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April 7, 2009

Ms. Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Via email: rule-comments@sec.gov

File Number: S7-27-08

Re: Comments on the proposed rule, *Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by US Issuers* ("Roadmap").

I offer the following comments as a co-author of a recent textbook on accounting ethics (*Understanding Accounting Ethics*, second edition), an instructor in accounting ethics, and an independent consultant in accounting ethics related matters.

I am a disinterested observer of the debate over convergence with IFRS, and I do not represent any "constituent" or "stakeholder." However, my study of the profession of accounting and its history leaves me with certain concerns about how convergence might change both the accounting profession, and the SEC in its relationship to the accounting profession.

In fact, these comments differ from others that have been offered insofar as they take as their primary starting point the "interests" of the SEC. I am principally concerned with such things as the SEC's legislative mandate; the longstanding posture that the SEC has adopted toward the accounting profession; the SEC's fundamental task of protecting the investor and serving the public interest; and the consistency of the Roadmap with previous SEC policy statements.

The burden of my comments is that the SEC's Roadmap represents a policy that would in effect undermine the authority of the SEC, rendering it incapable of carrying out the only task for which it exists.

I present first a summary of my comments, and then those comments together with the arguments and evidence in support. In some cases I take the liberty of quoting freely from past SEC documents, and speeches by former SEC Chairpersons, Commissioners, and Chief Accountants. I ask the reader's indulgence in those cases, on the grounds that sometimes it is necessary to establish the appropriate historical context, if the force of a comment is to be appreciated.

Summary of comments:

1. **The Roadmap would permanently impair the SEC in its responsibility to protect U.S. investors and serve the public interest.** (p. 3)

2. **The very form of the proposal of the Roadmap—its lack of clarity and indecisiveness—is a manifestation of the changed status that the SEC would have if reporting under IFRS becomes mandatory.** (p. 9)

3. **The coincidence in goals between the SEC and the IASB is superficial, because these entities do not aim to act "in the public interest" in the same way; in contrast, the fundamental goals of the SEC and the U.S. accounting profession do coincide.** (p. 10)

4. **Consequently, the SEC would apparently even lack the authority to recognize the IASB as a standard-setter.** (p. 13)

5. **The Roadmap is inconsistent with many earlier and carefully considered policy statements of the SEC.** (p. 13)

6. **IFRS is not a "high quality" standard, according to criteria previously set down and endorsed by the SEC.** (p. 16)

7. **The SEC itself gives a variety of compelling reasons why one should expect that the greater comparability promised by the Roadmap would not be attained.** (p. 18)

8. **Moreover, even if greater comparability were attained, it would be short-lived.** (p. 22)

9. **The SEC gives no objective evidence or substantive arguments that the costs of the Roadmap will not far outweigh the benefits.** (p. 23)

10. **In light of the above mentioned shortcomings, the SEC should return to the *status quo* and continue on a path of convergence only through the instrumentality of the FASB.** (p. 25)

Comments:

1. **The Roadmap would permanently impair the SEC in its responsibility to protect U.S. investors and serve the public interest.**

For this comment to be clear, it is necessary to begin with some history about the SEC's relationship to the accounting profession: it is because the Roadmap would radically alter this relationship for the worse the SEC would be impaired in fulfilling its responsibilities.

Both by law and by the SEC's historic practice, the authority of the SEC has been understood as an authority best exercised in partnership with the profession of accounting—and the relatively recent language of "designated standard-setter" should not be allowed to obscure this fact.

Such a partnership was part of the SEC's original mandate and was envisaged by the Securities Acts. In writing the original Acts, Congress, with the approval and concurrence of President Franklin D. Roosevelt,[1] deliberately rejected a proposal that would require that financial statements be certified by government accountants,[2] and instead specified that financial statements submitted to the SEC be certified by "independent public accountants":

> At the time when Congress was considering the Securities Act of 1933, Col. Arthur Carter, representing the accounting profession, testified that the bill should include a requirement that financial statements be audited and reported on by independent accountants. Such a provision was ultimately added to the Act before passage. In addition, the Act did not follow the example of companies acts throughout the world which generally define required financial statements in considerable detail but rather gave authority to an independent agency to set forth accounting and disclosure requirements. *Thus Congress created the necessity of the partnership between agency and profession that has since existed*.[3]

The SEC likewise, from its beginning, has acted in recognition of such a partnership and with a view to fostering it:

[1] As President Roosevelt wrote in his letter introducing the Securities legislation, "This proposal adds to the ancient rule of *caveat emptor* the further doctrine, 'Let the seller also beware.' It puts the burden of telling the whole truth on the seller. It should give impetus back to honest dealing in securities and thereby bring back public confidence. The purpose of the legislation I suggest is to protect the public with the least possible interference to honest business," 73 *Cong. Rec.* 937 (1933).

[2] The cost, duplication, lack of independence of the regulators, and the difficulty of maintaining top-level expertise under the proposal, were all urged as arguments against it.

[3] John C. Burton, Chief Accountant of the SEC, "The SEC and the Accounting Profession: Responsibility, Authority and Progress," Accounting Colloquium III, University of Kansas, May 10-11, 1973, my emphasis. Burton goes on to say: "In the years since its creation, the Commission has looked to the profession to assume the leadership in setting accounting principles. Authority and responsibility have been delegated and have been accepted by the profession."

> During its early years the Commission considered undertaking the establishment of a uniform system of accounting standards, but determined in 1938 that the primary responsibility for accounting principles should remain in the private sector with those who practice the accounting profession. [4]

In 1938, in Accounting Series Release No. 4, the SEC recognized "substantial authoritative support" for financial statement disclosures deriving from the judgments of accounting professionals. This approach was reaffirmed in 1976, with Accounting Series Release No. 150. Most recently it was reaffirmed in 2003, with the policy statement, *Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter*, pursuant to Sarbanes-Oxley Section 108.

