Comment on the Securities and Exchange Commission's Staff Paper for a Work Plan for Considering the Incorporation of IFRS into the Financial Reporting System for U.S. Issuers (May 26, 2011)

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My comment will be limited to the Staff's characterization of this Work Plan and to its implications for providing a level playing field for foreign and U.S. domestic registrants.

The term "condorsement," which has been coined to combine convergence with endorsement, is used to characterize the SEC's proposed operating framework for incorporating IFRS into the U.S. financial reporting system. This term was debuted in the speech by Deputy Chief Accountant Paul A. Beswick on December 6, 2010. I believe that this term is wholly inappropriate to characterize this proposed operating framework. What the SEC actually proposes is a version of convergence. I will elaborate.

The term "endorsement" is, as far as I know, used for IFRS by the European Union alone. The EU employs an elaborate procedural "comitology" approach in which a private-sector expert group (EFRAG), overseen by a public-sector expert group (SARG), counsel both the European Commission and the Accounting Regulatory Committee, composed of representatives of the governments of the EU's 27 Member States, on whether to "endorse" IFRS, which means making it a part of EU law. The European Parliament may exercise its veto power in this process, as has been seen with IFRS 8. The aim of this process is to convert the IASB's standards and interpretations, including amendments to existing standards, one by one, into EU law without introducing any deviations. Such an endorsement process is required in the EU, because there was no other accepted procedure for converting standards developed by a private-sector body into EU law. Endorsement is a legalistic *cum* political process that carries out the terms of the EU's IAS Regulation 1606, which was approved in June 2002. Endorsement of IFRS is unique to the EU. No other jurisdictions around the world refer to endorsement of IFRS in their respective processes. They refer to adoption or convergence.

The rest of the world is divided into jurisdictions which have **adopted** IFRS and those which have been **converging** with IFRS. The former, as exemplified by Australia, New Zealand, Hong Kong, Canada, Brazil, and Chile, have involved a multi-period transition toward a date on which a competent authority in the jurisdiction decides that, henceforth, all IFRS thus far issued will be required for use by listed companies in their financial statements. Subsequently issued IASB standards and interpretations, including amendments to existing standards, will similarly become required by such companies once a competent authority adopts them. The aim is to adopt all of the IFRS so long as they are not prohibited by jurisdictional law. For example, Australia has not adopted the fair presentation override in IAS 1, because it is prohibited by the country's Corporations Act of 1991. Japan has taken the first step toward adoption by allowing its listed companies to adopt IFRS voluntarily as from March 31, 2010. It intends to decide by 2012 whether and, if so, when, all listed companies will be required to comply with IFRS.

A subset of the adopting jurisdictions has decided that, once the IASB issues a standard or interpretation, or an amendment, it will become automatically required for use by listed companies, without any action needed to be taken by a competent authority. So far, only South Africa and Israel have chosen this approach.

The approach of adoption was implied in the proposed roadmap which was approved 5-0 by the Commission and was enthusiastically supported by the Division of Corporation Finance, the Office of the Chief Accountant, the Office of Economic Analysis, the Office of International Affairs, and the Office of the General Counsel in testimony during the SEC's hearing on August 27, 2008. Based on the latest Work Plan, It is remarkable how much the thinking of the SEC's staff has apparently diverged from its unanimous support for the roadmap in only 2½ years.

Convergence is the term used to describe the process used in still other jurisdictions, by which (1) a private-sector standard-setting body (for example, in India, the Philippines, and Malaysia) ordinarily with express or implied oversight by a government ministry or securities commission or (2) a public-sector standard-setting body (for example, in China and Singapore) gradually, over an extended period of years, act to incorporate IFRS, at times with deviations to suit jurisdictional interests, into jurisdictional GAAP.

