



Financial Reporting Council

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

Dear Ms Morris,

Re File Number S7-13-07

Acceptance from Foreign Private Issuers of Financial Statements prepared in accordance with International Financial Reporting Standards without reconciliation to US GAAP

On behalf of the Financial Reporting Council I am pleased to submit our comments on the Commission's proposal to eliminate, in certain circumstances, the US GAAP reconciliation requirement for foreign private issuers.

The Financial Reporting Council (FRC) is the United Kingdom's independent regulator responsible for promoting confidence in corporate reporting and governance. The FRC's functions are exercised principally by its operating bodies (the Accounting Standards Board, the Auditing Practices Board, the Board for Actuarial Standards, the Financial Reporting Review Panel, the Professional Oversight Board and the Accountancy & Actuarial Discipline Board) and by the Council. The Committee on Corporate Governance, whose members are drawn from the Council, assists it in its work on corporate governance.

The FRC's conclusions on the proposal

The FRC welcomes the Commission's proposal to accept financial statements from foreign private issuers prepared in accordance with International Financial Reporting Standards (IFRS) without reconciliation to US GAAP.

We note that the Commission's proposal would only apply to foreign private issuers who comply with the English language version of IFRS as issued by the IASB.

The FRC believes that the requirement to comply with the version of IFRS issued by the IASB is appropriate and is consistent with the long-term goal of having a single set of accounting standards which is accepted globally. In coming to this view the FRC has had regard to the fact that IFRS contains a number of optional accounting requirements and that a decision by an individual foreign private issuer or by a foreign jurisdiction not to adopt or permit one of these options would not of itself constitute a failure to comply with IFRS as issued by the IASB.

Although the FRC understands the importance which the Commission attaches to the fact that financial statements filed with the Commission must be in English, it recommends that the Commission considers permitting the use by preparers of non-English versions of IFRS which are published by the IASC Foundation or which have been prepared by an official translation service of a foreign jurisdiction, such as the European Commission.

The FRC believes that implementation of this proposal will result in short-, medium- and long-term benefits to users and preparers of financial statements.

The short-term benefit will derive from the savings in the costs incurred by foreign private issuers in the US as a result of the proposal.

The medium-term benefit will derive from the likelihood that the number of foreign private companies choosing to issue securities in the US will be higher than would be the case if the proposal was not implemented. This will make it easier for companies to raise capital and will increase the range of investment opportunities available to investors in the US markets.

The long-term benefits will derive from the fact that this proposal will increase the likelihood of there being a single set of globally-accepted accounting standards, which has the potential to contribute to the broadening and deepening of capital markets throughout the world with benefits to both providers and users of capital. We regard this benefit as being considerably harder to achieve than the short- and medium-term benefits. The main reason for this is that although there are advantages in having a single global set of accounting standards, these advantages could be outweighed if the single set which emerged was of poor quality or if the costs to investors and preparers of changing to the single set was excessive or if the effect of having a single global set of standards was to impair the responsiveness of accounting standards to new transactions or market circumstances.

In the light of these benefits, the FRC believes that the Commission should implement the proposed rule changes as soon as possible.

The principal reason for the FRC's conclusions

The FRC's conclusions are based primarily on its belief that IFRS is a high quality set of accounting standards which is capable of ensuring adequate disclosure for the protection of investors and the promotion of fair, orderly and efficient markets. This

belief is informed by the experience in the European markets where there has been no market disruption or loss of investor confidence as a result of the introduction of IFRS in 2005. Indeed it is our understanding that substantial amounts of capital have been invested by US investors in European companies which report under IFRS, thus suggesting that many US investors already have concluded that IFRS is a fit-for-purpose financial reporting framework.

Specifically in the UK, the Financial Reporting Review Panel, which is part of the FRC, and which is the body with statutory powers to review and enforce compliance with accounting standards, has concluded that the introduction of IFRS has been accomplished satisfactorily, although, as is to be expected, it did note some potential for improvement in future years. The Panel's latest report is available on the FRC website (<http://www.frc.org.uk/frp/press/pub1402.html>).

It has been the FRC's practice in recent years to commission independent surveys of the opinion of investors, company directors and auditors as to their level of confidence in corporate reporting in the UK. These surveys cover the period before and after the introduction of IFRS. The surveys indicate that confidence has been consistently high throughout recent years and has actually increased since the introduction of IFRS. The results of the survey are included in the FRC's Annual Report which is available on our website. (<http://www.frc.org.uk/documents/pagemanager/frc/Annual%20Report%202006-07%20web.pdf>).

Whereas the decision by the European Union to adopt IFRS was somewhat of a leap of faith, since at that time there was no significant evidence of the impact which IFRS would have in practice, the SEC in reaching its decision has the benefit of market evidence that investors, including some US investors, find IFRS to be a fit-for-purpose financial reporting framework.

Having made these points, the FRC recognises that IFRS is neither complete nor perfect in all respects and it looks forward to benefiting from the IASB's efforts to improve IFRS in the coming years in line with the IASB's core mission to develop "in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements".