Similarly, the practice of the SEC from its inception has involved a large reliance upon and deference to the accounting profession in the formulation of sound accounting principles. This has been manifested in the SEC's active efforts to help establish and then recognize professional bodies responsible for formulating authoritative principles (the Committee on Accounting Procedures; the Accounting Principles Board; the FASB), as well as its use of a light hand in oversight, and its being reluctant directly to contravene considered professional judgment.[5]

The historical relationship just described has not been a matter of a government entity's designating, perhaps in the interest of efficiency, some group of experts to specify accounting principles, but rather of the deliberate cooperation of a regulatory authority with a pre-existing profession. One SEC Chairman has referred to this cooperative endeavor as "The Great Treaty":

> In both the Securities Act and the Exchange Act . . . Congress gave us the authority to establish accounting principles. The Commission declined to exercise this authority in what I like to refer to as the Great Treaty. We would accept statements prepared in accordance with generally-accepted accounting principles, which would be principles having substantial authoritative support, except that where several inconsistent principles had substantial authoritative support, we might insist on one rather than another.[6]

The fact is that the profession of accounting arose nearly a century before the SEC was created. Its practitioners had been certified and licensed for decades beforehand. The accounting profession

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[4] John R. Evans, Commissioner of the SEC, "The SEC, the Accounting Profession, and Self-Regulation," Distinguished Speaker Series, Department of Accounting, University of Kentucky, Lexington, Kentucky, Feb. 28, 1979.

[5] "[T]he Commission has historically looked to the standard-setting bodies designated by the private accounting profession to provide leadership in establishing and improving accounting principles, subject to Commission oversight. With minor exceptions, the Commission has regarded the determinations of such bodies as responsive to the needs of investors," Harold M. William, Chairman of the SEC, in "The Role of the SEC in Overseeing the Accounting Profession," Nuffield College, Oxford, England, March 13, 1980.

[6] Ray Garrett, Jr., Chairman of the SEC, "The Accounting Profession and Accounting Principles," Second Annual Robert M. Trueblood Memorial Conference, Illinois CPA Foundation, Palmer House, Chicago, Illinois, October 3, 1975.

possessed at that time, and still does possess, all of the distinctive characteristics of a learned profession, just as much as medicine or law.[7]

Thus, for the SEC to have proceeded in such a way as to replace, usurp or override its function—even if this had been allowable under the Securities Acts—would have been an unwise use of the SEC's authority. It would have been as if a governmental entity given authority to regulate public health took upon itself the task of developing and determining medical science.

The precise conceptual reason why it would have been unwise for the SEC to take upon itself the function of the accounting profession is found in the so-called "principle of subsidiarity," which may be stated as follows:

> *The Principle of Subsidiarity: A task should be performed by an entity at the lowest level of social organization at which the task can be competently performed; and a higher-level association should intervene in the activity of this entity only by way of correction and guidance, or to restore it to proper functioning when it fails at its task, and never in such a way as to subvert or take over its role*.

The "Great Treaty" between the SEC and the U.S. accounting profession has evidently worked out for the benefit of both parties. The accounting profession, for its part, has offered to the SEC expert judgment in accounting principles, which it has arrived at through drawing upon resources far greater than the SEC could command on its own; using more reliable processes; with better access to necessary information; and with greater insulation from political considerations.[8] In reciprocation the U.S. accounting profession has benefitted from the SEC's oversight in several obvious ways: by its being urged and encouraged to achieve advancements in accounting more quickly than it would have done otherwise; by the fact that its expertise has been directed in a more focused way in the service of the public interest; and by the profession's securing as a result an importance in the U.S. economy which

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[7] Because of its altruistic character in serving the interests of distant investors, accounting has some of the distinctive marks of a profession to an even greater degree than medicine or law. See Mark Cheffers and Michael Pakaluk, *Understanding Accounting Ethics*, Second Edition, Allen David Press, 2005, chapter 1, where the standard sociological analysis of a profession is shown to apply to accounting. The following remark by Harold M. Williams, Chairman of the SEC, is pertinent: "In many ways, accounting is unique among the professions. It does not advocate, heal, or counsel; nor does its primary obligation run to those who retain its services. Rather, it applies a coherent system for communicating financial status and position and certifies to its presentation. That is, it seeks to assure users of financial statement that the statements are meaningful, and that they can be accepted as credible and relied upon. As such, if the profession's work is to have value, it must rest on the profession's ability to maintain and justify a high degree of public trust and confidence," address to the San Diego chapters of the National Association of Accountants and the California CPA Society, San Diego, California, January 21, 1981.

[8] "As you know, the Commission has long deferred to the recognized professional bodies as the appropriate vehicle by which to study accounting issues and set accounting standards that most fairly and accurately present the true picture of an enterprise's economic activities and condition. I have no doubt that that position is correct. An effectively functioning private-sector body is better situated – in terms of resources, processes, and access to the necessary information and insight -- to do the job better and more timely. It is also better able to ensure that the processes and rules established are insulated from political considerations," Harold M. Williams, *Ibid.*

has served to increase its prominence, prestige, and financial rewards.[9] And the U.S. public has benefited from the partnership as well: witness the 75 years of relatively steady growth in capital formation, business enterprises, investor success and standard of living since the passage of the Securities Acts.