In most of the jurisdictions, regardless of whether they adhere to the endorsement, adoption, or convergence approach, the national standard setters participate more or less actively in the ongoing work of the IASB. This includes the development by them of research to support the IASB's projects as well as conveying the jurisdictional views on the IASB's agenda, project development, discussion papers, and exposure drafts. A number of the national standard setters contribute full-time staff to the IASB. Today, the IASB has 56 technical staff from 24 countries, including eight from the United States. In the EU, national standard setters participate directly and indirectly with the IASB. The indirect approach is through membership of the U.K., German, and French standard setters on EFRAG's Technical Expert Group. EFRAG itself is a highly proactive body in dealing with the IASB. In addition to the annual meeting which the IASB holds of World Standard Setters, there is a separate group of National Standard Setters, organized some years ago by Ian Mackintosh (then Chairman of the UK Accounting Standards Board), which meets semi-annually and works proactively with the IASB on particular areas of interest. Two years ago, standard setters in Asia and the South Pacific formed the Asian-Oceanian Standard Setters Group, which also works proactively with the IASB on matters of interest to its members. Consequently, regardless of whether jurisdictions endorse, adopt, or converge with IFRS, their national standard setter can choose to participate, or not, in the IASB's process.

The term "endorsement" in and of itself does not denote, or even connote, participation "in the development and improvement of accounting standards…." Endorsement refers to an adoption-like process which the EU uses in a political and economic community of Member States. From the beginning, it was, of course, hoped that the IASB would be responsive to the views expressed by EFRAG, but endorsement was not made contingent on the degree of this responsiveness.

In my view, the description of the process exposed in the Work Plan is one of convergence, US style, and does not reflect any of the attributes of endorsement as seen in the EU or adoption as seen in other jurisdictions. Furthermore, in view of the modifications that the FASB would be entitled to make in its process of producing a U.S. "flavor" (the SEC's term in its Work Plan) of IFRS, as part of "a customized, U.S.-specific transition plan," I am dubious that, in the light of the likely, and perhaps many, deviations, domestic registrants and their auditors would believe that the financial statements reflecting such incorporated IFRS are compliant with IFRS as issued by the IASB, when they affirm compliance with US GAAP. While the SEC's Work Plan recommends that modifications of IFRS "should be rare and generally avoidable," the very likelihood that some, if not many, would occur means that the incorporation of IFRS into US GAAP could do no more than approximate IFRS. One could well ask: should the SEC require that domestic registrants include a footnoted reconciliation to full IFRS, very much in the style of the Form 20-F reconciliation for foreign registrants not affirming compliance with IFRS as issued by the IASB? Why should foreign registrants be required to affirm such compliance in order to avoid preparing the Form 20-F reconciliation, when domestic registrants, under this proposed framework, may be permitted to deviate from IFRS, all in the same capital market, and nonetheless be permitted to affirm compliance with something which represents a variation of IFRS? Does this affirmation with IFRS-incorporated US GAAP, without a reconciling footnote, promote comparability, transparency, and full disclosure, which the SEC said in its press release of April 11, 1996 collectively constitute "high quality" financial reporting?

Even if the FASB does not approve any new modifications of IFRS, the Staff Paper reminds us that a pre-existing modification of IFRS is "the possible continuation of some existing U.S. GAAP requirements that have no specific IFRS counterparts." These would include industry standards. Yet, from the beginning, the IASB has preferred not to set industry standards, and it seems plausible to believe that it would be difficult to develop common industry standards for use in very different jurisdictional settings that would enhance worldwide comparability. So when would those deviations from IFRS ever be resolved? In addition, what is to become of the SEC's Staff Accounting Bulletins and the financial reporting requirements, including disclosures, in Regulation S-X? These are matters over which the FASB has no authority. What will become of the SEC's prescriptions on the contents of Management's Discussion & Analysis? There are important differences between these and the IASB's recent practice statement on Management Commentary.

In its release approved on November 15, 2007 to lift the Form 20-F reconciliation requirement for foreign registrants that affirm compliance with "IFRS as issued by the IASB," the SEC attached great importance to this precise wording of affirmation, both by the company and by the auditor. Yet, under its Work Plan, the SEC proposes to allow domestic registrants to affirm a compliance which may be no more than an approximation of IFRS, yet no reconciliation with full IFRS would be required. The SEC can be accused in this respect of being hypocritical, or at least of countenancing a double standard, one for foreign registrants and another for domestic registrants.