



15 October 2010

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File No: 4-607 / 4-608

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

By email: rule-comments@sec.gov

Dear Elizabeth

Notice of solicitation of public comment on consideration of incorporating IFRS into the financial reporting system for U.S. issuers

- 1 The ICAEW is pleased to respond to your request for comments on the Notice of solicitation of public comment on *consideration of incorporating IFRS into the financial reporting system for U.S. issuers*.
- 2 The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

Support for the convergence of IFRS and US GAAP

- 3 We have supported the convergence process to date. A single set of globally adopted and consistently applied international financial reporting standards will considerably improve comparability of company financial statements between different jurisdictional capital markets. Such consistency in treatment will bring significant benefits to users who will more readily be able to understand and compare company financial information. We applaud the convergence efforts of the FASB and IASB to date and are encouraged by the significant progress that has been made. We will continue, through our engagement in the consultation process, to encourage the Boards to resolve those areas of difference that still exist and believe that by mid 2011 agreement will have been reached on a range of important decisions. However, the

convergence issue has always run the risk of diluting the quality of the standards produced by the process. We are therefore of the view that, from mid-2011, the IASB should refocus its efforts on producing the best quality standards for its constituents, whether or not the US has decided to accept or mandate IFRSs. Convergence to one set of international standards has, in our view, a limited life.

ICAEW detailed studies on the experience of IFRS adoption in Europe

- 4 We feel that the adoption experience of the UK and of the European Union (EU) more widely may be of relevance to the SEC in considering the likely impact of adoption in the U.S. Publicly traded companies established in EU member nations have been required since 2005 to adopt IFRS (as endorsed for use in the EU) in their consolidated financial statements. ICAEW published in 2007 a detailed study of the adoption experience of EU groups ***EU Implementation of IFRS and the Fair Value Directive***, a copy of which is attached with this letter. The study is the most comprehensive assessment to date of compliance with the requirements of IFRS and the overall quality of IFRS financial reporting. It evaluates the application of IFRS across EU industries, market places and member states. The study includes a detailed review of the 2005 financial statements of 200 companies drawn from across 25 EU member states. It also features an evaluation of the reactions to the transition to IFRS reporting of preparers, users and auditors through an on-line survey and roundtables held across the EU. While the US may have some specific local issues to deal with, we believe that many of the issues faced on adoption of IFRS for the first time are of universal application.

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- 5 Based upon our experience of IFRS transition in the UK, we have set out below the main issues that investors should be aware of:

Investors' current knowledge of IFRS and preparedness for incorporation of IFRS

- 6 Early preparation and communication is key here such that investors have adequate advance notice of the likely effect on the financial statements of transition. UK listed companies were required to transition to IFRS in 2005. The regulatory authorities encouraged companies to indicate the likely impact of IFRS on their 2005 results and on their financial position in their 2003 financial statements, and to publish restated numbers for 2004 at the time of, or soon after, the publication of the GAAP financial statements.

Investors' education process on changes to accounting standards and timeliness of such education

- 7 The educational process needs to commence as early as possible such that all constituents are adequately conversant with the new requirements, and their likely effect before transition. The educational process needs to encompass all of those involved in the preparation and use of financial statements including new accountancy students. In the UK it was found to be particularly important for transitioning companies to explain very clearly to analysts and other stakeholders differences between the IFRS numbers and the figures previously reported under national GAAP, because of their unfamiliarity with IFRS concepts, vocabulary and requirements.

Extent of, logistics for, and estimated time necessary to undertake any necessary changes

- 8 As set out above, investors should seek to commence the educational process as early as possible. Preparers can assist in this process by publishing an indication of the effect of transition on their performance and position as early as possible and in engaging in additional activities to explain these factors to investors.

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The implications of IFRS transition for preparers

9 We have set out below what our research has shown to have been the main lessons learned by UK preparers in their IFRS transition exercise:

The Process

- 10** A key message for preparers of accounts is that it is never too early to start the transition process, especially because, when they present their first IFRS financial statements (which for listed companies are likely to be interim statements), they will need to present comparative IFRS information for the prior year. It is recommended that the process should therefore begin no later than the start of the year before IFRS adoption is mandated, and perhaps even earlier, to ensure that all data required is captured. In the UK, and presumably in other EU member States, this was frustrated to some degree by the fact that the EU had to endorse the IASB's standards and interpretations, and this was not completed until a relatively late stage.
- 11** The IFRS conversion process should be treated like any other major business project, and not as a technical accounting issue. A robust project plan from the outset was invariably a prerequisite for a smooth transition to IFRS. Companies typically had initial meetings with their auditors at which likely significant issues were identified, leading to production of a table of the items in their financial statements showing the degree to which these would be impacted by IFRS adoption using an "ABC" (or similar) grading – "A" representing items likely to have major issues and or impact on conversion to IFRS, "B" representing modest impact or issues, and "C" representing items which were unlikely to be significantly affected. This was designed to focus the company's attention on the key areas affecting them and to enable them to budget the time needed in each case.
- 12** A dedicated project manager needs to be given the appropriate authority to undertake the work, and appropriate resources need to be provided to meet the costs and time of conversion, including IFRS expertise. The choice is between recruiting experienced, IFRS-knowledgeable employees or relying on external advisors – the auditors, subject to independence constraints, and other professional and training firms. As IFRS knowledge is needed on an ongoing basis after implementation, recruitment or the thorough training and retention of existing employees may be regarded as the most desirable option. Using in-house expertise also means that the ability to take quick corrective action as delays and problems are identified is enhanced.
- 13** All staff involved in the accounting process need to be made aware of how the change to IFRS will impact their work. Meetings held at an early stage were successfully used to inform staff of what was expected of them and to listen to their views. Often, staff will have valid operational points to make, such as system limitations, which can then be investigated.
- 14** In some industries, there was a sharing of thoughts and issues through regular meetings of representatives from leading companies in the same sector, sometimes including their auditors. This helped to ensure some consistency of approach for industry-specific issues and assisted those charged with implementation.

