FINANCIAL ACCOUNTING FOUNDATION
401 Merritt 7, P.O. Box 5116, Norwalk, Connecticut 06856-5116 | 203-847-0700
Fax: 203-849-9714

Ms. Nancy M. Morris
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
File Number S7-20-07

November 7, 2007

Dear Ms. Morris:

This letter responds to the request for comment on the Securities and Exchange Commission's (SEC) *Concept Release on Allowing U.S. Issuers to Prepare Financial Statements in Accordance with International Financial Reporting Standards* (the Concept Release). Some of our comments are also relevant to the SEC's deliberations on its proposal, *Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards without Reconciliation to U.S. GAAP* (the Proposing Release). The Financial Accounting Standards Board's (FASB) mission, undertaken with oversight by the Trustees of the Financial Accounting Foundation (FAF), is to establish financial accounting and reporting standards for public, private, and not-for-profit entities, through an independent and open process, resulting in financial reports that provide useful information for investors, creditors, and other external decision makers. The views expressed in this letter are those of the FASB and the FAF. Board members and Trustees strongly support the proposal described below that U.S. public companies transition to an improved version of international accounting standards; however, individual Board members and Trustees may have differing views on some of the other recommendations outlined in this letter.

The views in this letter are shaped primarily by our perceptions of the benefits and costs of providing financial information to investors and the capital markets. We give priority to the needs of investors because we believe that the primary reason for high-quality financial reporting standards for public companies is to enhance the efficiency of capital markets by giving investors the information and the confidence needed to provide capital and invest in the securities of companies. We also give careful consideration to the benefits and costs to other stakeholders of the companies that prepare the accounting information and to the costs imposed on auditors, regulators, and the rest of society, although, in our view, these benefits and costs are secondary criteria for setting external financial reporting standards.

The views in this letter primarily were developed from internal discussions between the FASB and its senior staff, the FAF Trustees, and the Financial Accounting Standards Advisory Council (FASAC). The views also were informed by other factors such as:

- Comment letters on the Proposing Release, including letters from the FASB's Investors Technical Advisory Committee (ITAC)[1] and the Private Company Financial Reporting Committee (PCFRC);[2]

[1] ITAC provides technical accounting advice, from the investor's perspective, on current FASB projects. As such, ITAC identifies critical financial reporting deficiencies, proposes items for the Board's agenda, and provides investor perspective on the implementation of new standards.
[2] The PCFRC focuses on how standard setting affects day-to-day technical activities and procedures for nonpublic

- Reports from the Bruegel Blueprint Series, Standard and Poor's, and others; and
- Transition plans for adopting international accounting standards in other jurisdictions.

The views contained in our letter can be summarized in the following four main points:

1. Investors would be better served if all U.S. public companies used accounting standards promulgated by a single global standard setter as the basis for preparing their financial reports. This would be best accomplished by moving U.S. public companies to an improved version of International Financial Reporting Standards (IFRS). We believe permitting extended periods of choice between U.S. Generally Accepted Accounting Principles (GAAP) and IFRS results in a two-GAAP system that creates unnecessary complexity for investors and other users of financial information. Permitting choice would add to the overall complexity of our reporting system.
2. We, the SEC, and other affected parties should work together to develop a transition plan or "blueprint" for moving U.S. public companies to IFRS. As noted in the Concept Release, a move to IFRS by all U.S. public companies would be a complex, multi-year endeavor. The U.S. needs a blueprint that provides an orderly move to IFRS that minimizes the disruptions and costs to capital market participants and to other U.S. entities that use FASB standards.[3]
    - The blueprint should identify a target date or dates for completing the transition to IFRS along with interim milestones. The target date should allow adequate time to make the many necessary changes to the various elements of the U.S. financial reporting infrastructure (auditing standards, GAAP-based regulations, education systems, licensing requirements, etc.).
    - The blueprint should identify the areas of IFRS that should be improved during the period of transition to IFRS by U.S. public companies. We believe the best way to make those improvements would be through the continued joint development of common standards by the International Accounting Standards Board (IASB) and the FASB. To complete the move to IFRS, the blueprint should outline the process by which we would adopt IASB standards in other areas "as is."
3. The SEC should seek international cooperation to identify and implement changes we believe are necessary to sustain the IASB and to secure it as the independent global body that establishes high-quality international accounting standards. In particular:
    - Mechanisms should be established to provide the IASB with sufficient and stable funding and staffing levels, thereby ensuring its sustainability as an independent[4] setter of high-quality accounting standards.

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business entities of all sizes. The PCFRC sets its own agenda and makes specific technical recommendations for possible modifications for private companies on existing or developing FASB standards.

[3] The financial reporting needs of private and not-for-profit entities that currently use U.S. GAAP are considered further in Part 2 of our comment letter.

[4] "Independence" here refers to the ability of the standard setter to resist pressure from preparers, auditors, jurisdictional governments, and others to design accounting standards in pursuit of goals other than providing investors and other users with neutral, decision useful information. A funding source that is concentrated among a few entities or within a particular geographical region could threaten the IASB's independence.

- Agreements are needed to eliminate the separate review and endorsement processes that various jurisdictions apply to each IFRS after it is issued by the IASB. These after-the-fact jurisdictional processes are inconsistent with the objective of a single set of high-quality international accounting standards, as evidenced by the local variants of IFRS that have developed in some jurisdictions. Jurisdictions, including the U.S., need to make their views known as part of the IASB's due process rather than after the standards are issued.

