

COUNCIL OF INSTITUTIONAL INVESTORS

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Via Email

April 20, 2009

Florence E. Harmon
Acting Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number S7-27-08

Dear Ms. Harmon:

I am writing on behalf of the Council of Institutional Investors (“Council”), an association of more than 130 public, corporate and union pension funds with combined assets of over \$3 trillion.¹ The Council appreciates the opportunity to comment on the Securities and Exchange Commission’s (“Commission”) “Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers: Proposed Rule” (“Proposal”).²

As a leading voice for long-term patient capital, the Council strongly believes that independent private sector accounting standard setting is critical to the development of a single set of high quality global accounting standards that meet the needs of investors—the primary consumers of financial reports. Last fall, after research and deliberations by the Council’s staff, policies committee, and board of directors,³ including consultation with the Chairman of the International Accounting Standards Board and other leading international and domestic accounting experts, the Council’s general members⁴ approved a policy⁵ that directly addresses the key issue raised by the Proposal: What are the necessary milestones that must be met to ensure the protection of investors *before* the Commission considers requiring or even allowing the use of International Financial Reporting Standards (“IFRS”) by U.S. issuers?⁶

¹ Additional information about the Council of Institutional Investors (“Council”) and its members is available on the Council’s website at http://www.cii.org/about/council_members.

² Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers: Proposed Rule, Securities Act Release No. 8982, Exchange Act Release No. 58,960, File No. S7-27-08, 73 Fed. Reg. 70,816 (Nov. 21, 2008), <http://www.sec.gov/rules/proposed/2008/33-8982fr.pdf>.

³ A listing of the Council’s board of directors and their affiliations is available on the Council’s website at http://www.cii.org/about/council_board.

⁴ A description of the general members of the Council is available on the Council’s website at http://www.cii.org/about/council_members.

⁵ The policies of the Council are part of a living document that is constantly reviewed and updated. The policies are intended to set standards or recommended best practices that the Council members believe companies and boards should adopt. The policies are available to the public and can be downloaded without charge at <http://www.cii.org/policies>.

⁶ See 73 Fed. Reg. at 70,817.

Our policy sets forth the following seven criteria that we believe must, at a minimum, be achieved to ensure that any replacement of U.S. generally accepted accounting principles (“GAAP”) with IFRS results in high quality standards and a high quality standard setting system that produces comparable, reliable, timely, transparent and understandable financial information that meets the needs of investors:

- In the aggregate, the information that results from the application of international accounting and auditing standards is, at a minimum, of the same quality as the information resulting from U.S. accounting and auditing standards;
- The application (by U.S. companies and their auditors) and enforcement (by U.S. regulators) of the international accounting and auditing standards are at least as rigorous and consistent as the application and enforcement of U.S. accounting and auditing standards;
- The international standard setter has sufficient resources—including a secure stable source of funding that is not dependent on voluntary contributions of those subject to the standards;
- The international standard setter has a full-time standard-setting board and staff that are free of bias and possess the technical expertise necessary to fulfill their important roles;
- The international standard setter has demonstrated a clear recognition that investors are the key customer of audited financial reports and, therefore, the primary role of audited financial reports should be to satisfy in a timely manner investors’ information needs. This includes having significant, prominent and adequately balanced representation from qualified investors on the standard setter’s staff, standard-setting board, oversight board and outside monitoring or advisory groups;
- The international standard setter has a thorough public due process that includes solicitation of investor input on proposals and careful consideration of investor views before issuing proposals or final standards; and
- The international standard setter has a structure and process that adequately protects the standard setter’s technical decisions and judgments (including the timing of the implementation of standards) from being overridden by government officials or bodies.⁷

Unfortunately, the Commission chose to largely ignore,⁸ without any explanation or evidence of substantive analysis, the criteria contained in our policy.⁹

In our view, the Proposal’s milestones are woefully inadequate and fail to provide investors with reasonable assurance that the use of IFRS by U.S. issuers will not lower the quality of financial reporting. The basis for our view is described in more detail in the attachment which includes our responses to a number of the specific questions raised in the Proposal.

⁷ Council, Policies on Other Governance Issues, Independence of Accounting and Auditing Standard Setters 1-2 (update Oct. 7, 2008), [http://www.cii.org/UserFiles/file/council%20policies/CII%20Policies%20on%20Accounting%20and%20Auditing%2010-7-08\(1\).pdf](http://www.cii.org/UserFiles/file/council%20policies/CII%20Policies%20on%20Accounting%20and%20Auditing%2010-7-08(1).pdf).