Systems

- 15** Systems may well need to be upgraded. If systems changes are to be made, these need to be specified very early on in the project, to allow time for development, testing and corrective action, and to ensure that the system is ready for operation when required. The time taken to achieve this should not be underestimated.
- 16** Many companies met project deadlines by "workarounds" – the use of spreadsheets to produce certain figures and disclosures which were not embedded in the accounting systems. Whilst this may have been necessary in the first instance, it is generally not desirable because

companies had to do more work the following year to bring information within their normal accounting systems. There is also an increased risk of error.

Training

- 17** It is important to train all staff affected by the adoption of IFRS. This is not limited to finance teams but extends to budget holders and any other internal or external stakeholder who needs to understand and interpret IFRS accounting information, or who is rewarded based on such information. The early involvement of the human resources department is likely to be necessary to ensure training is carried out efficiently and comprehensively.

Business issues

- 18** The company must consider the effect that IFRS adoption will have on, among other things:
- 1** Management compensation structures (profits may become more volatile under IFRS adoption, especially if the company is exposed to the extensive use of fair values for financial instruments);
 - 2** Taxation implications;
 - 3** Debt covenants based on financial statement ratios; and
 - 4** Key performance indicators, which may need to be amended as a result of the switch to IFRS.

Contractual arrangements

- 19** The issues set out above provide an indication of the issues to be considered in assessing the effect of transition on contractual arrangements. To the extent that contracts contain references to US GAAP then these may need to be updated to reflect IFRS. More significantly, attention should be paid to measurement differences between the two GAAPs to the extent that they affect the quantification of amounts in contracts; for example, bonuses may be measured against 'profit' a figure that could change on transition. Changes in these amounts are likely to have a real economic impact on the transitioning company and therefore need to be considered carefully. The difficulty of this process should not be overstated, however, as such arrangements are often affected by changes in accounting requirements within domestic GAAP, so most companies should be used to keeping them under review and making changes where necessary.

Corporate governance; stock exchange listing requirements

- 20** The board of directors/officers should be engaged from the start of the process. IFRS adoption has the potential to significantly affect earnings and net assets, and senior management needs to be aware of this early on. There are indications that directors of many EU-listed companies are more involved in financial reporting decisions than under previous national accounting regimes.
- 21** The company's auditors should also be consulted early on in the process, where key judgements and estimations will be required, to ensure that no last-minute revisions of the financial statements will be necessary.
- 22** In the UK, listed companies appoint audit committees, consisting primarily of non-executive directors, to liaise with the external auditors. The audit committee will be involved in the selection of appropriate accounting policies and – as IFRS permits alternative treatments in many cases and requires significant exercise of judgement – this will be a time-consuming task, requiring an initial training period in IFRS principles for the committee members.

Statutory distribution restrictions, tax and other legal standards tied to financial reporting standards

- 23** The EU IAS Regulation mandated the use of IFRS only in the consolidated financial statements of listed groups. The stand-alone financial statements of the parent and the individual entities making up the group could, and in some countries were required to, continue to be prepared in accordance with existing local GAAP. Therefore the effect on distributable profits (in Europe the extent to which distributions can be made is tied into the accounting at an individual legal entity level) was muted as these are calculated on the basis of the individual legal entity.
- 24** Changes were however made to UK Company Law which allowed any company to adopt IFRS should it wish. Few companies made this voluntary conversion as it was seen to carry few benefits, although it did prove more popular for parents of listed groups whose financial statements were presented in the same document as the IFRS consolidated accounts. Where a company adopted IFRS in its individual accounts there was in many cases an effect on profit that filtered down into the amount available for distribution. However, given the complex rules in this area in the UK the difference in reported profit between the two GAAPs was not necessarily equal to the difference in distributable profit.
- 25** There were also certain impacts on corporate taxes that had to be dealt with through tax legislation. These were complex, but were perhaps more specific to the UK's tax rules and may be less applicable in a US context. This is nevertheless a major area that should be examined.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely



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