International cooperation in these two areas is needed to foster the sustainability of the IASB as a global standard setter and to ensure that IFRS, as promulgated by the IASB, becomes and continues to be a single set of high-quality international accounting standards. If the recommended changes in these two areas are not made, we believe the benefits from transitioning U.S. public companies from our well-established financial reporting system to IFRS could decrease dramatically.

4. The removal of the requirement that foreign private issuers reconcile their reported results to U.S. GAAP is a difficult and sensitive issue that could have important implications for the continued development of a truly international financial reporting system. We suggest the timing of any removal of this requirement should coincide with the following:

   - Development of and commitment to the blueprint by key parties in the U.S.; and
   - Commitment by key international parties to undertake the steps necessary to strengthen and sustain the IASB as the independent body responsible for establishing high-quality international standards.

   We strongly agree with the SEC that the reconciliation requirement would be removed only for companies applying IFRS as adopted by the IASB.

The remainder of this letter is divided into two parts and two appendices. The first part explains our vision of the ideal global financial reporting system and our proposal for a blueprint to coordinate the transitioning of U.S. public companies to an improved version of IFRS. It also discusses the need to foster the sustainability of the IASB. The second part discusses some matters we believe should be covered in such a blueprint. The two appendices describe current and past efforts to converge accounting standards internationally and other approaches for transitioning to a single set of international accounting standards that we considered but rejected.

Sincerely,

Robert E. Denham Robert H. Herz

Robert E. Denham	Robert H. Herz
Chairman, Financial Accounting Foundation	Chairman, Financial Accounting Standards Board

Part 1: Planning for a Transition to a Globally Accepted Set of Accounting Standards

The Ideal Global Financial Reporting System

We agree with the Commission's view that "having a widely used single set of high quality globally accepted accounting standards accepted and in place could benefit both the global capital markets and investors."[5] From its very beginning, the practice of accounting has facilitated trade between unrelated individuals and entities. Basic bookkeeping allowed neighboring city-states to develop trading alliances,[6] and bookkeeping evolved into national financial reporting systems, which entrepreneurs used to attract local investment capital. The SEC's Concept and Proposing Releases are part of the next stage of evolution in accounting and financial reporting—the stage in which divergent national practices converge toward a single global financial reporting system that should enable more efficient capital markets and enhance worldwide economic growth. The issues raised by the two Releases are important and timely, and we commend the SEC for stimulating a dialogue about the issues.

We also agree with Section IV of the Concept Release, "IFRS Implementation Matters for U.S. Issuers," which clarifies that a high-quality financial reporting system requires more than simply high-quality accounting standards. Achieving the ideal global financial reporting system that supports decision making across borders requires improvements and convergence in various elements of the infrastructure supporting international capital markets, including:

- A single set of common, high-quality accounting standards developed and promulgated by an independent, sustainable global standard-setting organization, with a global interpretive body to provide timely guidance as implementation issues arise;
- Common, high-quality disclosure requirements beyond the financial statements and footnotes (e.g., MD&A, market risk disclosures, executive compensation) promulgated by an international group such as the International Organization of Securities Commissions (IOSCO);
- Cooperative international regulatory, enforcement, and corporate governance regimes focused on the needs of investors and other key users of reported financial information;
- Common, high-quality auditing standards, including auditor independence requirements;
- Systems for training and educating capital market participants (investors, auditors, preparers, regulators, etc.).

We believe that achieving this ideal global financial reporting system would significantly improve the overall usefulness and comparability of reported financial information across international capital markets, leading to increased investor confidence in financial reports of listed companies worldwide. In addition, the ideal global system should reduce the complexity that investors and companies currently face due to the multiple financial reporting languages in use today. As a result, global capital markets should function more efficiently and effectively, enhancing worldwide economic growth.

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[5] SEC Concept Release, Section III.A.

[6] A discussion of how accounting facilitated the development of large scale economies can be found in Sudipta Basu and Gregory B. Waymire, "Recordkeeping and Human Evolution," *Accounting Horizons* (September 2006): 201–229.

In stating our preference for a global financial reporting system, we are not disputing the research evidence documenting how some of the existing differences in national financial reporting practices can be explained by differences in legal structure, corporate governance, etc.[7] Instead, we interpret these results as implying that historical differences in the mechanisms for raising capital across jurisdictions can result in financial reporting differences. These historical differences seem to be disappearing rapidly as governments and regulators worldwide adopt more investor-oriented policies that allow companies in their jurisdictions to raise capital from local and foreign investors. As the mechanisms for raising capital used by public companies worldwide converge toward a global norm, we believe U.S. companies and investors will be participants in a global capital market, and as such, their interests are best served by requiring U.S. public companies to use high-quality globally accepted accounting standards.[8]

The ideal reporting system described above is not a new concept. Work is under way to improve and converge various elements of the international financial reporting infrastructure, and we encourage and support the continuation of those efforts. Convergence in accounting standards, in particular, is progressing—IFRS is becoming the basis of financial reporting in an increasing number of jurisdictions, and the FASB and IASB continue to pursue convergence efforts. Appendix A to this letter describes our convergence efforts in more detail.