⁸ See Letter from Paul Simenauer to The Honorable Christopher Cox 1 (Oct. 9, 2008), [http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/Letter%20to%20Chairman%20Cox%20on%20IFRS%20related%20policy%20\(final\)%20\(2\).pdf](http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/Letter%20to%20Chairman%20Cox%20on%20IFRS%20related%20policy%20(final)%20(2).pdf) (“We would respectfully request that those milestones be revised, as necessary, to include the seven criteria contained in our attached policy”).

⁹ We acknowledge that the Proposal’s milestones on “Improvements in Accounting Standards” and “Accountability and Funding of the IASC Foundation” are partially responsive to the Council policy’s milestones regarding the “quality” of international standards and the need for a “secure stable source of funding” for the international accounting standard setter. See 73 Fed. Reg. at 70,820-22.

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We appreciate the opportunity to comment on the Proposal. If you have any questions or need any additional information, please feel free to contact me at 202.261.7081 or jeff@cii.org.

Sincerely,

A handwritten signature in cursive script that reads "Jeff Mahoney".

Jeff Mahoney
General Counsel
Council of Institutional Investors

Attachment

Council of Institutional Investors
Attachment to Comment Letter
File Number S7-27-08
Selected Questions and Responses

- 1. Do commentators agree that U.S. investors, U.S. issuers and U.S. markets would benefit from the development and use of a single set of globally accepted accounting standards? Why or why not? What are commentators' views on the potential for IFRS as issued by the IASB as the single set of globally accepted accounting standards?**¹

The Council's policies reflect our view that U.S. investors, U.S. issuers, and U.S. markets would benefit from "a single set of high quality standards designed to produce comparable, reliable, timely, transparent and understandable financial information that will meet the needs of institutional investors and other consumers of financial reports."² We agree with the U.S. Securities and Exchange Commission ("SEC" or "Commission") that International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") has the "potential to become the set of accounting standards that best provide a common platform on which companies can report and investors can compare financial information."³ We, however, believe much more work must be done before that potential can ever be fulfilled.

¹ Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers, Securities Act Release No. 8982, Exchange Act Release No. 58,960, File No. S7-27-08, 73 Fed. Reg. 70,816, 70,827 (Nov. 21, 2008), <http://www.sec.gov/rules/proposed/2008/33-8982fr.pdf>.

² Council of Institutional Investors, Policies on Other Governance Issues, Independence of Accounting and Auditing Standards Setters 1 (Updated Oct. 7, 2008), [http://www.cii.org/UserFiles/file/council%20policies/CII%20Policies%20on%20Accounting%20and%20Auditing%2010-7-08\(1\).pdf](http://www.cii.org/UserFiles/file/council%20policies/CII%20Policies%20on%20Accounting%20and%20Auditing%2010-7-08(1).pdf) [Hereinafter Policy].

³ 73 Fed. Reg. at 70,818.

More specifically, we believe the Commission must first address the many legitimate issues that have been raised by the Council and other investors⁴ about IFRS, including issues surrounding the quality of information that would result from the application and enforcement of IFRS in the U.S. environment,⁵ and the quality of the governance of IFRS standard-setting. Those, and other, issues should be thoroughly studied, analyzed, and resolved, as part of a public due process, *prior* to the SEC making any decisions about allowing or requiring the use of IFRS by U.S. issuers.⁶

2. Do commentators agree that the milestones and considerations described in Section III.A. of this release (“Milestones to be Achieved Leading to the Use of IFRS by U.S. Issuers”) comprise a framework through which the Commission can effectively evaluate whether IFRS financial statements should be used by U.S. issuers in their filings with the Commission? Are any of the proposed milestones not relevant to the Commission’s evaluation? Are there any other milestones that the Commission should consider?⁷

As indicated by the Council’s policy, we strongly disagree that the milestones and considerations described in the release comprise a framework through which the Commission can effectively evaluate whether IFRS financial statements should be used by U.S. issuers in their filings with the Commission.⁸ Consistent with our policy, we believe that, at a minimum, the following additions or revisions to the milestones should be adopted:⁹

- *A comprehensive study of whether the aggregate information that results from the application and enforcement of IFRS will, at a minimum, result in the same quality of information to investors as the information that results from the application of U.S. generally accepted accounting principles (“GAAP”).*

⁴ See, e.g., Letter from Jack T. Ciesielski to Ms. Florence E. Harmon 1-6 (Jan. 30, 2009),

http://www.fasb.org/investors_technical_advisory_committee/itac_01-30-09.pdf [hereinafter ITAC].

⁵ We note that one study has found that because “U.S. GAAP constitute a set of high-quality standards, . . . it is difficult to argue that a move to IFRS would bring a significant improvement of the standards within the U.S. context. Luzi Hail, et al., *Global Convergence and the Potential Adoption of IFRS by the United States: An Analysis of Economic and Policy Factors* 5 (Feb. 2009) (emphasis added), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1357331 [hereinafter Hail].

