FASB publicly agreed to push back the June 2011 targeted completion date for issuing final standards on four major joint projects noting that more time was needed to evaluate the feedback received and that the "quality of the standards remains of the utmost importance."[128]

Global Accountability Report

Despite concerns expressed by certain constituents, the IASB has achieved acclaim for stakeholder engagement and transparency. In 2007, the G*lobal Accountability Report*, the product of One World Trust — an independent think tank, assessed the IASB as possessing the best developed external stakeholder engagement capabilities among 30 of the world's most powerful global organizations and a high performer in both transparency and evaluation. Specifically, the IASB topped global rankings across all evaluated organizations for stakeholder participation. Among international non-governmental organizations, the IASB was ranked first for evaluation and second for transparency. Lloyd,[129] lead author of the report, commented, "[t]he IASB has developed procedures that bring transparency, predictability and consistency to the way its key constituencies are involved in its activities and should be congratulated on its achievements. We would like to see more global organisations doing the same."

Criterion #7:

The [IASB] has a structure and process that adequately protects the standard setter's technical decisions and judgments (including the timing of the implementation of standards) from being overridden by government officials or bodies.

Findings supporting a conclusion that criterion #7 has not been met

- The IASB's technical decisions and judgments have been subject to significant pressures from governmental officials and bodies, particularly those representing the EU. During the credit crisis the IASB's independence was challenged by, among others, the French president and the EC. Other challenges to the IASB's and national standard setters' independence are well documented.

The following discussion briefly summarizes the political pressures facing the IASB and their implications for independent global accounting standard setting.

A paper by Zeff[130] presents an assessment of the "continuing pressures brought on the [IFRS Foundation] and on the IASB, as well as the EU's ever-lengthening endorsement process for each new IASB standard . . . ."[131] Zeff explains that, the SEC has been relatively comfortable with accounting standards being set in the private sector. This level of comfort, however, does not exist in continental Europe.

From the infancy of the IASB's predecessor, the International Accounting Standards Committee,[132] in the 1970s, the EC has been "suspicious of private-sector standard setting, even by a supposedly independent body, as not being in the public interest."[133] According to Zeff, the EC decided to adopt international standards only when it became evident that "it was the only game in town."

The EC makes the final decision on endorsement of each IFRS after receiving advice from 26 "political" and 26 "technical" panels. Today, the European Parliament does not leave this decision entirely to the EC. In an "acutely political context," Parliament exerts the right to intervene on accounting standards that are proposed to become, in effect, EU law. Presently, endorsement may take months following the IASB's approval of an IFRS.

The paper by Zeff[134] also explains that during the IASB's deliberative process, European trade associations, major companies, and banks lobby the IASB on controversial standards. Zeff cautions that countries using IFRS in other parts of the world:

> [C]an hardly secure a sympathetic hearing for their views in competition with the steady flow of insistent views emanating from the EU's powerful bloc of 27 member states . . . . [T]hey must stand silently . . . while the EU proceeds through its lengthy and tortuous endorsement process, which provides the EU member states as well as vocal private-sector interests with opportunities to intervene . . . . The endorsement process now proceeds very much as does the legislative process. The impact . . . would be any changes in a final standard or interpretation which might be reluctantly conceded by the IASB in order to secure endorsement by the EU.[135]

The FASB is of course also lobbied by various vested interests.[136] Examples include the impact on Statement of Financial Accounting Standard (SFAS) 115, *Accounting for Certain Investments in Debt and Equity Securities*, resulting in the introduction of the available for sale portfolio for marketable equity securities and held to maturity category for marketable debt securities, and the original version of SFAS 123, *Accounting for Stock-Based Compensation*, requiring only footnote disclosure of dilutive stock options on income as opposed to recognition in the income statement as preferred by the FASB.[137]

Zeff's[138] paper ponders a world where the United States adopts IFRS, and the private-sector standard-setting process for U.S. companies moves to London. He opines that "the SEC may well believe that it must become more aggressive in carrying out its statutory responsibilities for investor protection. And, like the EU, it may develop a screening process of its own for newly issued IASB standards."[139] Zeff suggests that in such a world all countries that have committed to adopt IFRS would face a future where the United States and EU would likely have the dominant influence over the IASB's operation and the viability of IFRS.

In conclusion, as the SEC considers adoption of IFRS in the United States, it is of the utmost importance that investors and other constituents acknowledge that unless all countries adopt full IFRS as issued by the IASB (as opposed to adapting or converging with IFRS), it is highly questionable as to whether the SEC's pursuit of truly global accounting standards is attainable.

Endnotes

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84 The IFRS Foundation Trustees include Scott Evans of TIAA-CREF, Antonio Vegezzi of Capital Group, Jeff van Rooyen of a private equity company in South Africa, Oscar Fanjul of Omega Capital and Dick Sluimers of APG Group. Following appointment of Sluimers in February of 2011, Sir Bryon Nicholson, chair of the IFRS Foundation Trustees' Nominating Committee, stated, "[t]he Trustees are committed to providing a diversity of perspectives across the organisation, and in recent years we have focused on enhancing participation from the investor community. Dick Sluimers is a highly respected leader of a large European pension provider. His appointment further strengthens the already impressive investor representation on the Trustees." IFRS Foundation, Press Release (Feb. 9, 2011), http://iasplus.com/pressrel/1102Sluimers.pdf.

