

# Investors Technical Advisory Committee

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## Via Email

November 2, 2007

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

Re: File Number S7-20-07: Concept Release on Allowing U.S. Issuers to Prepare Financial Statements in Accordance with International Financial Reporting Standards (Release)

Dear Ms. Morris:

The purpose of this letter is to provide the Investors Technical Advisory Committee's (ITAC or Committee) views on the above referenced Release. The ITAC comprises twelve individuals from the investment profession possessing strong technical accounting knowledge.<sup>1</sup>

The purpose of the ITAC is to provide independent technical advice, from the investors' perspective, to the Financial Accounting Standards Board and its staff. At its September 6, 2007 meeting, the ITAC concluded that, given the importance of the Release to the FASB's standard setting activities, the Committee should submit a comment letter to the United States (US) Securities and Exchange Commission (SEC or Commission) in response to the Release. This letter represents the views of the ITAC and does not necessarily represent the views of its individual members, the organizations by which they are employed, or the views of the FASB or its staff.

Recently, International Financial Reporting Standards (IFRS) have been a critical part of the Commission's work. In July, the Commission proposed the elimination of the financial statement reconciliation between IFRS and US generally accepted accounting principles (GAAP) that is required for foreign registrants' filings. While the Release's scope is much broader than the previous proposal's, many principles contained in our response to that proposal also apply to the Release.

Our overall position on the Release: we support the goal of convergence to a single set of high quality financial reporting standards by the International Accounting Standards Board (IASB) and the FASB. When that goal is reached within the boundaries of reason, then the question of whether or not US companies should be allowed to choose between the two regimes is moot. Until genuine convergence is achieved, we harbor serious reservations about allowing US registrants to choose between IFRS and US GAAP reporting. We consider "genuine convergence" to be achieved when the differences in results from applying the two sets of standards would not impact the investment decisions of reasonable investors. Based on the current differences between the two systems as exposed by the IFRS-to-US GAAP reconciliation, we do not believe genuine convergence has been achieved at this time.

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<sup>1</sup> For more information about the Investors Technical Advisory Committee ("ITAC"), including a list of the current members and the organizations in which they are employed, see [http://www.fasb.org/investors\\_technical\\_advisory\\_committee/itac\\_members.shtml](http://www.fasb.org/investors_technical_advisory_committee/itac_members.shtml).

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In the absence of genuine convergence, we believe that non-beneficial costs would be injected into the capital markets. Investors would have to take actions on their own to adjust published information to suit their needs. Such information would not necessarily be complete or accurate, and investors might raise the cost of capital to compensate for the additional work involved in evaluating the performance of a firm that has switched from US GAAP to IFRS reporting.

Additionally, firms might employ IFRS when they see an opportunity to diminish disclosures or present transactions in a more favorable light. This is not because IFRS is an inherently weaker set of standards: we believe it might occur because the option would create more choices in reporting.

Multiple accounting treatments within just US GAAP exist for a single kind of item to be accounted for; inventory and leases are but two common examples. This multiplicity of possible treatments has long been the bane of investors. We fail to understand how adding an entire reporting regime that currently contains differences from US GAAP will help investors in this regard. In fact, there are some standards between the two systems that have nothing in common with each other. There are no IFRS standards for the insurance and extractive industries, while such standards exist in US GAAP.

Furthermore, we are concerned that convergence efforts may not be as robust if the choice is granted, and that would create more differences between the two regimes. Investors might try to cope with the differences, but are handicapped from the outset: first, by having to spend the time to devise strategies to make comparisons possible, and second, by lacking the kind of information that only a firm's managers will possess. Facing this situation, investors might charge an "uncertainty premium" for companies choosing to report in IFRS.

While allowing a choice might have a further unintended effect of raising the cost of capital, we believe that there would be beneficial effects on the cost of capital if the two systems are genuinely converged. We believe that investors would benefit more by using financial information prepared on equivalent bases than by having sheer numbers of new investment choices available that may not be as comparable or prepared with the same consistent level of quality.

We also have concerns that the option might create a two-tier market. A shift to IFRS in US reporting by large multinational firms domiciled in the United States might sop up all available IFRS accounting talent. As the Commission is aware, the pool of experienced accountants with an international accounting background is very shallow. Small firms perceiving a benefit in moving to IFRS would be at a serious disadvantage in competing for scarce talent. As the experience with Section 404 of the Sarbanes-Oxley Act of 2002 (SOX) has shown, some smaller firms have serious reservations about their ability to shoulder costs of increased accounting demands. If genuine convergence is achieved over a longer period of time than the end of 2008, smaller firms might have an easier time dealing with any incremental costs that might occur along the path to convergence. They will not find it so smooth if they find themselves competing with larger competitors possessing much greater resources.