⁶ See, e.g., James L. Bothwell, *Adopting International Financial Standards for Use in the United States: An Economic and Public Policy Perspective* 9 (Jan. 23, 2009) (on file with Council) (Recommending “that material differences between IFRS and USGAAP should be addressed and reconciled . . . and certain improvements in IASB’s operations, structure and funding should be required to be made, **before** IFRS use is permitted”) [Hereinafter Bothwell].

⁷ 73 Fed. Reg. at 70,827.

⁸ See Policy, *supra* note 2, at 1.

⁹ *Id.*; see also Letter from Paul Simenauer to The Honorable Christopher Cox 1 (Oct. 9, 2008), [http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/Letter%20to%20Chairman%20Cox%20on%20IFRS%20related%20policy%20\(final\)%20\(2\).pdf](http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/Letter%20to%20Chairman%20Cox%20on%20IFRS%20related%20policy%20(final)%20(2).pdf) (“We would respectfully request that those milestones be revised, as necessary, to include the seven criteria contained in our attached policy”).

We note that the release's proposed milestone entitled "Anticipated Timing of Future Rulemaking by the Commission" includes the requirement of "a study and report [by the Office of the Chief Accountant] to the Commission on the implications for investors and other market participants of the implementation of IFRS for U.S. issuers."¹⁰ We agree with the need for the study, but believe that the milestone should be revised to be more specific and to require that the scope of the study address, at a minimum, two issues.

First, whether replacing U.S. GAAP with IFRS will result in lower quality information to investors because of the differences in the two sets of standards.

On this issue there is little disagreement that U.S. GAAP and IFRS are different and provide different reporting results.¹¹ An analysis of a sample of those differences by one prominent accountant/analyst found:

[A]llowing for the convergence progress made to date, 61% of the firms in the study would have higher earnings under IFRS compared to GAAP, with a median difference of 10.0%. Another 36% of the firms would have had lower earnings, with a medium difference of 7.6%.¹²

The more difficult question is whether those differences result in the delivery of lower quality information to investors. We note as significant that a team of senior staff and board members of the IASB and the Financial Accounting Standards Board ("FASB") (collectively, the "Team") appear to have answered that question in the affirmative.¹³

¹⁰ 73 Fed. Reg. at 70,823-24.

¹¹ See Jack T. Ciesielski, *The SEC's IFRS Roadmap: Best Not Followed?*, Analyst's Acct. Observer, Vol. 18, No. 4, at 6 (Feb. 10, 2009) (on file with Council) ("The two systems do not provide similar results") [hereinafter AAO]; see also Sidney J. Gray, et al., *Have 'European' and U.S. GAAP Measures of Income and Equity Converged Under IFRS?* 28 (Forthcoming Acct. & Bus. Res. 2009) (on file with Council) (Noting "evidence of significant de facto differences between IFRS and U.S. GAAP that still need to be resolved") [Hereinafter Gray].

¹² AAO, *supra* note 11, at 6; cf. Gray, *supra* note 11, at 26 ("IFRS income measures for 2004-2006 for European companies filing IFRS-based financials with the SEC in 2005 are, in general, significantly higher than the corresponding U.S. GAAP income measures").

¹³ Information for Observers IASB/FASB 21 Apr. 2008 Meeting ¶ 16-17 (on file with Council).

More specifically, in an April 2008 joint memorandum the Team concluded that there were “fundamental deficiencies in IFRS that require completion as a high priority . . . [prior to] U.S. adoption of IFRS.”¹⁴ They go on to describe four major areas of needed improvement:

1. Revenue recognition. The Team described existing IFRS guidance in this area as “incomplete, insufficient, and internally inconsistent.”¹⁵
2. Fair value measurement. The Team stated that this area was “critical to the adoption of IFRS . . . [because] IFRS lacks a consistent/robust definition of fair value . . . [and] the lack of ‘Statement 157 disclosures’ in IFRS is a significant issue for investors.”¹⁶
3. Consolidation Policy. The Team noted that it was “critical” that the IFRS guidance be “improved . . . relating to effective control and special-purpose entities.”¹⁷
4. Derecognition. The Team described the IFRS guidance in this area as “internally inconsistent and anecdotal evidence indicates that it is inconsistently applied in practice.”¹⁸

¹⁴ *Id.*

¹⁵ *Id.* ¶ 17.

¹⁶ *Id.* ¶ 25.

¹⁷ *Id.* ¶ 30-31.

¹⁸ *Id.* ¶ 34.