Consequently the working relationship between the SEC and the U. S. accounting profession has been consistently described by SEC Chairpersons, Commissioners, and Chief Accountants as a "partnership." It is a partnership which involves a kind of balance of complementary authority. The authority which is exercised is *complementary*: that of the accounting profession derives from knowledge and expertise; that of the SEC derives from law. And the authority is *balanced*, insofar as each is in a position to provoke a stand-off:

> Where two groups, both with elements of responsibility and authority over a field of endeavor, and both with a similar overall view of the objectives of the field, seek to exercise their authority, coalition is the natural result. In such a situation, each group recognizes the power and authority of the other but does not seek to test it because conflict under such circumstances nearly always represents a negative sum game. Thus it is with the SEC and the accounting profession.[10]

In its day-to-day working the relationship is most typically characterized by implicit cooperation, and the SEC exercises its regulatory authority more through influence than through command backed up by the coercive power of law.[11] At the same time, the SEC retains the authority to correct decisions of the

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[9]"[O]ver the nearly 50 years since enactment of the first federal securities laws, the federal government has played a sometimes restrained – but nevertheless always attentive -- role in the activities of the profession. This governmental interest has not, in my view, hampered the profession and its work. Indeed, the development, sophistication, and financial rewards of the profession are, at least in some measure, attributable to the critical importance placed upon financial reporting and disclosure -- as well as the certification process – under the securities laws. Moreover, it may be argued that, without the discipline instilled by actual -- or potential -- governmental involvement in the standard-setting and auditing activities of the profession, advancements in the profession might not have proceeded as rapidly or responsibly as they have, and the public might not now perceive the profession as being accountable and credible," Harold M. Williams, address to the San Diego chapters of the National Association of Accountants and the California CPA Society.

[10] John C. Burton, Chief Accountant of the SEC, "The SEC and the Accounting Profession: Responsibility, Authority and Progress."

[11] See David S. Ruder, Chairman of the SEC, "Private Sector Accounting Standards: The SEC's Oversight Role," remarks before the AICPA sixteenth National Conference on Current SEC Developments, Washington, D.C., January 10, 1989, who gives an excellent description of the constant and implicit influence of the SEC in its dealings with the FASB: "The Commission engages in active oversight of the FASB, interacts daily with the FASB, and thus is in an excellent position to evaluate the FASB's performance. The Commission monitors the development of new standards and then deals with subsequent implementation and interpretation of the standards through ongoing advisory, examination, and enforcement programs. The SEC's oversight is extensive and covers all aspects of FASB's activities. The Commission staff discusses issues with the FASB staff on a daily basis and the two staffs meet regularly to discuss the FASB's agenda, current problems, and other matters of mutual interest. The FASB also meets periodically with the Commission members in open meetings to discuss topical issues. The Commission's staff also actively monitors the structure, activities, and decisions of the FASB. Each of the projects on the FASB's technical agenda is assigned to Commission staff members who follow the project developments, review comment letters submitted to the FASB, attend FASB meetings and public hearings, and confer with FASB staff."

accounting profession when an alternative and plausible view seems more consistent with the public interest, and it has the responsibility of doing so.

From this brief description of the historic relationship between the SEC and the accounting profession, one can characterize this relationship as:

(i) a complementary and quasi-equal *partnership*;
(ii) involving the sort of recognition of responsibility, by a government entity of a private entity, which is characteristic of a relationship of *subsidiarity*;
(iii) with oversight that is exercised by a controlling authority through *implicit influence and persuasion*; and
(iv) where this controlling authority retains the power of making a final decision unilaterally, when this seems necessary *to promote or preserve the public interest*.

We may then ask how this historical relationship would fare if the Roadmap were adopted and followed, with the result that it became mandatory that financial statements filed with the SEC be prepared in accordance with IFRS instead of U.S. GAAP.

We observe, first, that the Commission fails to pose this question. The Roadmap leaves unaddressed its effects on the SEC's relationship to the U.S. accounting profession; its potential effects on the accounting profession itself; and its effects on the SEC's ability to participate effectively in the standard-setting process in such a way that it can adequately protect the U.S. investor and public interest.

Second, it is clear that none of the essential elements of the historic partnership between the SEC and the U.S. accounting profession, as enumerated in (i)-(iv) above, would be preserved if the Roadmap were followed, and it becomes mandatory that financial statements filed with the SEC be prepared in accordance with IFRS instead of U.S. GAAP.

As regards (i), one might initially wonder whether there is or can be such a thing as an international accounting profession, or rather, instead, whether every profession in the true sense is situated within some particular polity. That is, one might argue that there can be a profession in the strict sense only where there is the possibility of licensing, and licensing is always within a particular polity and for the common good of that polity.[12]

However, if one grants for the sake of argument that there is an international accounting profession, and that the IASB may be taken as a representative or authoritative body of that profession, it is clear that after mandated conversion to IFRS the SEC would not be an equal partner either of that profession

[12] Indeed, it seems an unfortunate confusion in the accounting profession today that international accounting firms might themselves be mistakenly regarded as quasi-professional bodies—whereas in fact the professional membership and higher allegiance of an accounting professional must always be to an association outside of the firm with which he or she is associated, no matter how large or important the firm may be.

or of the IASB. Rather, the SEC would become merely one among many regulating authorities belonging to the Monitoring Board as contemplated by the IASC constitution.[13]

The Roadmap refers to this issue only once, in passing and almost euphemistically: "We will evaluate the effectiveness of the oversight mechanism (including the functioning of the multilateral nature of the Monitoring Group) in making the determination whether mandating IFRS is in the public interest for the protection of investors and our markets."[14] But the Roadmap exhibits no concern that conversion to IFRS would imply an end to the longstanding partnership relationship that has existed between the SEC and the accounting profession.