If the benefits of having a single set of accounting standards which is accepted globally are to be realised then jurisdictions which require or permit the use of these standards need to accept that they will have less influence on the content of the international standards than they would have on the content of "national" standards. At the same time the organisation which develops accounting standards which are intended to be globally-accepted must be both technically and politically neutral. This means that it is undesirable for the IASB to be subject to undue pressure to comply with the technical or political requirements of any particular jurisdiction.

The FRC also recognises that the long-term goal of having a single set of accounting standards which is accepted globally is compatible with the continued existence of national GAAPs (eg US GAAP) which might be used extensively by companies whose securities are not traded internationally. Indeed, one implication of the Commission's proposal is that US GAAP and IFRS would co-exist, unreconciled, in the US capital markets, which corresponds to the position which has operated satisfactorily in the European capital markets in recent years.

The FRC's views on other considerations relating to the proposal

The Commission's paper also refers to a number of other considerations and invites comments as to their significance in determining whether to proceed with the proposal. The FRC wishes to draw to the attention of the Commission its views on some of these considerations.

Extent of convergence between IFRS and US GAAP

The Commission's paper states:

"We do not believe that a particular degree of convergence should be a prerequisite for our acceptance of financial statements prepared under IFRS as published by the IASB without reconciliation."

The FRC believes that the Commission is correct in this judgement. Specifically, as is explained above, the only significant factor in the decision should be whether IFRS is a high quality set of accounting standards.

Indeed the FRC believes that it would be inappropriate for a particular degree of convergence to be a consideration in this decision. The main reason for this is that *it is neither possible nor desirable to define what is meant by sufficient or satisfactory convergence.*

The FRC notes that there is currently no authoritative policy statement as to what would constitute a sufficient degree of convergence, nor as to what would constitute a satisfactory basis for convergence (ie to what extent should IFRS change to become more like US GAAP, or should US GAAP change to become more like IFRS, or should both change to something unlike either).

The FRC believes that it would be impossible to draft such a statement on a basis which would command widespread support, including in countries which currently use neither US GAAP nor IFRS but may wish to use IFRS in the future. It is also unclear which organisation could confer authoritative status on such a statement. Furthermore, it would be undesirable to attempt to draft such a statement as this would compromise the decision-making independence of both the IASB and FASB.

The FRC observes that the absence of an authoritative policy statement as to what would constitute sufficient and satisfactory convergence has led some commentators on this issue to propose their own criteria. For example, it has been suggested that

the proposal should not be implemented until the reconciliation differences between IFRS and US GAAP have been reduced to an immaterial level. We believe that the practical effect of such a definition of convergence would be to delay the decision on the US GAAP reconciliation for many years thereby delaying the realisation of the benefits which are set out in the first section of this letter.

A robust process for convergence between IFRS and US GAAP

The Commission's paper states:

"Our proposal to [eliminate the requirement for reconciliation] is based on, among other considerations, the robustness of a process that lends itself to continued progress of the IASB and FASB towards convergence over time ..."

The FRC notes that there is currently no authoritative policy statement as to what would constitute "a robust process for convergence". The FRC believes that there is a risk that this consideration could introduce a significant degree of uncertainty in the minds of foreign private companies as to the reporting requirements which they would have to meet if they were to enter or remain in the US capital markets. For example, this consideration could be interpreted as meaning that the Commission's policy would be to re-impose the reconciliation requirement if, at some future time, it judged that the pace and/or direction of convergence was unsatisfactory or if new differences between IFRS and US GAAP were to be introduced.

The FRC believes that this uncertainty would be unhelpful to both investors and issuers. For this reason the FRC believes that it would, therefore, be advantageous if the Commission could clarify the policy intention underlying this consideration and the interaction between this consideration and the Commission's view that elimination of the reconciliation should not be dependent on a particular degree of convergence. It would be particularly helpful if the Commission could confirm that a robust convergence process is compatible with a wide range of outcomes as to the extent to which IFRS should change to become more like US GAAP, or US GAAP should change to become more like IFRS, or both should change to something unlike either. The FRC believes that this confirmation will help to re-enforce the actual and perceived technical neutrality of the IASB which, in turn, will help to re-enforce the IASB's political neutrality.

A specific issue on which clarification would be useful is the implications of "a robust process for convergence" on the ability to make improvements to either US GAAP or IFRS. For example, it might be interpreted to mean that any significant change to either US GAAP or IFRS would need to be approved and implemented simultaneously by both the IASB and FASB. Some of the IASB's stakeholders might interpret this as, in effect, giving FASB a right of veto over the IASB, which would damage the credibility and acceptability of IFRS. Similarly, some of FASB's stakeholders might interpret this as, in effect, giving IASB a right of veto over the FASB, which would be equally unacceptable.

The implications of a robust convergence process on improvements to accounting could be particularly important in the light of the Commission's innovative and far-

sighted decision to establish an Advisory Committee on Improvements to Financial Reporting (CIFiR). As Chairman Cox said in his remarks to the Committee in August:

"... not only are financial statements difficult for investors to understand, but also companies incur excessive costs as a result of complying with voluminous and overly prescriptive accounting and reporting rules."