Other areas that have been frequently cited by commentators as likely to result in lower quality information to investors if IFRS were to replace U.S. GAAP include the accounting for insurance, extractive industries, and mutual funds.¹⁹ One recent study explains:

Unless USGAAP-IFRS convergence is achieved first, U.S. investors in particular industries – the insurance and the extractive industries are often cited – could lose significant information that is currently made available by industry-specific standards in USGAAP that have no counterpart in IFRS. Of particular relevance for individual U.S. investors is the potential loss of basic information about the holdings, financial highlights and operations of U.S. mutual funds that are enumerated among other serious concerns about IFRS adoption expressed by the Investment Company Institute (ICI).²⁰

We acknowledge that all of the above referenced areas, except for the accounting for mutual funds, are listed on the IASB’s current work plan.²¹ We, however, question, given the complexity and controversial nature of these projects, whether the projects will be completed, and if completed, whether the resulting standards will be of sufficient quality to provide investors the information they require.

Second, and a related issue that requires further study as part of the milestone, is whether the application and enforcement of IFRS in the U.S. environment will result in IFRS providing lower quality information to investors than U.S. GAAP. As described in one recent study:

The importance of accounting standards for the quality of corporate reporting is more limited than often thought. Other supporting institutions play an important role in determining reporting outcomes. Academic studies suggest that *firms’ reporting incentives and enforcement standards* are at least as important as accounting standards in influencing reporting *practices*.²²

¹⁹ See, e.g., Bothwell, *supra* note 6, at 9. Other “problematic differences” include long-lived assets and foreign currency translation. Gray, *supra* note 11, at 31 (Noting that “Aegon NV’s 2006 20-F adjustment for ‘revaluation of real estate’ represents 14% of U.S. GAAP income, and Turkcell Illetisim Hizmetleri A.S.’s adjustment for ‘translation of financial statements’ represents 24% of U.S. GAAP income, thereby, suggesting convergence in these areas is also crucial”).

²⁰ Bothwell, *supra* note 6, at 9 (footnotes omitted).

²¹ International Accounting Standards Board, IASB Work Plan—projected timetable as at 25 January 2009, at 1-4 (last visited Apr. 13, 2009).

²² Hail, *supra* note 5, at 4 (emphasis added).

Although the release does touch on some of the issues relating to implementation and enforcement of IFRS,²³ a comprehensive study of those issues and their impact on the quality of the resulting information should be explicitly mandated by the milestone.

- *IASC Foundation funding is not dependent on voluntary contributions of companies and their auditors that are subject to the standards.*

The release includes a milestone entitled “Accountability and Funding of the IASB” that states that “our future determination regarding the required use of IFRS for all U.S. issuers should only occur after the IASC Foundation reaches its goal of securing a stable funding mechanism that supports the independent functioning of the IASB.”²⁴ We strongly agree with this milestone but believe it should be strengthened, consistent with the language and intent of Sections 108-109 of the Sarbanes-Oxley Act of 2002,²⁵ to make clear that a stable funding mechanism that supports the independent functioning of the IASB is one that is not dependent on voluntary contributions of companies and their auditors that are subject to the standards.²⁶

In a letter to the IASC Foundation commenting on this issue we stated:

Notwithstanding the Trustees’ progress towards the establishment of a broad-based funding system, we remain concerned with the IASCF’s financing. We agree with those experts who have concluded that “economic . . . independence is an important guiding principle in institutionalizing a standard setting body that is responsive to the needs of investors and capital markets.”

²³ 73 Fed. Reg. at 70,822-23, 70,825-26.

²⁴ *Id.* at 70,821.

²⁵ S. Rep. No. 107-205, at 12 n.21 (June 26, 2002), http://thomas.loc.gov/cgi-bin/cpquery/?sel=DOC&&item=&r_n=sr205.107&&sid=cp1076vwgR&&refer=&&db_id=cp107&&hd_count=& (“(t)o restore confidence in our standards setters, we should take immediate steps to secure independent funding for the FASB funding that does not depend on contributions from constituents that have a stake in the outcome of the process”).

²⁶ *Cf.* Charles D. Niemeier, Keynote Address on Recent International Initiatives, 2008 Sarbanes-Oxley, SEC and PCAOB Conference 3 (Sept. 2008), http://www.pcaobus.org/News_and_Events/Events/2008/Speech/09-10_Niemeier.pdf (“If the IASB wants its standards to be considered for use in the U.S., it should present a plan for independent funding for the SEC to consider under the framework set forth in Section 108”).

We note that per review of the IASB’s website it appears that the first, second, third, and fourth largest single contributors to the IASB’s “long-term funding” are Deloitte, Ernst & Young, KPMG, and PricewaterhouseCoopers. The combined voluntary contributions of those “big four” accounting firms amounts to approximately thirty percent of the IASB’s entire funding.