As regards (ii), clearly there is no sense in which the IASB, the IASC, or a putative international profession of accounting could be regarded as subsidiary to the SEC and its regulatory task; rather, it would seem that the SEC itself would become subordinate, as assuming the position of only one constituent of a potentially very large Monitoring Board.

As regards (iii), according to the duties and responsibilities assigned to members of the Monitoring Board by article 19 of the IASC Foundation Constitution (revised, Feb. 1, 2009), the SEC will not be able to have the sort of constant and close working relationship with the IASB, which would allow for continuous and implicit influence.[15]

As regards (iv), the SEC's status under the IASC Foundation Constitution would be that of one among many "stakeholders," rather than a determining authority.[16] The SEC would not have the authority, after due deliberation, unilaterally to determine IFRS,[17] in the way that the SEC now has the authority and responsibility under the Securities Acts to make final determinations as to U.S. GAAP.

It is true that the IASC Foundation Constitution asserts that decisions of the Monitoring Group must be by consensus, and therefore the SEC Commissioner would have veto power, but this would be only for the apparently limited domain involving which "common positions" the Monitoring Group will adopt;

[13] The IASC Constitution (revised, Feb. 1, 2009) states that "at the outset" (*nota bene*) the Chairman of the SEC would be only one of seven members of the Monitoring Group. The Monitoring Group could, and probably would, expand far beyond its initial constituency of seven, and there is apparently no reason why a member of the Group must always remain a member.

[14] Roadmap, p. 27.

[15] Nor apparently will the Trustees even have such a relationship: see Articles 15-17.

[16] "[T]he Trustees are accountable not to a single group, but to the wide range of international stakeholders that have an interest in the IASC Foundation's efforts to achieve its objectives. To ensure the transparency of their work and public accountability to these broad interests, the Trustees have identified stakeholder groups with which they maintain regular contact and are establishing mechanisms to receive input outside formal consultations. These stakeholder groups include official organizations, policymakers, investor groups and private sector institutions from around the world," in "Proposals and Issues for the Constitution Review," n. 10.

[17] "The Monitoring Board shall reach decisions to approve the appointment of Trustees and establish any common positions *by consensus,*" IASC Foundation Constitution, Article 23, my emphasis.

the SEC Commissioner's veto power would not extend to particular decisions of the IASB as to what counts as an IFRS.

The IASC Foundation Constitution states that the relationship between the Monitoring Board and the Trustees "seeks to replicate on an international basis, the link between accounting standard-setters and those public authorities that have generally overseen accounting standard-setters."[18] As to whether the Constitution succeeds in replicating the sort of "link" that binds public authorities and "standard-setters" in other countries, one may only speculate. But, as regards the United States, and its context and history, it is perfectly clear that not only will the Monitoring Board not have a partnership with the IASB similar to that which the SEC has with the FASB and the U.S. accounting profession, but also, and more to the point, the SEC as a member of that Monitoring Board will not have such a relationship.[19]

Thus I conclude that the Roadmap would undermine the historic partnership between the SEC and the accounting profession in the United States, and that this relationship would not be replaced by anything equivalent or equally satisfactory.

One might expect that the Roadmap would therefore either bring to an end or radically diminish the benefits that have been gained by each through this partnership. Furthermore, and as a result, it would permanently impair the SEC in its responsibility to protect U.S. investors and serve the public interest.

The next two comments follow are related to this conclusion:

2. **The very form of the proposal of the Roadmap—its lack of clarity and indecisiveness—is a manifestation of the changed status that the SEC would have if reporting under IFRS becomes mandatory.**

Given that the SEC will not have a partnership relationship with the IASB, the SEC's influence upon the determinations of the IASB, as I have noted, will not take the form of constant and implicit guidance. The Commission's influence will change from being organic, incremental, and persuasive, to being extrinsic and all-or-nothing.

That the SEC will be forced to assume such a relationship is already evident from the curious lack of clear determination shown in the Roadmap. The SEC aims to decide whether IFRS reporting becomes mandatory, but without really deciding. In its arbitrary rule permitting companies to report under IFRS if a plurality of the largest 20 companies in their industry already does so, the Commission is apparently

[18] See Article 18.

[19] This point is somewhat lamely conceded and downplayed in the Roadmap, yet the SEC recognizes no implications as flowing from it: "We recognize that our relationship with the IASB is currently less direct than our relationship with the FASB. Further, constituents of the IASB are greater in number and more varied than the constituents of the FASB. The result is that our view—based on U.S. constituents—is one of many views that the IASB receives from around the world and considers when developing future standards," pp. 126-7.

looking to see whether a trend or "critical mass" develops.[20] And then in light of this it will determine, on grounds which are obscure, whether it will require all companies to report under IFRS.

This procedure is on its face irrational, since it is irrational to expect that decisions left to individual companies, to be made in the interests of those companies, will of themselves tend to a result that is in the interest of U. S. investors; or, alternatively, if mandatory reporting under IFRS were clearly in the interest of investors, then it would be irrational for the SEC not to mandate it forthwith. But this hesitancy and lack of clarity is understandable if it is viewed as the first manifestations of the uncertain authority that the SEC will assume once it no longer is in a partnership relationship with the professional body which serves as the standard-setter.

Indeed, an unfriendly critic might even characterize the Roadmap as the SEC's abdicating its responsibility to determine accounting standards, and its turning over this decision to the forces of the marketplace:

> That original commitment [by the SEC to a Roadmap] was enormously consequential, because it implied a great deal. It meant that IFRS and U.S. GAAP would someday compete freely in America's capital markets, and that two accounting systems would operate side by side — at least until the process of convergence concludes with actual convergence, and there is truly one global accounting standard and seamless international comparability of reporting. It meant that issuers, markets, and investors would have a choice — because they, not the government, will decide between IFRS and U.S. GAAP. [21]

But the Securities Exchange Act precisely did assign to the SEC the responsibility for deciding this, not "issuers, markets and investors."

