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July 22, 2011

James L. Kroeker  
Chief Accountant  
Office of the Chief Accountant  
100 F Street, N.E.  
Washington, DC 20549

Re: SEC Staff Paper Exploring a Possible Method for Incorporation of IFRS

Dear Mr. Kroeker:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to comment on the SEC staff paper, *Exploring a Possible Method for Incorporation*.<sup>2</sup> The Staff Paper explores one possible approach for incorporating IFRS into the financial reporting system for U.S. issuers that combines the convergence and endorsement approaches that have been used in other jurisdictions. The “condorsement” approach described in the Staff Paper would retain U.S. GAAP and make the FASB responsible for incorporating IFRS into GAAP over a defined time period. The approach contemplates a transitional period during which certain differences between GAAP and IFRS would be reduced or eliminated (*i.e.*, converged) through ongoing FASB standard-setting efforts. At the end of the transition period (*e.g.*, 5-7 years) a U.S. issuer compliant with GAAP should also be able to represent that it is compliant with IFRS as issued by the IASB. After the transition period, the FASB would endorse new IFRSs and incorporate them into U.S. GAAP.

We have previously commented in support of excluding investment companies from the Commission’s roadmap for incorporation of IFRS into the U.S. financial reporting system.<sup>3</sup> Our comments noted that the typical investor benefits associated with a transition to a single set of accounting standards, (*e.g.*, comparable financial information for U.S. and foreign issuers) do not

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<sup>1</sup> The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$13.3 trillion and serve over 90 million shareholders.

<sup>2</sup> SEC 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, May 26, 2011 (the “Staff Paper”).

<sup>3</sup> See letter from Gregory M. Smith, Director – Compliance and Fund Accounting, Investment Company Institute to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, regarding Roadmap for Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers (April 20, 2009).

apply to investment companies as issuers of financial statements. This is because U.S. securities laws strongly limit or discourage investment by U.S. persons in foreign funds and U.S. tax rules discourage foreign investment in U.S. investment companies. The cross-border sale of foreign funds in the U.S., and of U.S. investment companies in overseas markets, is therefore extremely limited. Further, even absent these impediments, the typical investor benefits would be limited because few European countries apply IFRS to open-end funds.<sup>4</sup>

We have also previously expressed concern that the application of IFRS to investment companies would result in financial statements that are *less* meaningful and *less* transparent than those prepared under GAAP.<sup>5</sup> This is because GAAP for investment companies is an industry-specific reporting model that reflects the unique characteristics of pooled investment vehicles.<sup>6</sup> In contrast, IFRS does not provide accounting standards or guidance specific to investment companies. Accordingly, investment companies would have to abide by the same financial reporting standards followed by general corporate enterprises, resulting in financial statements that fail to provide the types of financial information most relevant to fund investors (*e.g.*, financial highlights, schedules of portfolio investments, separate presentation of net investment income, realized gain/loss, and change in unrealized appreciation/depreciation).

We have also previously described how the application of IFRS to investment companies would conflict with Regulation S-X and the Investment Company Act of 1940 (1940 Act).<sup>7</sup> For example, IFRS treats shares issued by open-end funds as liabilities causing these funds to have no equity or net assets. In contrast, rule 6-04 of Regulation S-X characterizes fund shares as equity and further requires funds to disclose the components of net assets (*e.g.*, paid in capital, undistributed net investment income, accumulated net realized gains/losses, and unrealized appreciation/depreciation, *etc.*). Additionally, rule 22c-1 under the 1940 Act requires purchase and redemption orders for open-end fund shares to be processed at the net asset value per share next calculated after receipt of the order. Under IFRS, however, there would be no net assets and no net asset value per share. These conflicts as well as other accounting, reporting, and operational issues we have described would need to be addressed before IFRS could be applied to investment companies.

In our view, investment companies and their shareholders would incur significant costs in connection with any mandated transition to IFRS. These costs include: 1) decreased utility of financial statements delivered to fund shareholders; 2) initial conversion costs relating to accounting and financial reporting systems; 3) human capital/training costs; 4) ongoing systems and recordkeeping costs associated with increased volume of book/tax differences; and 5) increased printing and mailing costs attributable to the increased length of shareholder reports.

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<sup>4</sup> See Ernst & Young, International Financial Reporting Standards European Investment Fund Survey (January, 2010).

<sup>5</sup> See letter from Gregory M. Smith, Director – Compliance and Fund Accounting, Investment Company Institute, to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission, regarding Commission Request for Comment on Allowing U.S. Issuers to Prepare Financial Statements in Accordance with IFRS (November 13, 2007).