Consistent with our policy, we believe that the IASB should have an adequate, stable, and mandatory funding source. Such a funding source, if properly structured, would contribute to improving the IASB’s independence and likely enhance the credibility of its standards.²⁷

- *IASB board members are full-time and include significant representation from qualified investors.*

The release fails to include any milestones directed specifically at the IASB, notwithstanding that the IASB would presumably replace the FASB as the primary standard setter for U.S. issuers.²⁸ Consistent with our policy, we believe that at least two fundamental criteria should be required of the IASB board before we consider adopting the IASB as the U.S. standard setter: (1) that all IASB board members be full-time standard setters;²⁹ and (2) that the IASB board include significant representation from qualified investors—the consumers of financial reports.³⁰

On the issue of full-time board members, in a letter to the IASC Foundation, we explained:

We acknowledge that to-date the IASB part-time positions may have “attracted high qualified candidates.” We, however, believe that having full-time board members is absolutely essential to ensuring the ongoing independence of the IASB.

²⁷ Letter from Jeff Mahoney to Tamara Oyre 8-9 (Mar. 26, 2009) (footnotes omitted), [http://www.cii.org/UserFiles/file/resource%20center/correspondence/2009/March%2026%202009%20Letter%20to%20Oyre%20\(final%20with%20letterhead\).pdf](http://www.cii.org/UserFiles/file/resource%20center/correspondence/2009/March%2026%202009%20Letter%20to%20Oyre%20(final%20with%20letterhead).pdf) [hereinafter March Letter].

²⁸ See 73 Fed. Reg. 70,821-22.

²⁹ The International Accounting Standards Board (“IASB”) website indicates that the IASB currently has two part-time members. International Accounting Standards Board, Members of the International Accounting Standards Board (last visited Apr. 16, 2009), <http://www.iasb.org/About+Us/About+the+IASB/IASB+members.htm>.

³⁰ Policy, *supra* note 2, at 1.

Part-time board members could potentially be conflicted by positions taken by their employer and could face difficult decisions as to which constituency they owe their allegiance.

Those potential conflicts are not hypothetical. They have occurred with part-time accounting standard setters in the past.

As one example, the creation of the FASB as the first accounting standard setter in the U.S. with full-time members was largely in response to concerns that the decisions of the part-time members of the prior accounting standard setting organization—the Accounting Principles Board—were influenced by “conflict[s], real or apparent, between the member’s private interest and the public interest.” We believe the part-time members of the IASB would likely be subject to similar and perhaps more frequent conflicts of interest.³¹

On the second and more important issue of greater investor representation on the IASB board, we note that our policy on this issue is generally consistent with the following conclusions and recommendations of the Commission’s Advisory Committee on Improvements to Financial Reporting:

Investor perspectives are critical to effective standards-setting, as investors are the primary consumers of financial reports. Only when investor perspectives are properly considered by all parties does financial reporting meet the needs of those it is primarily intended to serve. Therefore, investor perspectives should be given pre-eminence by all parties involved in standards-setting.³²

³¹ Letter from Jeff Mahoney to Tamara Oyre 8-9 (Sept. 25, 2008) (footnotes omitted), [http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/September%2025%202008%20Council%20Letter%20to%20Oyre%20\(final\)\(1\).pdf](http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/September%2025%202008%20Council%20Letter%20to%20Oyre%20(final)(1).pdf) [hereinafter September Letter].

³² Financial Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission 57 (Aug. 1, 2008), <http://www.sec.gov/about/offices/oca/acifr/acifr-finalreport.pdf>. We note that the United States Securities and Exchange Commission (“SEC” or Commission”) recently indicated their approval of the “pre-eminence of the perspectives of investors” objective for financial reporting in their recent Report and Recommendations Pursuant to Section 133 of the Emergency Economic Stabilization Act of 2008: Study on Mark-To-Market Accounting 206 (Dec. 30, 2008), <http://www.sec.gov/news/studies/2008/marktomarket123008.pdf>. We are hopeful that the SEC will begin applying this objective to this and all financial reporting issues that come before the Commission.

More specifically, we believe the most direct and effective means of ensuring that investor perspectives are given pre-eminence in the accounting standards setting process is for the standard setting board to have significant representation from the investor community. Unfortunately, only one of the current fourteen IASB Board members has such a background.³³ That is simply unacceptable.

On this issue, our views are generally consistent with those of the FASB's Investors Technical Advisory Committee ("ITAC") whose comment letter in response to the release explained:

As long as investors are not admitted to the deliberation table and do not have a substantial decision-making authority for either the governance (proposed Monitoring Group and IASC Foundation) or standard setting activities of the IASB, this body [the IASB] cannot credibly serve as the sole global financial reporting standard setter for investors and global markets.³⁴

- *The IASC Foundation/IASB have a structure and process that adequately protects the standard setter's technical decisions and judgments (including the timing of the implementation of standards) from being overridden by governmental officials or bodies.*

The release's milestone entitled "Accountability and Funding of the IASC Foundation" fails to address the critical issue of whether the IASC Foundation has the right structure and process to adequately protect the IASB's decisions and judgments from being overridden by governmental officials or bodies. As one commentator has stated:

From the investor's perspective, achievement of this goal [a single set of high quality accounting standards] is desirable *if* the standard setter is capable of protecting its integrity from well-organized pressure groups.³⁵

³³ International Accounting Standards Board, Members of the International Accounting Standards Board, <http://www.iasb.org/About+Us/About+the+IASB/Stephen+Cooper.htm> (last visited Apr. 15, 2009).