3. The coincidence in goals between the SEC and the IASB is superficial, because these entities do not aim to act "in the public interest" in the same way; in contrast, the fundamental goals of the SEC and the U.S. accounting profession do coincide.

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[20] The language of "trends," "market forces" and "critical mass"—rather than investor protection—has been disturbingly dominant from the beginning in SEC speculations about international harmonization or convergence, for instance, "I look forward to 2006 when a critical mass of non-U.S. companies who file with the SEC (foreign private issuers) will begin filing financial statements prepared using IFRSs with the U.S. Securities and Exchange Commission"; "I believe that market forces will provide the incentive for the body of IFRSs to succeed"; in Donald T. Nicolaisen, Chief Accountant of the SEC, "A Securities Regulator Looks at Convergence," *Northwestern University Journal of International Law and Business*, April 2005; "If a critical mass of non-U.S. companies in a certain industry sector or market reports in accordance with IFRS, then there may be pressure for U.S. issuers in that industry sector or market to likewise report in accordance with IFRS," SEC Concept Release 33-8831, On Allowing U.S. Issuers to Prepare Financial Statements in Accordance with International Financial Reporting Standards, p. 12.

[21] Christopher Cox, Chairman of the SEC, "Chairman's Address to the SEC Roundtable on International Financial Reporting Standards," Washington, D.C., March 6, 2007.

The historic and fruitful partnership between the SEC and the U.S. accounting professional has been possible because both parties have the aim of acting in the public interest. The SEC is charged by Congress with protecting investors and acting in the public interest; and members of the accounting profession in the United States, according to standard codes of ethics and professional conduct, also pledge and profess to act in the public interest.[22] They both aim to serve the public interest; therefore they can cooperate in promoting that public interest through accounting standards useful to investors.

But is this also true of the SEC in relation to the IASB? There is reason to doubt that it is, because there is ambiguity in the phrase, "in the public interest," and the way in which the SEC is charged to act in the public interest seems different from the way in which the IASB members serve in the public interest.

The SEC is charged with acting "in the public interest" in the sense of acting "in the national public interest," that is, for the common good of the United States. This is clear from section 2 of the 1934 Securities Exchange Act, which explains the necessity of that legislation in terms of the "national public interest"[23] and refers to the need to protect persons and institutions of the United States, including interstate commerce, the national credit, the Federal taxing power, the national banking system and Federal Reserve System, and U.S. markets. This conception of the public interest is a relatively full conception, since by statute it includes taking into account considerations of "efficiency, competition, and capital formation."[24]

Of course, typically the common good of a nation coincides with what is good for nations in general: a nation in pursuing its common good, as properly understood, will typically at the same time be promoting the good of people throughout the world in general, just as an individual who pursues his own good as properly understood typically thereby also promotes the good of others generally. Thus acting "in the national public interest" will typically have a wide scope and is not equivalent to a narrow nationalism. Nonetheless, in those unusual cases where the common good of a nation conflicts with what is good for nations in general, then in that case a government institution such as the SEC, charged with promoting the "public interest"—that is, the "national public interest" as properly understood—is obliged to favor the common good of the nation it serves.[25]

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[22] "Given the importance and public nature of the accounting profession's work, it is one which is clearly imbued with the public interest," Harold M. Williams, address to the San Diego chapters of the National Association of Accountants and the California CPA Society. On this point, see Cheffers and Pakaluk, *Understanding Accounting Ethics*, second edition, chapter one. See also the AICPA Code of Professional Conduct, ET Section 54, Article II, "The Public Interest."

[23] "… transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto…."

[24] "Whenever pursuant to this subchapter the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.,"15 U.S.C. §77b(b).

[25] Note that a subsidiary professional accounting body acting in partnership with a governmental body, such as the FASB, as representing the U.S. accounting profession, acting in partnership with the SEC, presumably also acts for

Now although the IASC Foundation Constitution states that, "The members of the IASB shall be required to commit themselves formally to acting in the public interest in all matters,"[26] it is clear that they do not act "in the public interest" in the same sense as the SEC, since they do not aim to promote the good of nations and people in general *through promoting* the common good of the United States, and they are not obliged in cases of conflict to prefer the common good of the United States.

It should also be added that, whereas the conception of the "public interest" which the SEC is charged with promoting is full and broad, that which IASB members pledge to advance is apparently narrow and technical. This is clear from the IASC Foundation's discussion of its Constitution. The Constitution provides that members of the IASB must represent five distinct geographical areas: the Asia/Oceania region, Europe, North America, Africa, South America. (Note that this arrangement itself is curious, if the IASB members are supposed to be capable of acting in "the public interest." After all, there is no geographical representation in the FASB.) In its reflection on this Constitutional arrangement, the IASC Foundation remarks that the requirement of geographical distribution serves "to strengthen the legitimacy of the IASB in the view of the countries choosing to adopt IFRSs."[27] Then it says something that reveals how it understands the phrase, "in the public interest":

> At the same time, the Trustees believe that the Constitution's emphasis on 'professional competence and practical experience' should remain paramount. Accordingly, IASB members must commit themselves formally to acting in the public interest by, among other things, continuing to put the objective of the IASB above individual philosophies and interests, thereby not acting as a representative of any geographical component with which they may be associated.[28]

That is to say, the conception of the "public interest" advanced by IASB members is both *negative* and *technical*: negative, because to act in the public interest is defined negatively, as *not* acting in accordance with one's own "individual philosophy" or "interest;"[29] technical, because to act in the public interest, as a member of the IASB board, is to act from professional competence, that is, from technical accounting considerations.