<sup>6</sup> See FASB ASC Topic 946 and Article 6 of Regulation S-X.

<sup>7</sup> See letter from Gregory M. Smith, Director – Compliance and Fund Accounting, Investment Company Institute, to Jaime Eichen, Assistant Chief Accountant, Division of Investment Management, U.S. Securities and Exchange Commission, regarding application of IFRS to investment companies (May 24, 2011).

We are hard-pressed to see any benefit to funds or their shareholders associated with requiring investment companies to apply IFRS. We encourage the Commission to identify any benefits and ensure that they exceed the related costs before it requires investment companies to apply IFRS.

### Staff Paper

The condorsement approach described in the Staff Paper envisions that the FASB would continue as the U.S. accounting standard setter. The FASB would be responsible for evaluating each IFRS individually to determine the timing and manner of transition (*i.e.*, convergence or endorsement) to U.S. GAAP. The endorsement process would be predicated on a finding by the FASB that such incorporation of IFRS is consistent with the public interest and the protection of investors. Further, the approach described in the Staff Paper contemplates that FASB would have the authority to develop supplemental or interpretive guidance for U.S. constituents. For example, where existing GAAP requirements have no specific IFRS counterparts, the FASB could decide to carry forward the existing GAAP requirements with any necessary conforming amendments. Such U.S. GAAP-specific requirements would remain in effect until the IASB developed corresponding requirements, at which time the U.S. GAAP-specific requirements would be rescinded subject to the FASB's endorsement of the IASB's new standard. The FASB would continue to have an active role in the development of global accounting standards by facilitating communication between the IASB and U.S. constituents; providing assistance with research and the development of implementation guidance; and ensuring that U.S. interests were suitably addressed.

If, contrary to our recommendation, the Commission decides to include investment companies in a mandatory transition to IFRS, we believe that the condorsement approach described in the Staff Paper would better serve the interests of funds and their investors than the alternative approaches currently under consideration (*i.e.*, full adoption of IFRS on a specified date without any endorsement mechanism, or full adoption of IFRS after a staged transition over several years). Requiring each individual IFRS to be endorsed prior to its incorporation into U.S. GAAP subject to a public interest finding provides an enhanced level of investor protection to funds and their investors, relative to the alternative of direct incorporation of IFRS as issued by the IASB. We agree that the FASB is the entity best equipped to implement the approach described in the Staff Paper and we believe that the FASB's extensive experience in dealing with the IASB on their Memorandum of Understanding projects affords it the level of influence needed to ensure that the interests of U.S. constituents are addressed in the on-going development of accounting standards.

Furthermore, we believe that it would be appropriate, as outlined in the Staff Paper, for the Commission to provide the FASB with the authority to provide supplemental and interpretive guidance and the authority to carry forward existing GAAP based requirements for which there are no IFRS counterparts. As we have previously noted, U.S. GAAP contains a robust and effective industry specific reporting model for investment companies (ASC Topic 946) and that model is consistent with the Commission's reporting requirements applicable to investment companies (Article 6 of Regulation S-X). In contrast, IFRS contains no guidance or reporting requirements specific to investment companies. If the Commission decides to include investment companies within a mandatory transition to IFRS following the approach described in the Staff Paper, it should ensure that the FASB has the authority to carry forward the industry-specific reporting model currently employed by investment companies until such time as the

IASB adopts standards and guidance specific to investment companies. We believe the forthcoming IASB proposal that would establish the concept of an investment company in IFRS (and create an exemption from consolidation of controlled investees) while helpful, should not be viewed as a substitute for carrying forward ASC Topic 946 in its entirety.

Standard Setter for Investment Companies

If investment companies are excluded from a mandatory transition to IFRS, the Commission should consider what entity will be responsible for maintaining the accounting principles under which funds report their results of operations and financial position. For example, if operating companies and issuers other than investment companies transition to IFRS as issued by the IASB on a specified date, without any endorsement mechanism, we envision that investment companies would continue to report under U.S. GAAP. In this circumstance, we believe it would be imperative that the Commission designate a standard setter for investment companies (*e.g.*, the FASB or the SEC itself) so that the accounting principles under which investment companies report could be maintained.

We would be pleased to answer any questions you may have on our comments or to provide additional information. Please contact the undersigned at (202) 326-5851.

Sincerely,

/s/ Gregory M. Smith

Gregory M. Smith  
Director – Operations/  
Compliance & Fund Accounting

cc: Paul A. Beswick, Deputy Chief Accountant  
Office of the Chief Accountant

Jaime Eichen, Chief Accountant  
Division of Investment Management