³⁴ ITAC, *supra* note 4, at 5.

³⁵ Chris Dreyer, *In the Balance*, CFA Inst. Mag., Jan./Feb. 2009, at 12 (emphasis added) (on file with Council).

Consistent with our policy, we believe that there are distinct and obvious disadvantages to having the public sector control the accounting standard-setting function.³⁶ The most significant of those disadvantages is that the government is “more susceptible to political pressures . . . [resulting in] . . . standards being designed to accomplish the self serving objectives of private interest groups rather than solely to meet the needs of those who use financial statements in making economic decisions.”³⁷

A successful private sector accounting standard setter, however, must be properly designed so that its decisions and judgments can be shielded from political interference. This is all the more critical for an international accounting standard setter that will be subject to pressures from multiple governments with differing priorities.³⁸

Unfortunately, it is clear to us that the current governance structure of the IASC Foundation is not sufficient to protect the independence of the IASB. As we explained in our recent letter to the IASC Foundation:

This . . . issue is particularly critical in light of the October 2008 decision by the IASCF to suspend established due process procedures in response to pressure from the financial services lobby and European politicians. That highly questionable action was then compounded by the International Accounting Standards Board . . . decision, approved without any public due process, by . . . [12] of . . . [14] board members, to amend IAS 39 and IFRS 7 in a manner that the Board members knew or should have known was not an improvement to financial accounting and reporting from the perspective of most investors.³⁹

³⁶ Policy, *supra* note 2, at 1.

³⁷ American Institute of Certified Public Accountants, Report of the Establishment of Accounting Principles 22 (Mar. 29, 1972) (on file with Council).

³⁸ Donna L. Street, *International Convergence of Accounting Standards: What Investors Need to Know* 30 (Oct. 2, 2007), [http://www.cii.org/UserFiles/file/resource%20center/key%20governance%20issues/international%20convergence/International%2520Convergence%2520White%2520Paper%2520\(Final\)%252011-14-07.pdf](http://www.cii.org/UserFiles/file/resource%20center/key%20governance%20issues/international%20convergence/International%2520Convergence%2520White%2520Paper%2520(Final)%252011-14-07.pdf).

³⁹ March Letter, *supra* note 27, at 3 (footnotes omitted).

It, unfortunately, is also clear to us that the recent formation of the “Monitoring Group,” will not be sufficient to protect the independence of the IASB going forward.⁴⁰ We note that, despite our suggestions to narrowly define the duties of the Monitoring Group to “focus primarily on educating and communicating with representatives of public authorities around the world about the benefits of independent private sector standard setting,”⁴¹ the list of duties established for the Monitoring Group fails to include *any* responsibility for protecting or defending the independence of the IASB.⁴²

In our view, unless the IASC Foundation/IASB structure, process, and composition is significantly modified to provide greater protection from political interference, the IASB faces a real danger of becoming a “representative, politicized, polarized, bureaucratic, UN-style body” unable or unwilling to serve the needs of investors—the primary consumers of financial reports.⁴³

3. Do commentators agree with the timing presented by the milestones? Why or why not? In particular, do commentators agree that the Commission should make a determination in 2011 whether to require the use of IFRS by U.S. issuers? Should the Commission make a determination earlier or later than 2011? Are there any other timing considerations that the Commission should take into account?⁴⁴

We do not agree with the timing presented by the milestones. If the milestones are interpreted as having any substance, it is, in our opinion, pure fantasy to believe that in 2011 the Commission could reasonably conclude that the milestones have all been achieved.

⁴⁰ September Letter, *supra* note 31, at 4-7.

⁴¹ *Id.* at 6.

⁴² Memorandum of Understanding to Strengthen the Institutional Framework of the International Accounting Standards Committee Foundation ¶ 7 (2009), <http://www.iasb.org/NR/rdonlyres/FD1356A8-5F81-4B8B-8BF9-BD70B9BBCA46/0/MoU.pdf>.

⁴³ Ray Ball, International Financial Reporting Standards (IFRS): Pros and Cons for Investors 50 (Sept. 8, 2005), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=929561.

⁴⁴ 73 Fed. Reg. at 70,827.