Despite the steady and continuing efforts of the FASB and IASB, U.S. GAAP and IFRS are not yet converged. Studies of foreign filers using IFRS as published by the IASB document that the 20-F reconciliations report large differences in earnings and equity.[9] Moreover, two SEC studies of accounting issues[10] conclude that both existing U.S. GAAP and IFRS need improvement. For those reasons, we believe the current approach to convergence is not achieving the vision of high-quality global accounting standards in a sufficiently timely manner. We therefore believe the time has come to consider a new approach to convergence—one that moves U.S. public companies to IFRS.

<u>Moving the U.S. toward the Ideal System</u>

The Concept Release asks, "… could commenters foresee a scenario under which it would be appropriate for the Commission to call for all remaining U.S. [non-governmental] issuers to move their financial reporting to IFRS?"[11] We believe the answer to that question is "yes." In our view, now is the time to develop a plan for moving **all** U.S. public companies to an improved version of IFRS.

We support the adoption of IFRS by U.S. public companies because current trends suggest that IFRS will become the global financial reporting language. Although U.S. GAAP has enjoyed wide acceptance in the past, to date, over 100 jurisdictions, including the EU, Hong

[7] Financial Reporting Policy Committee of the Financial Accounting and Reporting Section of the American Accounting Association, "Response to SEC Proposing Release," September 24, 2007, p. 8.
[8] For other entities that use U.S. GAAP but do not raise capital in the global capital market (e.g., private companies and not-for-profit entities), Part 2 of our letter calls for their financial reporting needs to be considered when developing the blueprint.
[9] Financial Reporting Policy Committee, p. 4.
[10] SEC, "Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System," July 25, 2003, and SEC, "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," June 15, 2005.
[11] SEC Concept Release, question 33, p. 41.

Kong, and Australia either require or permit the use of IFRS or a local variant of IFRS.[12] Recently, other jurisdictions with significant capital markets (e.g., Canada, Japan, and Korea) have announced plans to replace their national GAAP with IFRS. Thus, we believe that planning for a transition to an improved version of IFRS is the logical way forward to achieving the comparability and quality of financial reporting that investors demand.

We propose to work with the SEC and other affected parties in developing a blueprint for moving U.S. public companies to IFRS. As noted in the Concept Release, a move to IFRS would be a complex, multi-year endeavor.[13] A smooth transition will not occur by accident. The SEC, FAF, FASB, Public Company Accounting Oversight Board, users, preparers, auditors, regulators, educators, and other parties with a stake in the U.S. financial reporting system need to develop a blueprint for coordinating and completing the transition from U.S. GAAP to an improved version of IFRS.[14] The objective in developing the blueprint is to identify the most orderly, least disruptive, and least costly approach to transitioning to IFRS. The blueprint should set a target date or dates for U.S. registrants to move to IFRS that allow adequate time to make the many necessary changes to various elements of the U.S. financial reporting infrastructure (auditing standards, GAAP-based regulations, education systems, etc.). Some of the key infrastructure elements to consider in developing the blueprint include the following:

- How to effectively train and educate issuers, their auditors, investors, and other users of financial statements about the improved version of IFRS, including implications for the U.S. education system and the uniform Certified Public Accountant examination;
- How a move to IFRS will affect audit firms and auditing standard setting;
- How a move to IFRS might be affected by the litigation environment in the U.S.;
- How a move to IFRS would affect regulatory agency policies, contractual arrangements, and/or state legal requirements that are currently based on U.S. GAAP financial reports;
- How a move to IFRS by public companies might affect financial reporting by private and not-for-profit entities; and
- How current SEC accounting and disclosure requirements would mesh with the reporting requirements under IFRS.

Section IV of the Concept Release raises these and other issues. We believe the success of the transition to IFRS depends on identifying the critical elements of infrastructure and then developing a blueprint for addressing each of those issues. For this reason, Part 2 of this letter discusses several of these issues in more detail. The blueprint developers should consider these and other potential key issues and determine the appropriate priority and sequencing for resolving the issues. For example, the sustainability of the IASB should probably be addressed before the U.S. spends a lot of effort to adapt its infrastructure to IFRS. Also, some key pieces of infrastructure—such as revised banking regulations—may need to be in place before we begin adopting IFRS. Some issues discussed here and in Part 2 of our letter may be less critical to a

[12] See http://www.iasplus.com/country/useias.htm (updated as of October 5, 2007).
[13] SEC Concept Release, Section IV.
[14] A portion of the blueprint will identify the areas in U.S. GAAP and IFRS that require improvements (as discussed below). The IASB would need to be involved in developing this portion of the blueprint.

successful transition, in which case the sequencing of their resolution will have minimal effects on the move to IFRS by U.S. public companies.

We are not recommending immediate adoption of existing IFRS because various elements of the U.S. financial reporting system need to change before moving to IFRS, and those changes will take several years to complete. In addition, further improvements to IFRS are needed before U.S. public companies transition to IFRS.[15] Thus, we propose transitioning from U.S. GAAP to IFRS via a two-pronged "improve-and-adopt" process.