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We also have concerns about the effect on the auditing profession of allowing such a choice. There is the matter of staff supply: accountants with sufficient IFRS experience are scarce, as noted above. There is a larger issue, however, with regard to the auditing firms. In recent years, there has been much concern over the concentration of power within the auditing profession and the dominance of the Big Four auditing firms. These firms crowd out other, next-tier auditing firms when it comes to attracting and retaining accounting talent. They also have the international resources and networks to handle audit engagements of multinational firms more effectively and efficiently than next-tier firms. Those are important competitive strengths for the Big Four, and allowing firms the choice of selecting IFRS or US GAAP will play to those strengths: those firms will be able to more effectively assist firms that want to make the transition. Allowing U.S. registrants a choice of reporting bases will only strengthen the competitive advantages of the Big Four in the auditing profession.

As we indicated in our prior comment letter in response to the July proposal, we are not yet confident that there is consistent auditing and enforcement of the application of IFRS. Given the fragmentation of international auditing standards and disciplines and the inconsistent state of the application of IFRS,<sup>2</sup> we reiterate our suggestion that the Commission undertake an evaluation of the differences in the auditing and enforcement disciplines of IFRS versus the auditing and enforcement of US GAAP and how those differences may impact the comparability and credibility of the resulting financial reports before concluding that firms should be allowed to choose between the two reporting bases.

We also wish to repeat and reemphasize from our previous letter: we respect the work of the IASB and its staff. Nevertheless, giving US companies the choice of two reporting bases would raise the IASB to the level of a recognized standard setter as defined in Section 108 of the SOX. Section 108 names specific attributes that a standard setting body must possess in order to be recognized the SEC. One of those attributes, described in Section 109, is funding from fees mandated from "issuers." The IASB does not currently raise its funding this way, and in fact its funding mechanism is of some concern to us. As we wrote before, the existing funding mechanism for the IASB could have a negative effect on the quality and timeliness of the standards it produces and may jeopardize its independence.

The FASB has been funded by public fees since 2003 as required by the SOX, and as such, is an adequately funded independent standard-setter that is free of the potential influences that might occur in seeking contributions from constituents to fund its operations. The IASB does not enjoy the same degree of independence: its operations are funded by donor contributions, and its trustees are still in the process of establishing a long-term funding program.

The ITAC does not oppose convergence of accounting standards: we welcome it, in fact. We, however, are concerned that there will be only one chance to achieve it properly, if investor confidence in our markets is to be maintained. This is why we urge the Commission to focus its efforts on supporting and defending the private sector process that the FASB and IASB have established to resolve the reconciling differences by working jointly to improve the overall quality of financial accounting and reporting standards.

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<sup>2</sup> See SEC Staff Observations in the Review of IFRS Financial Statements 2 (July 2, 2007), available at [http://www.sec.gov/divisions/corpfin/ifrs\\_staffobservations.htm](http://www.sec.gov/divisions/corpfin/ifrs_staffobservations.htm) (indicating inconsistent application of International Financial Reporting Standards in a number of areas including statement of cash flows, common control mergers, recapitalizations, reorganizations, acquisitions, and minority interests).

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We recommend that the Commission establish concrete evidence that the two sets of standards are substantially equivalent before giving US registrants the choice of a reporting basis. In that regard, we recommend that the Commission undertake an evaluation of the IFRS/US GAAP differences commonly found in 20-F reconciliations, and survey the two bodies of accounting literature to determine which standards produce the most disparate results. Upon completing the evaluation and publicly disseminating the results, the Commission should set a realistic timeline for the FASB and IASB to achieve convergence on those standards - and work with them to ensure that convergence is reached.

Given limited experience with projects of this magnitude, we cannot offer a realistic timetable for convergence. We believe that the size of such a project dictates that it would likely take longer than the end of this decade. If, however, genuine convergence is planned over say, a five-year time horizon, rather than simply "switched on" at the end of a year, we believe that the issues we have raised can be addressed satisfactorily.

If you have any questions, please feel free to contact the undersigned or any ITAC member.

Sincerely,

A handwritten signature in cursive script that reads "Jack Ciesielski". The signature is written in black ink and is positioned above the printed name.

Jack Ciesielski

Member

Investors Technical Advisory Committee