As but one illustration, the release’s milestone entitled “Improvements in Accounting Standards,”⁴⁵ as discussed in response to question 2, should, at a bare minimum, require that the FASB and IASB complete their major joint projects on improving the accounting for consolidation, derecognition, insurance contracts, and revenue recognition in order to satisfy that milestone.⁴⁶ Although we acknowledge that all four of those projects are currently in process, the Commission should be aware that since the IASB and FASB began actively pursuing major joint projects in October 2002, they have produced exactly *two* major joint standards—Business Combinations and Noncontrolling Interests in Consolidated Financial Statements.⁴⁷ Thus, even if the IASB and FASB were to *triple* their past joint standard setting production, they would be unable to complete the aforementioned four major improvements to accountings standards prior to 2012.⁴⁸

As indicated, we believe that any Commission determination about requiring the use of IFRS by U.S. issuers should not be made until all of the milestones, including the suggested revisions and additions to the milestones described in response to question 2, are fully satisfied. We believe that much planning and work remains to be done to achieve that goal and, therefore, we are unable at this time to even estimate the year in which it might be appropriate for the Commission to make a determination to require or permit the use of IFRS by U.S. issuers.

- 8. Would a requirement that U.S. issuers file financial statements prepared in accordance with IFRS have any affect on audit quality, the availability of audit services, or concentration of market share among certain audit firms (such as firms with existing international networks)? Would such a requirement affect the competitive position of some audit firms? If the competitiveness of some firms would be adversely affected, would these effects be disproportionately felt by firms other than the largest firms?**

⁴⁵ 73 Fed. Reg. at 70,820-21.

⁴⁶ Cf. Bothwell, *supra* note 6, at 2 (“Existing material differences between IFRS and USGAAP should be addressed and reconciled **before** use of IFRS is permitted, even on a trial or option basis”). The staff of the United States Securities and Exchange Commission might appropriately conclude that the “Improvements in Accounting Standards” milestone should, at a bare minimum, require completion of projects in the five areas that the staff found to “have the greatest potential to result in improved transparency” in their June 2005 report to the President and Congress in response to a requirement in the Sarbanes-Oxley Act of 2002. Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 On Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers 105 (June 15, 2005), <http://www.sec.gov/news/studies/soxoffbalancercpt.pdf>. Those five areas included leases, defined-benefit retirement arrangements, consolidation policy, all financial instruments at fair value, and a disclosure framework. *Id.* at 105-113.

⁴⁷ Financial Accounting Standards Board, Project Updates, http://www.fasb.org/project/bc_acquisition_method.shtml (last visited Apr. 15, 2009).

⁴⁸ Cf. Gray, *supra* note 11, at 31 (Commenting that the “ever growing lobby faced by the IASB raises the question of whether significant convergence by 2011 is feasible”).

We note that the Department of the Treasury’s Advisory Committee on the Auditing Profession, in which the Council’s Executive Director participated, recently issued their final report.⁴⁹ That report includes recommendations to address concerns that many have raised about public company audit market concentration and competition.⁵⁰

A requirement that U.S. issuers file financial statements prepared in accordance with IFRS would appear, in our view, to exacerbate the concerns about concentration of market share and the competitive position of firms in the audit industry. On this issue, we generally agree with the following views expressed by the ITAC:

As a consequence, and due to their global reach, the most significant body of IFRS expertise lies in the Big Four auditing firms. In fact, their experience in understanding and applying IFRS is far more extensive than that of the SEC staff, of whom the proposal states: “the Commission staff has continued to develop its familiarity with IFRS and such efforts would need to continue and intensify if the Commission were to require” IFRS reporting for domestic registrants. The Big Four, a group that this proposal would benefit enormously from a business standpoint, is also likely to enjoy a significant technical knowledge advantage over their regulator if this proposal is enacted. The Big Four already dominates the market for audits of global enterprises, and there have long been concerns about the concentration of power in the auditing profession. We are uncomfortable with the additional monopoly status that this proposal’s convergence approach would confer upon them.⁵¹

12. What are investors’, U.S. issuers’ and other market participants’ views on the resolution of the IASB governance and funding issues identified in this release?⁵²

⁴⁹ Dep’t of the Treasury, Final Report of the Advisory Committee on the Auditing Profession (Oct. 6, 2008), <http://treas.gov/offices/domestic-finance/acap/docs/final-report.pdf>.

⁵⁰ *Id.* at VIII:1-23.

⁵¹ ITAC, *supra* note 4, at 5.

⁵² 73 Fed. Reg. at 70,828.