- The first part of the process involves working with the IASB to improve areas where neither U.S. GAAP nor IFRS is considered to be of sufficiently high quality.[16] The 2006 Memorandum of Understanding identifies a number of those areas (e.g. leases, financial statement presentation, revenue recognition), but other areas such as completing key aspects of the conceptual framework also should be considered.[17] The blueprint would establish a timetable for producing a new common high-quality standard in each of the improvement areas.
- The second part of the process involves the FASB adopting applicable IFRS in all other areas that are not the subject of the improvements program.[18] This will move U.S. public companies to most of the IASB's standards in an orderly fashion while allowing the IASB and FASB to focus their resources on providing significant improvements in financial reporting.

We support the improve-and-adopt approach for several reasons.

- Both existing U.S. GAAP and IFRS require improvement in several major areas. A cooperative effort between the IASB and the FASB to develop improved standards in those areas will benefit financial statement users both here and abroad.
- This approach results in the adoption of IFRS standards over several years, which avoids or minimizes the capacity constraints that might develop in an abrupt mandated switch to IFRS.
- This approach allows other infrastructure elements to improve and converge while IFRS are improved or adopted.
- The improve-and-adopt approach avoids the added cost and complexity to U.S. capital market participants of dealing with two accounting systems.

Like any good set of blueprints, this one should include a target date or dates for finishing the overall project, "construction milestones" with target dates for completing the milestones, and a

[15] Delaying the transition to IFRS until improvements in major areas are complete should reduce transition costs for U.S. public companies. Those companies will adopt the improved version of IFRS, rather than adopt existing IFRS in major areas followed by transition to an improved version of those standards a few years later.

[16] The IASB would also need to address areas where IFRS guidance is lacking (e.g., insurance and extractive industries).

[17] Appendix A contains more information about the 2006 Memorandum of Understanding projects.

[18] If the IASB were to conclude that the U.S. standard in one of the "adoption" areas is more desirable than the international standard, the IASB might adopt the U.S. standard instead of the FASB adopting the international standard.

due process system whereby the parties to the blueprint and their constituents periodically assess whether the improvement and adoption projects are on schedule.[19]

We cannot overemphasize the importance of developing a proper blueprint; it facilitates a smooth and timely transition to a single set of standards. Conversely, if the transition is poorly planned, then investors, preparers, auditors, and regulators will bear unnecessary costs and complexity, and investors could become less confident in our financial reporting system.

Changes Needed Internationally to Strengthen and Sustain the IASB as the Independent International Accounting Standard Setter

The Concept Release states that "the sustainability, governance, and continued operation of the IASB are important factors for the development of a set of high-quality, globally accepted accounting standards and are important factors in the Commission's consideration of the IASB's work."[20] We agree with that view. We support continued convergence and the adoption of IFRS only if IFRS becomes a high-quality international financial reporting language and can be sustained as such. Thus, in addition to developing the blueprint described in this letter, we recommend that the SEC and other international parties work together to implement key changes we believe are necessary to sustain the IASB over the long term and to enhance its technical capacity, independence, and recognized legitimacy as the body that establishes high-quality international accounting standards.

First, to ensure the IASB's sustainability, we believe the IASB's funding and staffing mechanisms need to be improved. The ongoing efforts by the Trustees of the International Accounting Standards Committee Foundation to establish a stable funding mechanism are highly commendable. Also, through our daily interactions with the IASB, we believe its board members and staff are dedicated, hardworking people who share our objective of developing high-quality accounting and reporting standards. We believe the current funding levels and staffing mechanisms of the IASB are not adequate for the tasks it will face if the improved version of IFRS becomes the single set of global accounting standards. Moreover, the current funding sources appear unstable, and they give rise to independence concerns.[21] For those reasons, we recommend that a global consortium—possibly led by the SEC and IOSCO—collaborate with the Trustees of the International Accounting Standards Committee Foundation to establish a funding mechanism that provides adequate resources while protecting the independence of the IASB. We believe the development of the blueprint for moving U.S. public companies to IFRS should begin before the improved funding mechanism is finalized, but we do not support moving U.S. public companies to IFRS until mechanisms to adequately fund the IASB's activities over the long term are developed.

Second, to achieve the goal of a single set of high-quality, globally accepted standards, international agreement is needed to use IFRS as issued by the IASB. Currently, many

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[19] Setting and assessing milestones are important elements in the approach adopted by the Canadian standard setter ("Implementation Plan for Incorporating IFRSs into Canadian GAAP," Accounting Standards Board of Canada, March 31, 2007).

[20] SEC Concept Release, Section III.B.

[21] Nicolas Véron discusses the funding problems and potential threat to independence in more detail in "The Global Accounting Experiment" (Bruegel Blueprint Series, vol. II, 2007), pp. 39 and 40. He also discusses the need for some sort of restructuring to permit accountability to the IASB's stakeholders. We note that by receiving voluntary contributions from preparers and accounting firms, the IASB's current funding mechanism appears inconsistent with the mechanisms envisioned in Section 108 of the Sarbanes Oxley Act.

jurisdictions review and endorse each IASB standard after it is issued. Such mechanisms can produce local variants of IFRS, which is inconsistent with the goal of a single set of international standards. For example, the EU has permitted companies the option of ignoring a part of one IASB standard, and the press speculates that other standards may be altered or rejected entirely.[22] To ensure that IFRS becomes and remains the single high-quality set of international standards, we believe those mechanisms need to be changed.