85 IASB members from the investment community include: Stephen Cooper, former Managing Director in the Equities business of UBS Investment Bank; Patrick Finnegan, former director of the Financial Reporting Policy Group at CFA Institute Centre for Financial Market Integrity; and Patricia McConnell, former senior managing director in Equity Research and Accounting, and Tax Policy Analyst for Bear Stearns & Co. Two current members of the IASB joined the board from securities regulators, Philippe Danjou and Zhang Wei-Guo. Furthermore, both Hans Hoogervorst, the IASB chair-designate, and Ian Mackintosh, the vice chair-designate, have top level experience with securities regulators with investor protection mandates. IFRS, Members of the IASB, http://www.ifrs.org/The+organisation/Members+of+the+IASB/Members+of+the+IASB.htm (last visited May 27, 2011).

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[112] The Center for Audit Quality is an affiliate of the American Institute of Certified Public Accountants that focuses on serving investors, public company auditors, and the markets. Center for Audit Quality, About Us, http://www.thecaq.org/about/index.htm (last visited May 27, 2011).

[113] *Joint Statement of the Center for Audit Quality, the Council of Institutional Investors, and CFA Institute Opposing Suspension of Mark-to-Market Accounting* (Oct. 1, 2008), http://www.thecaq.org/newsroom/release_10012008.htm.

[114] D.L. Street, *supra* note 108.

[115] J. Hughes, *Fair Value Accounting Rules Eased*, London, Fin. Times (Oct. 14, 2008) (on file with author).

[116] Reclassification of Fin. Assets, Amendments to IAS 39 *Fin. Instruments: Recognition & Measurement* & IFRS 7 *Fin. Instruments: Disclosures* ¶ BC104E (Int'l Accounting Standards Bd. Oct. 2008).

[117] IFRS, Constitution Review, Major Changes as Part of the 2005 Constitution Review, http://www.ifrs.org/The+organisation/Governance+and+accountability/Constitution/Constitution+Review/Major+changes+as+part+of+the+2005+Constitution+Review.htm (last visited May 27, 2011).

[118] IFRS, Due Process Oversight Committee, Due Process Oversight, http://www.ifrs.org/The+organisation/Governance+and+accountability/Due+process+oversight/Due+process+oversight.htm (last visited May 27, 2011).

[119] Report of the IASC Foundation Trustees on Part 2 of their Constitution Review, *Changes for Enhanced Public Accountability and Stakeholder Engagement* 4, 18, 38, (Apr. 2010), http://www.ifrs.org/NR/rdonlyres/44908350-84DF-4949-84D1-DE9584CE407B/0/ConstitutionReviewApril2010.pdf.

[120] *Id.*

[121] IFRS Foundation, *supra* note 41, at 3.

[122] *Id.* at 16.

[123] In December of 2010, SEC Chair Schapiro indicated that while the Commission still plans to vote in 2011 on whether to require the use of IFRS, it is "'not committed to a June 2011 decision date . . . despite a common [misconception by the accounting] profession.'" A. Defelice, *Schapiro, SEC Staff Want Companies to Have Ample Time for IFRS Adoption*, J. Acct. (Dec. 6, 2010), http://www.journalofaccountancy.com/Web/20103625.htm.

[124] *See, e.g.*, IFRS, *supra* note 17.

[125] IFRS, Web Announcements, *IASB and FASB Update to G20 Leaders on Modified Convergence Strategy* (June 24, 2010), http://www.ifrs.org/News/Announcements+and+Speeches/update+to+G20+on+modified+convergence+strategy.htm.

[126] FASB Investors Technical Advisory Committee, Minutes of Meeting 2 (July 13, 2010), http://www.fasb.org/cs/ContentServer?site=FASB&c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176158029190.

[127] PwC, *Point of View: Slowing Down the Pace of Standard Setting* (July 8, 2010), http://www.pwc.com/us/en/point-of-view/slowing-down-the-pace-of-standard-setting.jhtml.

[128] IFRS, *supra* note 20.

[129] IFRS, Press Releases, *IASB Tops Global Rankings for Stakeholder Participation — Identified as 'High Performer' for Transparency and Evaluation* (Dec. 1, 2007), http://www.ifrs.org/News/Press+Releases/IASB+tops+global+rankings+for+stakeholder+participation+-+Identified+as+high+performer+for+transpare.htm.

[130] S. Zeff, *supra* note 69, at 279.

[131] *Id.; see also* R. K. Larson, and D.L. Street, *The 'Roadmap' to Global Accounting Convergence: Europe Introduces 'Speed Bumps'*, CPA J. 36-43 (Oct. 2006), http://www.nysscpa.org/cpajournal/2006/1006/essentials/p36.htm.

[132] See *supra* note 31 for a discussion of the IASC.

[133] S. Zeff, *supra* note 69, at 279.

[134] *Id.*

[135] *Id.* at 279-80.

[136] S. Zeff, Commentary, *"Political" Lobbying on Proposed Standards: A Challenge to the IASB*, 16(1) Acct. Horizons 43-54 (Mar. 2002), http://www.ruf.rice.edu/~sazeff/Political%20Lobbying%20on%20Proposed%20Standards%20.pdf.

[137] *Id.* at 50.

[138] S. Zeff, *supra* note 69, at 278.

[139] *Id.*

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