As indicated in response to question 2, and consistent with Council policy, we do not believe the Commission should consider requiring or allowing U.S. issuers to file financial statements prepared in accordance with IFRS unless and until the following IASC Foundation/IASB governance and funding issues have first been resolved:

- The IASB has a secure stable source of funding that is not dependent on voluntary contributions of companies and their auditors that are subject to the standards
- All IASB board members are full-time standard setters
- The IASB board and staff, the IASC Foundation, the Monitoring Group, and other IASB oversight or advisory groups all have significant representation from qualified investors—the primary consumers of financial reports, and
- The IASB has a structure and process that adequately protects the standard setter’s technical decisions and judgments from being overridden by governmental officials or bodies.⁵³

16. Do commentators agree that certain U.S. issuers should have the alternative to report using IFRS prior to 2011? What circumstances should the Commission evaluate in order to assess the effects of early adoption on comparability of industry financial reporting to investors?⁵⁴

We do not agree that it is in the best interests of investors for the Commission to permit certain U.S. issuers to have the alternative to early adopt IFRS. On this issue, we generally share the following views of a prominent accountant/analyst:

Increased comparability under early IFRS adoption is a hollow promise. While there’s some company-to-company comparability to be gained from the exercise, there’s much more comparability to be lost. The SEC’s idea of allowing a switch is more damaging to investors than it is rewarding to them. To encourage companies to gather more experience applying IFRS and build an experience pool, the SEC would do far better to require GAAP-to-IFRS reconciliations of earnings, assets and common equity for the kinds of companies it specifies in the roadmap.⁵⁵

⁵³ See Policy, *supra* note 2, at 1-2.

⁵⁴ 73 Fed. Reg. at 70,830.

⁵⁵ AAO, *supra* note 11, at 5.

- 34. What are commentators' views on Proposals A and B relating to U.S. GAAP reconciling information? Which Proposal would be most useful for investors? Is there a need for the supplemental information provided by Proposal B? Would the requirement under Proposal B have an effect on whether eligible U.S. companies elect to file IFRS financial statements? To what extent might market discipline (i.e., investor demand for reconciliation information) encourage early adopters to reconcile to U.S. GAAP even in the absence of a reconciliation requirement?⁵⁶**
- 39. Under Proposal B, should the proposed U.S. GAAP financial information be audited? Is the proposed role of the auditor appropriate? Should the proposed U.S. GAAP financial information be filed as an exhibit to the Form 10-K annual report, instead of as part of the body of the report? Is the proposed treatment of the information appropriate? For example, should the information be deemed "furnished" and not "filed" for purposes of Section 18 of the Exchange Act? Should we require that the supplemental U.S. GAAP information be contained in the annual report that is prepared pursuant to Exchange Act Rule 14a-3(b)? Should the supplemental U.S. GAAP information appear as a note to the financial statements? Is the proposed role of the auditor appropriate?⁵⁷**
- 42. Should we require supplemental U.S. GAAP information, such as that in Proposal B, for all quarterly periods covered by IFRS financial statements?⁵⁸**

As indicated in response to question 16, we do not believe that it is in the best interests of investors to allow certain U.S. firms to voluntarily early adopt IFRS because of the additional complexity and costs that such a two-GAAP system would create. If, despite our opposition, early adoption is permitted, we believe that, at a minimum, early adopters should be required to provide investors with quarterly audited reconciling information consistent with the release's Proposal B. We believe that such information would provide valuable assistance to investors enhancing their ability to better understand the effect of the many and material differences between IFRS and U.S. GAAP reporting when making comparisons between companies.

⁵⁶ 73 Fed. Reg. at 70,834

⁵⁷ *Id.*

⁵⁸ *Id.*

On this point, we again generally agree with the observation of a prominent accountant/analyst that:

The purpose of this proposal is supposedly to aid investors – who like to make comparisons, look for trends in financial data, and believe that they can rely on financial reporting to be reliably stated, with the aid of auditors. Why, then, is it even necessary to propose two transition methods – with neither of them entirely investor-friendly? Proposal B, if the information was audited [and quarterly], would be the most effective transition basis for investors.⁵⁹

67. Do you agree with our assessment of the costs and benefits as discussed in this section? Are there costs or benefits that we have not considered? Are you aware of data and/or estimation techniques for attempting to quantify these costs and/or benefits? If so, what are they and how might the information be obtained?⁶⁰

We agree with the Commission’s conclusion that one of the expected costs of the proposed amendments to investors is the potential that “IFRS financial statements yield . . . less information, or . . . lower quality information, about a particular issuer than the U.S. GAAP financial statements yielded.”⁶¹ Consistent with our response to question 2, we respectfully request that the Commission direct the Office of the Chief Accountant to include an evaluation of those expected costs as part of its study of the implications for investors of the implementation of IFRS for U.S. issuers. That study should be completed and made available to the public before the Commission considers whether IFRS should be required or allowed by U.S. issuers.

⁵⁹ AAO, *supra* note 11, at 5.

⁶⁰ 73 Fed. Reg. at 70,851.

⁶¹ *Id.* at 70,847.