We recognize that jurisdictional authorities are unlikely to completely cede their authority over financial reporting to anyone, including the IASB. The challenge is to get the authorities to agree to engage in the standard-setting process in a way that eliminates or significantly reduces the perceived need for establishing national variants of IFRS. We recommend that the SEC seek international cooperation to remove the existing review and endorsement processes that various jurisdictions currently apply to each IASB standard after it is issued. This can be accomplished in several ways.

- Jurisdictions could delegate the tasks of improving and maintaining GAAP to the IASB via new laws or regulations, in which case a jurisdictional review of a new standard would be on an exception rather than mandatory basis.
- Jurisdictions that apply IFRS might want to pool their resources and establish a single global oversight body to be responsible for developing and expressing the views of member jurisdictions during the IASB's due process.

Other alternatives likely exist for removing these after-the-fact "endorsement" mechanisms. The key point is that these endorsement mechanisms are inconsistent with the goal of a single set of high-quality international accounting standards, and their continued operation could significantly threaten the benefits of transitioning U.S. companies to IFRS.

<u>Implications of the Proposing Release for the Transition to an Improved Version of IFRS</u>

Our proposed development of a blueprint relates to the Concept Release's consideration of whether U.S. companies should be permitted to use IFRS. We observe mixed opinions on the possible elimination of the reconciliation requirement for foreign registrants. Foreign preparers and regulators, not surprisingly, support the elimination, although several request that the elimination be extended to foreign issuers using local variants of IFRS. Many U.S. companies support removal because reconciliations are costly, and respondents are concerned that they may face retaliatory reconciliation requirements in some foreign capital markets. Some financial statement users contend that the reconciliation arrives too late to affect their decisions, while others find it useful in their analysis of financial statements. Academics report evidence that the reconciling items between IFRS and U.S. GAAP are often material, and the differences could get larger once the reconciliation is removed.[23] Evidence also implies application and enforcement

[22] "EU Financial Reporting—IFRS: Time to Walk Away?" *Accountancy* (October 8, 2007). Some jurisdictions require publicly traded domestic companies to deviate from IFRS in preparing financial statements for statutory purposes. Other jurisdictions allow those companies to use IFRS as issued by the IASB or a local variant. The first type of endorsement mechanism is particularly problematic as none of the companies from that jurisdiction can fully comply with IFRS. The second type may be less of a problem if internationally active companies in that jurisdiction choose to apply IFRS as issued by the IASB.

[23] Existing IFRS standards permit alternative treatments in certain circumstances and, in some cases, an entity can avoid a U.S. GAAP reconciling item by choosing to use alternatives that are the same as U.S. GAAP. The

of accounting standards is of low quality in countries with weak investor protection laws,[24] and the reconciliation may help the SEC assess compliance until it has gained more experience with IFRS.

The question of whether to eliminate or retain the reconciliation requirement in the near future is a difficult and sensitive matter that could have important implications for the continued development of a truly international reporting system. We acknowledge the concerns of those who believe eliminating the reconciliation would be premature and would result in a loss of information that some investors and other users find important. However, the number of SEC registrants affected by this change appears relatively small when compared to the overall size of our capital market. Another concern is that continuing the reconciliation requirement could be perceived by some parties as a clear signal that the U.S. is not interested in participating in the development of an international financial reporting system, and such a perception could negatively affect the willingness of these parties to support continued convergence between IFRS and U.S. GAAP. Conversely, we believe that some parties view the convergence effort between the IASB and the FASB as the price of getting the SEC to eliminate the reconciliation; once the reconciliation requirement is eliminated, those parties will no longer support the continued improvement and convergence of IFRS and U.S. GAAP.[25] Recent comments reported in the public press and made by some in public forums are consistent with our belief.[26]

The decision about whether, when, and how to remove the reconciliation requirement rests with the SEC. However, if the requirement is removed, we believe it is very important to emphasize that a single set of high-quality international standards remains the ultimate goal and that continued progress toward that goal is expected. Thus, in our view, it would be advisable that the removal of the reconciliation requirement coincide with the completion of the blueprint development and with the SEC's obtaining commitments from others to implement the blueprint and to substantially resolve the IASB funding and IFRS endorsement issues.

If the SEC decides to remove the reconciliation requirement before key features of the blueprint are developed and agreed to by relevant parties or before international cooperation resolves the IASB funding and IFRS endorsement issues, we encourage the Commission to consider creating alternative ways of motivating the relevant parties to cooperate in these endeavors. Some have suggested that the SEC mandate a review of the progress toward convergence in accounting and other infrastructure elements a few years after the reconciliation requirement is removed, with such a review perhaps tied to a "sunset" provision on the suspension of the reconciliation requirement. A mechanism such as this would emphasize that

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elimination of the reconciliation requirement may eliminate incentives to choose the alternative that is closest to the U.S. GAAP requirement.

[24] The comment letter from the Financial Reporting Policy Committee (pp. 10–13) summarizes evidence from a variety of studies of foreign company financial reporting quality. Cross-listing in the U.S. appears to improve reporting quality, but difficulties in cross-border enforcement result in cross-listed companies having lower reporting quality on average than U.S. companies.