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the public interest in this sense, that is, it acts only indirectly for the interest of people generally, through acting with a view to the common good (as properly understood) of the citizens of the United States in particular.

[26] See article 25.

[27] IASC Foundation, "Review of the Constitution," July 2008, n. 8.

[28] *Ibid*.

[29] One might of course wonder whether it is possible for persons to separate themselves from their own philosophies, and whether it would be desirable for them to do so, if it were possible. Furthermore, one might urge that the view that one can and should separate oneself from one's own "philosophy" is itself the expression of a particular "philosophy"—as not all philosophies agree that this is possible or desirable.

4. **Consequently, the SEC would apparently even lack the authority to recognize the IASB as a standard-setter.**

In light of these considerations, one may even wonder whether it is open to the SEC to recognize the IASB as a standard-setter.

Indeed, Sarbanes-Oxley Section 108 stipulates that "In carrying out its authority under subsection (a) and under section 13(b) of the Securities Exchange Act of 1934, the Commission may recognize, as 'generally accepted' for purposes of the securities laws, any accounting principles established by a standard setting body … [which] has, for administrative and operational purposes, a board of trustees (or equivalent body) serving in the public interest …."

In its Roadmap, the Commission is rightly concerned to consider whether the IASB is constituted and funded in such a way that it is independent (which is another criterion stipulated by Section 108). Yet it fails to consider the equally important consideration of whether the IASB has members who serve in the public interest in the sense meant by the Securities Acts or Sarbanes-Oxley—and apparently they do not.

One might additionally observe that Section 108 seems in its language and legislative history to have been crafted specifically with the FASB as the intended standard-setter and that therefore, it might be argued, some other body might not, in accordance with the intention of the Act, be designated by the SEC a standard-setter, unless there existed some serious reason no longer thus to designated the FASB.[30]

5. **The Roadmap is inconsistent with many earlier and carefully considered policy statements of the SEC.**

The concern here is simply that the Roadmap presents itself as continuous with a long history of deliberation by the SEC and FASB about international harmonization and convergence of accounting standards, whereas in fact the Roadmap is discontinuous with that history. Therefore, the Roadmap cannot draw upon the arguments and justification for harmonization offered or accepted in that history. At the same time, the Roadmap does not offer any new arguments for the new approach that it endorses.

In the Roadmap the SEC turns away not simply from its historic partnership with the U.S. accounting profession, but also from its own previously articulated aim of "convergence." Convergence was understood previously, by both the SEC and the FASB, as the formulation of a new standard, distinct from and superior to both U.S. GAAP and IFRS. It was furthermore supposed that the maintenance of this new standard would require continued cooperation by the FASB and IASB, since such cooperation

[30] (and I maintain in the following comments, in effect, that the promise of greater "comparability" could *not* constitute such a reason).

would be necessary for the interpretation, implementation, and development of that standard over time. In the Roadmap, however, the SEC abandons convergence and instead proposes to substitute IFRS for U.S. GAAP as the standard.

In the Norwalk Agreement of 2002, the FASB and the IASB affirmed a common "commitment to the development of high-quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting." According to the Agreement, these "common, high-quality solutions" were to be arrived at by a cooperative and reciprocal process, involving comparison of U.S. GAAP and IFRS, in order to work toward a better alternative. The better alternative was to be constructed in part from U.S. GAAP, in part from IFRS, and in part as the result of special, joint deliberations of the FASB and the IASB.

Convergence was understood to require a sustained cooperation by the FASB and the IASB, in order to maintain this new and distinct standard:

> At that meeting, both the FASB and the IASB pledged to use their best efforts to (a) make their existing financial reporting standards fully compatible as soon as is practicable and (b) to coordinate their future work programs to ensure that once achieved, compatibility is maintained.[31]

Again, the "Memorandum of Understanding between the FASB and the IASB" of February 27, 2008, explicitly reaffirmed the Norwalk Agreement, and it additionally reported agreement on the thesis that:

> Trying to eliminate differences between two standards that are in need of significant improvement is not the best use of the FASB's and the IASB's resources—instead, a new common standard should be developed that improves the financial information reported to investors.

It referred to "short-term" convergence projects and also a long-term process of joint deliberation and maintenance of newer, shared standards. Again, the suggestion was that the FASB and the IASB were engaged in a long-term task to formulate a new and distinct standard—in the maintenance of which the FASB, under SEC insight, would presumably play an equal and enduring role.[32]

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[31] It is perhaps not unimportant that the Roadmap reports the conclusion of the Norwalk Agreement in a somewhat misleading way. The Roadmap states, "The two bodies acknowledged their joint commitment to the development, 'as soon as practicable'[sic], of high-quality, compatible accounting standards" (p. 21). But there is a difference between, "As soon as possible we need to bring about compatibility in the appropriate manner," which is what the Norwalk Agreement in effect says, and "As soon as possible we need to bring about compatibility," which is what the Roadmap takes it to say.

[32] See also the *Memorandum of Understanding of September 11, 2008*, which reaffirms the Norwalk Agreement and the earlier Memorandum, and provides a framework for FASB/IASB collaboration through 2011. Admittedly this Memorandum mentions "the possibility that some or all U.S. public companies might be permitted or required to adopt IFRS at some future date," but in acknowledging this it seems to have been concerned to anticipate a change of policy by SEC.