The FRC believes that these sentiments are widely shared by capital market participants in the US and in the UK.

We presume that in establishing CIFiR, and in encouraging it to be radical in its thinking, the Commission is open to the possibility that there may be potentially significant changes to US GAAP in the years ahead. The FRC believes that it would be helpful if the Commission could clarify that the importance which it attaches to a robust convergence process does not mean either that the ability of the US to introduce improvements to US GAAP is dependent on the approval of the IASB or that improvements to US GAAP are likely to lead to the possible re-imposition of the US GAAP reconciliation.

For these reasons the FRC believes that a robust convergence process is in practice a less important consideration than the fact that IFRS is a high quality set of accounting standards which is capable of ensuring adequate disclosure for the protection of investors and the promotion of fair, orderly and efficient markets. As a consequence the FRC believes that the only circumstances in which the Commission should re-impose the requirement would be if the Commission were to conclude that IFRS is no longer a high quality set of accounting standards.

Incentives for future convergence between IFRS and US GAAP

The Commission's paper states:

"We also will consider whether interested parties will continue to have an incentive to support ... convergence work should the Commission accept IFRS financial statements from foreign private issuers without reconciliation to US GAAP."

Consistent with the points which have been made earlier in this letter about the extent of convergence and the robustness of the process for convergence, the FRC believes that impact of the Commission's proposal on the incentives for future convergence is a secondary consideration. However, we believe that the Commission's proposal will have a significantly positive effect on these incentives.

Firstly, the Commission's proposal will enhance the international credibility of IFRS as a high quality set of accounting standards. The credibility of IFRS will be further enhanced in due course if the Commission were to allow US issuers to prepare financial statements in accordance with IFRS, as discussed in the Commission's concept release 33-8831. The FRC believes that the cumulative effect of the Commission's proposal and concept release will to establish IFRS as issued by the IASB as the only set of accounting standards which has a credible prospect of becoming globally-accepted.

Secondly, the increased reliance by investors and issuers on IFRS resulting from the Commission's proposal would increase the incentives on the IASB to deliver further improvements to IFRS. The FRC believes that in its search for improvements the IASB should, and will, continue to have regard to the accounting principles and practices in the US, which is still the world's largest capital market. Equally, the enhanced credibility of IFRS will increase the incentive for FASB to reduce the differences between US GAAP and IFRS.

Thirdly, the Commission's proposal would enhance the incentives to avoid a proliferation of national or regional variations of IFRS which would undermine the rationale for striving for a single set of high quality, globally accepted accounting standards.

Foreign country arrangements for auditing and for enforcement of standards

Some commentators have urged the Commission to make the decision to eliminate the reconciliation requirement conditional on the Commission being satisfied that there are satisfactory standards of auditing and mechanisms for enforcement of accounting standards in foreign countries.

The FRC is fully supportive of the need for high standards of auditing and for effective mechanisms for enforcing accounting standards; these are core elements of the FRC's responsibilities in the UK. The FRC shares the Commission's assessment that considerable efforts have been made by regulatory authorities in various jurisdictions and by international organisations such as the International Organisation of Securities Commissions and Committee of European Securities Regulators to improve the effectiveness and consistency of mechanisms for enforcing accounting standards, and the FRC is an active contributor to these efforts. The FRC also notes that considerable efforts are being made to improve the quality of auditing standards and the mechanisms for monitoring and enforcing auditing standards, including through the establishment of the International Forum of Independent Audit Regulators.

Notwithstanding the importance of these mechanisms, the FRC believes that it is unnecessary and undesirable for satisfactory standards of auditing and mechanisms for enforcement of accounting standards in foreign countries to be a condition of a decision to eliminate the reconciliation requirement. The principal reason for this is that the adequacy of the Commission's existing arrangements for regulating the auditors of individual foreign private issuers and for monitoring the compliance with accounting standards by individual foreign private issuers is not affected by the removal of the reconciliation requirement.

Specifically, the auditors of foreign private issuers have to register with the PCAOB, have to meet certain requirements imposed by the Commission and are potentially subject to sanctions by the PCAOB and the Commission. The Commission also has significant resources devoted to reviewing the financial statements of foreign private issuers and can take action to require improved accounting or disclosures. These

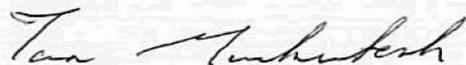
arrangements are not impaired by a decision to eliminate the reconciliation requirement and there is no need for the Commission to add requirements in relation to the systems in foreign countries to the arrangements which it has in relation to individual foreign private issuers.

The FRC believes that there are opportunities to improve the effectiveness and efficiency of audit regulation through the promotion of increased regulatory cooperation but the Commission's proposal on the US GAAP reconciliation should not be dependent on these opportunities.

Conclusions

In conclusion, the FRC believes that the Commission should implement the proposed rule changes as soon as possible and that this decision should be based primarily on the fact that IFRS is a high quality set of accounting standards and not on any particular degree of convergence between IFRS and US GAAP.

Yours sincerely



PA **Paul Boyle**
Chief Executive