[25] The SEC Proposing Release (p. 27) echoes the concern that "there is a risk that constituents of the [FASB and IASB] may not continue to support convergence if IFRS financial statements are accepted by the Commission without reconciliation to U.S. GAAP." We believe the IASB shares our commitment to continue working toward a single set of high-quality accounting standards, but some of their constituents seem less supportive.

[26] See, for example, Kate Burgess, "Rethink Is Urged over Accounting Proposals," *Financial Times* (July 11, 2007): 23; and "EU Fears U.S. Influence," *Accountancy* (August 1, 2007).

achieving a high-quality global financial reporting system is the end goal, and the removal of the reconciliation is just one step along the way.

Consistent with our stance against after-the-fact endorsement processes, we strongly support the position in the Proposing Release that the reconciliation requirement would be eliminated only for companies applying IFRS as issued by the IASB. Allowing multiple variants of IFRS in filings by foreign private issuers in the U.S. is inconsistent with our goal of achieving a single set of globally accepted accounting standards, and it would impose additional complexity on U.S. investors and other capital market participants.

In concluding this part of our response, we once again commend the SEC for encouraging a dialogue on allowing U.S. companies to use IFRS. To reiterate, we believe the needs of U.S. investors will be best met by developing a blueprint for moving U.S. public companies to IFRS via an improve-and-adopt approach.[27] We believe that move should be accompanied by cooperative international efforts to strengthen the process for setting global accounting standards by developing more stable and sustainable funding and staffing mechanisms for the IASB and by eliminating jurisdictional processes that require endorsement of each IFRS after it is issued by the IASB. The next part of our response discusses some transition issues in more detail.

[27] Appendix B of this letter describes other approaches to achieving the goal of a single set of high-quality accounting standards that we considered in developing this letter but rejected.

Part 2: Issues to Be Considered in Developing the Blueprint

If our recommendation to accelerate convergence by moving U.S. public companies to IFRS is accepted, then a myriad of transition issues need to be addressed. This second part of our comment letter describes several such issues that came to our attention during the development of our views in Part 1. A discussion of these issues illustrates some of the important challenges we expect to be encountered during the transition of the U.S. to IFRS. However, the preliminary suggestions in this part of our comment letter are not intended to restrict the development or scope of the blueprint.

We expect the blueprint to have a major effect on our activities during the transition period. An important aspect of our proposed "improve-and-adopt" approach of transitioning U.S. public companies to IFRS is the identification of the areas where existing IFRS and U.S. GAAP should be improved during the transition process. We expect the blueprint to classify existing differences between U.S. GAAP and IFRS into areas in need of improvement and other areas where the U.S. will adopt the IASB standards.[28] In addition, the blueprint should address the relative priority of other projects to maintain or repair existing U.S. GAAP.

In addition to changing our agenda, the blueprint developers might recommend altering some of our due process. We expect to follow our traditional due process of inviting comment and conducting deliberations in a public forum for the improvement projects. For the IASB standards that will be adopted "as is" during the transition process, the blueprint developers might recommend a different due process approach. Because the blueprint itself will be a major change in policy, we encourage the parties participating in the blueprint to seek broad consultation and provide some sort of due process as the blueprint is developed.

We believe that the blueprint should identify the future role(s) of the FASB after U.S. public companies transition to IFRS. Some of the alternatives are listed here.

- Like other jurisdictions, the U.S. might retain its standard-setting body to develop standards for private companies, not-for-profit entities, or other organizations that use U.S. GAAP but do not participate in the global capital market.
- The FASB might have a role in educating U.S. constituents in the application of IFRS or in identifying U.S. issues as candidates for IASB action.
- The IASB may see value in establishing regional affiliations to improve liaison with constituents outside Europe. The FASB might be able to fulfill that type of role.

The developers of the blueprint should consider how the transition of U.S. public companies to IFRS might affect the financial reporting by private and not-for-profit entities. Currently, private companies and not-for-profit entities apply U.S. GAAP. The developers of the blueprint should consider whether the users of financial reports of those entities would be best served by applying IFRS, a simplified version of IFRS,[29] U.S. GAAP, or some other set of standards.

[28] The initial blueprint classification of an area is subject to change as the IASB and FASB deliberate the issues. However, the urge to reclassify "adopt" areas as "improve" areas should be resisted, or else the transition date in the blueprint would need to be extended.

[29] In February, 2007, the IASB issued an exposure draft of a proposed *International Financial Report Standard for Small and Medium-sized Entities (SME)*. The draft, if adopted, would be a standalone document to be used by smaller companies with public accountability. The draft standard has some recognition and measurement simplifications, and it omits guidance for some issues that the IASB does not expect SMEs to encounter.

Consideration also should be given to the reporting by a private company that becomes a public company through listing shares or other securities in the U.S. or elsewhere.

Another potential transition issue to be considered by the blueprint developers relates to the use of U.S. GAAP financial information for contracting and regulatory purposes. Some examples are as follows:

- U.S. GAAP financial information is used as a basis for monitoring the safety and soundness of financial institutions and for defining requirements in governmental contracting;
- Debt and compensation contracts often contain clauses that depend on amounts in the company's U.S. GAAP financial statements;
- IFRS does not allow LIFO accounting for inventory, but LIFO is commonly used in the filings of U.S. companies (often due to a tax conformity requirement enacted by Congress[30]); and
- The transition to IFRS may affect the amount of alternative minimum tax collections[31] or the magnitude of utility rates set by states based on profitability and asset base.

