

June 30, 2008

**VIA ELECTRONIC MAIL**

The Honorable Christopher Cox, Chairman  
U.S. Securities and Exchange Commission  
Attn: Nancy M. Morris, Secretary  
100 F Street, NE  
Washington, DC 20549  
Electronic Address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

Re: SEC Unification of GAAP and IFRS Accounting Standards

Dear Chairman Cox:

The Office of Advocacy (Advocacy) offers the following comment to the Securities and Exchange Commission (SEC) regarding the Commission's plans to unify America's current generally accepted accounting principles (GAAP) with the International Financial Reporting Standards (IFRS). Advocacy is committed to helping the SEC reduce the overall burden on small businesses related to a change in policy that would require U.S. companies to prepare financial statements using IFRS.

**Office of Advocacy**

Congress established the Office of Advocacy in 1976 by Pub. L. No. 94-305 to represent the views and the interests of small business within the federal government. Advocacy is an independent office within SBA, so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. The Regulatory Flexibility Act,<sup>1</sup> as amended by the Small Business Regulatory Enforcement Fairness Act,<sup>2</sup> gives small entities a voice in the rulemaking process. For all rules that are expected to have a significant economic impact on a substantial number of small entities, federal agencies are required by the RFA to assess the impact of the proposed rule on small business and to consider less burdensome alternatives.<sup>3</sup>

**Background**

In 2007, the SEC issued guidance that permits American issuers the option of preparing financial statements using IFRS.<sup>4</sup> This guidance also contemplated whether it would be appropriate for the SEC to require all issuers to prepare financial statements in accordance with IFRS in the future.<sup>5</sup> Following the issuance of this

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<sup>1</sup> Regulatory Flexibility Act of 1980, Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified as amended at 5 U.S.C. § 601 et seq.).

<sup>2</sup> Small Business Regulatory Enforcement Fairness Act, Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. § 601 et seq.).

<sup>3</sup> 5 U.S.C. § 603.

<sup>4</sup> Concept Release on Allowing U.S. Issuers to Prepare Financial Statements in Accordance with International Financial Reporting Standards (Aug. 7, 2007), *available at*: <http://www.sec.gov/rules/concept/2007/33-8831.pdf>.

<sup>5</sup> *Id.* at 41.

guidance, in public speeches, SEC officials have indicated that the agency will require United States companies to use IFRS rather than GAAP.<sup>6</sup>

### Impact on Small Businesses

Small businesses that have been in contact with Advocacy have expressed concern that they would no longer be permitted to utilize the last in, first out (LIFO) inventory accounting method if the SEC requires American companies to use IFRS rather than GAAP. Small businesses have indicated to Advocacy that eliminating their ability to use LIFO would result in a tax increase that could ultimately force many small businesses to close.

Prohibiting businesses from using LIFO would raise business taxes in two ways. First, a business would see higher future taxes because it would be unable to use LIFO to protect itself from rising inventory costs. Under LIFO, the most recent (higher) costs of goods are expensed to the cost of goods sold, while the older (lower) costs remain in inventory. Absent LIFO, businesses would be taxed on the basis of the larger first in, first out (FIFO) cost of inventory (i.e., the difference between the older (lower) costs of goods and the more recent (higher) price realized once the goods were actually sold).

Second, a business would be required to pay taxes on its existing “LIFO reserves.” The LIFO reserve is an inventory account that will reflect the difference between FIFO cost and LIFO cost of a businesses inventory. As a consequence of consistently increasing costs due to inflation, the balance in the LIFO reserve account will have a credit balance. This credit balance is used to offset costs reported in a business’ inventory, and therefore, results in lower taxes on the business.

To illustrate how a business utilizes LIFO, and why prohibiting LIFO would be detrimental to the business, consider the following example: a business maintains a consistent inventory of ten units; every year, the business uses ten units for production and buys ten units to replace them; units cost \$1 in year one and inflation is 3 percent per year.

Inventory Purchases				LIFO Reserve	
Year	Number	Cost per Unit	Total Cost	Year	Reserve
1	10	\$ 1.00	\$ 10.00	1	0
2	10	\$ 1.03	\$ 10.30	2	\$ 0.30
3	10	\$ 1.06	\$ 10.61	3	\$ 0.61
4	10	\$ 1.09	\$ 10.93	4	\$ 0.93
5	10	\$ 1.13	\$ 11.26	5	\$ 1.26
6	10	\$ 1.16	\$ 11.59	6	\$ 1.59
7	10	\$ 1.19	\$ 11.94	7	\$ 1.94
8	10	\$ 1.23	\$ 12.30	8	\$ 2.30
9	10	\$ 1.27	\$ 12.67	9	\$ 2.67
10	10	\$ 1.30	\$ 13.05	10	\$ 3.05

This example illustrates that, in an inflationary environment, LIFO helps the business by enabling it to match up its current inventory costs with its current income, producing a more accurate picture of its annual income. Even mild inflation results in the LIFO reserve exceeding 20 percent the business’ inventory value in less than 10 years. The longer that the business uses LIFO, the larger its reserves will be relative to its inventory. If LIFO were no longer permitted, these reserves would be taxed at rates up to 35 percent, even though the reserves reflect nothing more than the impact of economic inflation on the value of the business’ inventory over ten years.

<sup>6</sup> See Sarah Johnson, *IFRS: No Longer If, but When*, CFO.com, Feb. 8, 2008, available at: <http://www.cfo.com/article.cfm/10673513?f=search>.

We appreciate this opportunity to voice our concerns with a mandate on small businesses to use IFRS. Advocacy stands ready to assist the SEC in gathering more information on how to minimize the burden on small businesses related to the unification of GAAP and IFRS. Advocacy looks forward to working with the SEC on this issue. If you have any questions or require additional information please contact Assistant Chief Counsel for Dillon Taylor at (202) 401-9787 or by email at Dillon.Taylor@sba.gov.

Sincerely,

/s/  
Thomas M. Sullivan  
Chief Counsel for Advocacy

/s/  
Dillon Taylor  
Assistant Chief Counsel for Tax

cc: The Honorable Susan E. Dudley, Administrator, Office of Information and Regulatory Affairs  
The Honorable Paul S. Atkins, Commissioner, U.S. Securities and Exchange Commission  
The Honorable Kathleen L. Casey, Commissioner, U.S. Securities and Exchange Commission