Likewise, earlier SEC policy statements on convergence have been consistent with the goal of convergence to a distinct, higher standard, as has been emphasized by a recent SEC Chairman:

> The process of reducing the differences between IFRS and U.S. GAAP gives us the opportunity, at the same time, of taking both to the highest quality level. That is why the SEC originally committed to the Roadmap, and why, years later, we are still committed.[33]

Elsewhere the Commission has referred to convergence as a "process of continuing discovery and opportunity to learn *by both U.S. and international standard setters*."[34] Indeed, in the Roadmap the SEC seems to suppose a continuation of this collaboration between the FASB and the IASB: "The current joint work plans of the two standard setters, as well as other work undertaken by them, furthers the goal of comprehensive, high-quality standards."[35] The Roadmap even "urges the two Boards to continue working towards the completion of their joint work plan."[36]

But then the Roadmap, inexplicably, begins to talk about "mandating use of IFRS by U.S. issuers"— as though IFRS as determined by IASB should be made the standard, rather than some standard which was the joint responsibility of the FASB and the IASB. This is to favor *substitution* (or "transition") rather than *convergence*.[37] To be clear: substitution is, strictly, distinct from convergence and implies the end of convergence, as the Commission itself conceded, when it remarked in an earlier Concept Release that "If U.S. issuers were permitted to prepare IFRS financial statements, then some could conclude that the

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[33] Christopher Cox, Chairman of the SEC, "Chairman's Address to the SEC Roundtable on International Financial Reporting Standards," Washington, D.C., March 6, 2007.

[34] *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) (my emphasis), which is quoted in SEC Concept Release 33-8831, *On Allowing U.S. Issuers to Prepare Financial Statements in Accordance with International Financial Reporting Standards* (August 7, 2007), p. 26.

[35] Roadmap, p. 22.

[36] *Ibid*., p. 23.

[37] The Pozen Committee report distinguishes between "transition," or "discrete transition," and "convergence," although it acknowledges that "some constituents" speak of the former under the rubric of convergence: "Some constituents understand 'transition' or 'convergence' to mean that U.S. GAAP and IFRS (as issued by the IASB) will eventually be harmonized, at which point no substantive differences will exist between the two bodies of accounting literature. Others understand it to mean a discrete transition from U.S. GAAP to IFRS at a specified date without respect to whether the two bodies of literature are substantially harmonized at the date of transition." See *Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission* (August 1, 2008), p. 2 note 7. Note that insofar as the Pozen Committee report does not take a position on the preferability of "discrete transition" versus "convergence" properly speaking, that report cannot be cited as an authority in support of the Roadmap—and yet the Roadmap does purport to cite that report as such an authority on p. 12.

convergence process would no longer be warranted because those U.S. issuers that see a benefit to reporting under IFRS would be free to do so."[38]

One might have expected *ex ante* that, if the SEC were going to opt for the substitution of single standard rather than convergence, it would promote U.S. GAAP as the world standard, rather than IASB, because of its wider acceptance and preferability in some respects on the merits.[39] But the main point to be made here is that the policy of substitution favored by the Roadmap is discontinuous with the history of international harmonization, which was toward convergence upon a new standard.

An interesting corollary is that the Roadmap becomes inconsistent, too, with the history of the SEC as recounted under Comment no. 1 above. As mentioned, the SEC has historically used a light hand in overseeing the accounting profession, and has been reluctant to contravene the judgments of the U.S. accounting profession outright. But in the Roadmap the SEC, in proposing to substitute IFRS for U.S. GAAP, shows little reluctance about rejecting the *entire body* of judgments of the U.S. accounting profession all at once.

Surely if an intervention which changes *part* of a system risks being heavy-handed, and should be undertaken only for grave reasons, then an intervention which changes *the whole system* should be undertaken for only the gravest and most serious of reasons.[40]

6. IFRS is not a "high quality" standard, according to criteria previously set down and endorsed by the SEC.

The Roadmap's preference for the substitution of IFRS for U.S. GAAP, rather than convergence upon a new and better standard, could not possibly be justified except on the assumption that IFRS is a "high

[38] See SEC Concept Release 33-8831, *On Allowing U.S. Issuers to Prepare Financial Statements in Accordance with International Financial Reporting Standards* (August 7, 2007), p. 16. The Commission gives no explicit definition of 'convergence' in the Concept Release, but from its remarks on p. 18 one can gather that the term means: "the content of IFRS and U.S. GAAP coming together" in order to constitute "a widely used single set of high quality globally accepted accounting standards."

[39] "As U.S. GAAP has been used longer and more extensively than IFRS, more U.S. GAAP implementation guidance has developed over time," (Roadmap, p. 44); "U.S. GAAP is accepted worldwide," (p. 127); "Currently, U.S. issuers, using exclusively U.S. GAAP, comprise a large portion of worldwide equity market capitalization, and foreign investors likely have a correspondingly thorough understanding of U.S. GAAP," (*ibid*).

[40] On this point compare the recommendation of the Commission's Pozen Committee in its report: "We believe that there should be a single standards-setter for all authoritative accounting standards and interpretive implementation guidance of general significance. The FASB should perform this function for U.S. GAAP, while the SEC should focus on registrant specific guidance as explained below. If the SEC staff identifies accounting issues of relatively broad significance in the process of reviewing filings by registrants, the SEC staff should refer such issues to the FASB through the proposed FRF. In those rare instances when the SEC staff believes it is necessary to quickly announce an accounting interpretation of broad significance, we strongly encourage the SEC to inform the FASB Chairman in advance of such interpretations" pp. 6, 72-4.

quality" standard, in the sense that this phrase has previously been understood in discussions of convergence—and yet if one employs the best definition of "high quality," then, by the Commission's own admissions, IFRS is not "high quality."