We believe the blueprint developers should recommend ways for various affected parties to adjust these policies to be compatible with IFRS. Adjusting IFRS in the U.S. to fit the existing U.S. policies could create a U.S. variant of IFRS, which we strongly oppose. The time required to implement any critical changes would be relevant in determining the target date or dates for moving all U.S. public companies to IFRS.

Existing IASB standards, in general, contain fewer rules and less implementation guidance than U.S. GAAP, and, thus, their application may require more judgment. A successful transition to IFRS will require changes in the U.S. financial reporting culture to enable the use of more judgment and less reliance on detailed guidance. The absence of such a change might result in calls for expanded implementation guidance in the U.S. market, possibly resulting in a U.S. variant of IFRS, a result that would be inconsistent with the goal of a single set of international standards. The blueprint developers should identify any impediments to increased reliance on judgment that might interfere with the smooth transition to IFRS, and they should set a timetable for implementing the changes necessary to remove those impediments. The findings and recommendations of the SEC's Advisory Committee on Improvements to Financial Reporting should be useful in this regard.

As the U.S. moves closer to requiring companies to file financial statements in XBRL, steps need to be taken to assure compatibility between the U.S. and IFRS versions of XBRL. Otherwise, the transition to IFRS will be complicated by system incompatibility and costly redesign.

An important part of the blueprint will be selecting the date or dates on which U.S. public companies must be fully transitioned to IFRS. The issues discussed above as well as others mentioned in Part 1 of our comment letter will likely be relevant to that selection, although it is

[30] International Accounting Standard 2, *Inventories*. The LIFO conformity rule is in the U.S. Internal Revenue Service regulations (26 CFR 1.472-2(e)).

[31] A corporation's alternative minimum taxable income is increased by the difference between net income reported to shareholders (as adjusted) and its alternative minimum taxable income (26 CFR 1.56-1).

important to distinguish between critical issues that must be dealt with before transition and less important issues that can be addressed as the transition occurs. While we do not support allowing companies to choose between U.S. GAAP and IFRS for an extended period, we acknowledge that the transition may be smoother if some large multinational companies are allowed to adopt IFRS one or two years prior to mandating IFRS for smaller domestically oriented public companies. The blueprint developers should consider whether staggered transition dates might allow the lessons learned in the initial wave of adoptions to reduce the costs for companies in the second wave without unduly increasing complexity for investors and other users.

Again, we commend the SEC for the thoroughness of the issues raised in the Concept Release. While we have not attempted to identify all potential issues that might need to be addressed in the blueprint, the list above suggests that a transition of the U.S. to IFRS would require careful planning and management.

Appendix A

History of Convergence Activities

Accounting standard setters from around the world have been working to develop a single set of high-quality international standards that could be used for both domestic and cross-border financial reporting. The FASB and other national standard setters have been working with the IASB and its predecessor (the International Accounting Standards Committee) for many years to improve and converge (or harmonize) accounting standards. Since the formation of the IASB in 2001, however, the pace of convergence toward a single set of high-quality international standards has accelerated.

Many jurisdictions around the world have since decided to require or permit public companies to use IFRS issued by the IASB. Many others are planning to move in this direction. Some of those jurisdictions, however, have a post-issuance process for endorsing each IFRS that has changed some of the standards issued by the IASB, resulting in "as-endorsed" or "as-adopted" versions of IFRS. Moreover, evidence reveals apparent differences in the implementation of IFRS in various jurisdictions that can and do result in national variants of IFRS.

In 2002, the FASB and IASB committed to the goal of developing a set of high-quality, compatible standards. The 2002 Norwalk Agreement describes the broad plans for achieving that goal, such as coordinating the agendas of both Boards so that all major projects are undertaken jointly and eliminating narrow differences in other projects through focused, short-term convergence projects. The 2006 Memorandum of Understanding ("MoU") sets specific milestones to be achieved by 2008. The SEC[32] and others (including the FAF Trustees and the FASAC) have encouraged and supported this approach.

The MoU contained both short-term and long-term projects. The long-term projects where the Boards planned to work together to produce better standards consisted of the following:

- Business combinations
- Consolidations
- Fair value measurement guidance
- Liabilities and equity distinctions
- Performance reporting / Financial statement presentation
- Postretirement benefits (including pensions)
- Revenue recognition
- Derecognition
- Financial instruments (replacement of existing standards)
- Intangible assets
- Leases

The IASB and FASB have made steady progress toward convergence since 2002. Standards have been issued by both Boards that improve financial reporting by reducing or eliminating differences between IFRS and U.S. GAAP in areas such as inventory, nonmonetary transactions, share-based payments, segment reporting, and the use of a fair value option to simplify the

[32] SEC News Release, "SEC Welcomes Plans of U.S., International Standard Setters for Convergence of Accounting Systems," February 27, 2006, http://www.sec.gov/news/press/2006-27.htm.

accounting for financial instruments. Both Boards will soon issue a common standard that improves, simplifies, and converges the accounting for business combinations and noncontrolling interests (one of the projects listed above). Differences in existing standards for business combinations are some of the more common reconciling items between U.S. GAAP and IFRS. In upcoming months, both Boards will be seeking comments from their constituents on additional joint projects in the list above, including financial statement presentation, liabilities and equity, and revenue recognition. In addition, both Boards are working together on an improved and converged conceptual framework.

If the SEC and other constituents accept our plan to converge to IFRS via the improve-and-adopt approach, then we expect the blueprint developers (with the cooperation of the IASB) to assess areas where existing U.S. GAAP and IFRS are not responsive to the needs of users. This process should lead to the identification of the improvements areas. Areas that we view as candidates for improvements include the unfinished items in the MoU and our joint project on the conceptual framework.

Appendix B

Approaches for Moving to IFRS That We Considered but Rejected

As stated in Part 1 of our comment letter, we support the vision of a high-quality global financial reporting system, and we believe that a key part of achieving that goal is the transition of U.S. public companies to IFRS via improvement and adoption. We believe this approach is better for investors than allowing U.S. domestic registrants to freely choose between U.S. GAAP and IFRS for an extended period of time. For one to believe that free choice will lead to a single set of high-quality accounting standards, one must expect market forces to eventually lead all preparers to select the same set of standards and that the standards selected will be high quality. We view such expectations as unrealistic. First, a primary purpose of accounting and external financial reporting standards for public companies is to give potential investors the information and confidence to buy securities from companies or other investors who may have greater access to such information.[33] To serve this purpose, the mechanics of the accounting system must be available to all capital market participants, which effectively makes the accounting standards "public goods," and economics shows that market forces alone often produce less than optimal quantities of public goods.[34] Second, market forces seldom lead to a single product being universally used by all consumers, and therefore we question whether market forces can be an effective approach for achieving the ideal of a single set of high-quality standards. Third, even if market forces can coalesce into a single set of standards, the dynamics of letting the market choose could result in some issuers taking advantage of lower quality alternatives to the detriment of investors. Thus, allowing companies to choose among accounting standards with the hope that market forces will determine the appropriate accounting policy is, in our view, a risky, potentially costly, and inappropriate strategy.

We acknowledge that financial statement preparers and the firms that provide them with financial reporting services might welcome the opportunity to select among alternative accounting systems. However, the coexistence of multiple sets of standards adds cost and complexity for users and other capital market participants. Indeed, the Concept Release contains a number of difficult questions that must be answered if companies are permitted to choose (for example, once an entity chooses to move to IFRS, should it have the option of choosing to move back to U.S. GAAP). As the Concept Release states, "A thriving capital market requires, among other things, a high degree of investor understanding and confidence. Converging towards or embracing a single set of high quality accounting standards could contribute to investor understanding and confidence."[35] In a prior concept release on international accounting, the SEC expressed an aversion to choice by stating that high-quality accounting standards should "result

[33] "Asymmetric information" is used to describe market situations where the buyer has less information than the seller. In his article "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism" (*Quarterly Journal of Economics*, [August 1970]: 488–500), George A. Akerlof illustrates how the market for used cars can collapse in cases of extreme information asymmetry. The information asymmetry can be reduced by establishing a reporting system that provides buyers with reliable information about the seller's car.

[34] The accounting system is a public good in the sense that buyers and sellers of securities in a capital market can get the benefits of the accounting system without having to pay for it directly. Because people have incentives to "free ride" when using public goods, if the provision of the accounting system is left to the forces of supply and demand, then the accounting system produced will be less than optimal. In cases such as this, economics suggests society as a whole can benefit from a regulator mandating a better accounting system than would be provided by private market forces.

[35] SEC Concept Release, p. 18.

in comparable accounting by registrants for similar transactions, by avoiding or minimizing alternative accounting treatments."[36] If choices **within** a set of accounting standards are undesirable, choice **between** sets of accounting standards cannot be optimal. Consistent with this, governments in jurisdictions with developed capital markets appear unwilling to allow decisions about the form and content of financial reports to be left totally to the discretion of the reporting entity, probably due to an unwillingness to tolerate a large number of investors being misled by low-quality financial reports, as they were in 1929 in the U.S. prior to the formation of the SEC.

Another possible transition path is to require U.S. companies to adopt **existing** IFRS in the near future. While this approach moves the U.S. capital market to the set of standards that is increasingly used in whole or in part around the globe, we view the abrupt switch as less desirable than transitioning via the improve-and-adopt approach. First, as stated earlier, the issue of establishing a stable source of funding for the IASB that provides an adequate sized and experienced staff has not yet been resolved, which argues against an immediate switch to IFRS. Second, a number of areas of U.S. GAAP and IFRS need improving; immediate adoption would replace a weak U.S. standard with a weak IASB standard now, and then require U.S. companies to incur additional costs to adopt a new improved standard at some point in the near future. Third, the existing and potential jurisdictional variants of IFRS imply that standards adopted by the IASB are not yet a single set of globally accepted accounting standards. The transition period will allow international cooperation aimed at limiting after-the-fact jurisdictional endorsement processes and the modifications they produce. Fourth, while some other jurisdictions mandated an abrupt switch from local GAAP to some version of IFRS, most of these cases come from the uniting of European countries or from countries with less developed capital markets; the benefits to the majority of U.S. companies and their investors from abruptly switching to **existing** IFRS are likely to be less than the benefits in these other jurisdictions.

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[36] *SEC Concept Release: International Accounting Standards*, Section IV.A.2 (February 18, 2000).