In the Roadmap, the Commission refers to a "high quality" standard as "a set of neutral principles that require consistent, comparable, relevant and reliable information that is useful for investors."[41] Yet this definition is unsatisfactory, since the defining terms are unsuitably vague and undefined. (What counts as sufficiently "consistent," "reliable," etc.?)

A better definition of "high quality" may be taken from the Commission's own Pozen Committee report on improvements to financial reporting.[42] Presumably a standard which met the recommendations of the Pozen Committee report would be "high quality" in the relevant sense, and one which fell short of those recommendations, although it might be a praiseworthy standard which had "quality," would not yet be of "high quality" in the relevant sense.[43] If the Pozen Committee report articulates criteria which would need to be satisfied for U.S. GAAP to count as a sufficiently "high quality" standard, then these are also criteria which would need to be satisfied by IFRS, if it is to count as sufficiently "high quality":

> Regarding the standards-setting process itself, our mandate focuses on recommending improvements to U.S. processes, which may be informed by best practices internationally. An explicit analysis of how international standards-setting could be improved was not in our purview. Nevertheless, we believe the principles underpinning our recommendations may be equally applicable *in any high-quality standards-setting regime*."[44]

These criteria would include the following:

(i) Bright lines should be eliminated, perhaps in favor of proportionate recognition (Recommendation 1.4, p. 9).

(ii) Standards should be based on business activities rather than industries; thus, industry-specific standards should be eliminated, except in rare circumstances (Recommendation 1.6, p. 9).

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[41] Roadmap, p. 23, note 58.

[42] *Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission* (August 1, 2008).

[43] By "'high quality' in the relevant sense" I mean the sense in which "high quality" has been meant in past discussions of convergence, where it has meant the higher quality expected of that standard to which both IFRS and U.S. GAAP would converge. Thus the Pozen Committee report in various places states that it regards its recommendations as relevant to the achievement of the "high quality" standard at which international convergence intends to aim: "we believe that the principles underlying our recommendations to improve the standards-setting process would be relevant to any accounting standards-setter" (p. 2); "we believe that the principles underlying our recommendations are relevant, regardless of the end state of convergence" (p. 21); "with respect to matters of convergence, we believe the principles underlying our recommendations will benefit financial reporting regardless of the approach ultimately taken in the U.S." (p. 26); and so on.

[44] *Ibid*., p. 57, my emphasis.

(iii) Similar activities should be accounted for in a similar manner, so that competing models should be eliminated, except in rare circumstances (Recommendation 1.9, p. 10).
(iv) Standards should be scoped with sufficient precision to minimize the use of scope exceptions (Recommendation 1.8, p. 10).
(v) Avoidable complexity should be minimized (Recommendation 2.2, p. 11).

And yet the Pozen Committee report denies that IFRS currently satisfies these criteria, especially as regards criteria (iii) and (iv):

> We note IFRS also contains competing models.[45]
>
> . . . we note that IFRS currently permits numerous alternative accounting policies.[46]
>
> . . . we note that IFRS currently has fewer scope exceptions than U.S. GAAP. We encourage the SEC to affirm the IASB's efforts in regard. However, we also note that, in certain circumstance where IFRS includes scope exceptions, they are sometimes more expansive than those under U.S. GAAP.[47]

In sum, putting aside the other pertinent considerations considered below, the substitution of IFRS for U.S. GAAP, rather than convergence of both upon some third standard, can possibly be justified only if IFRS is "high quality" in the relevant sense, and yet by the Commission's own criteria it is evidently not a suitably "high quality" standard.

7. The SEC itself gives a variety of compelling reasons why one should expect that the greater comparability promised by the Roadmap would not be attained.

In SEC and FASB statements prior to the Roadmap, comparability involving "high quality" was the stated goal of convergence in accounting standards. In contrast, although the Roadmap mentions "high quality" in passing, it justifies the mandating of IFRS only on the grounds that this will lead to greater comparability among financial statements.[48] The Roadmap takes a reductionist approach to conversion to IFRS, singling out only one criterion among many—comparability—in justification of its plan.

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[45] *Ibid*., p. 55.

[46] *Ibid*., p. 51.

[47] *Ibid*., p. 53.

[48] The focus on "high quality" seems to drop out of the Roadmap through a conflation of "international" with "world class": standards which are international are "world-class" and therefore (it is presumed without further argument) are high quality. See p. 22 of the Roadmap: "In November 2007, the Trustees of the IASC Foundation reiterated their support for continuing the work program described in these memoranda, noting that future work is largely focused on areas in which the objective is to develop new world-class international standards." Here "world-class international standards" replaces "high-quality international standards," as if the mere fact that a standard was widely adopted throughout the world made it "high-quality."

Thus, the Roadmap should not be endorsed if any one of the following holds true:

- comparability does not constitute the primary attribute of “high quality” accounting standards;
- the Roadmap would not actually lead to greater comparability;
- this greater comparability is not necessary to protect U.S. investors or in the public interest.

I see no argument or evidence offered in the Roadmap that comparability implies or constitutes “high quality” in an accounting standard. Admittedly, “comparability” is one among several important considerations in setting standards and ensuring sound information from which investment decisions will be made. But, obviously, the question of the most truthful presentation of any particular set of economic activities is more important than comparability. For instance, in current intense discussions taking place around “fair value,” “market value,” and “other than temporary impairments” associated with assets and liabilities, an investor would not be better off in this discussion if the relevant standards were uniform, and in that sense “comparable,” yet they improperly identified the correct or best disclosures to make.

For the remainder of this comment I address whether the Roadmap would lead to greater comparability, and in the next I discuss whether the Roadmap is in the public interest and would serve to protect investors.

It is important to observe that the sort of comparability urged in the Roadmap is not quite the same as the comparability or uniformity among financial statements historically sought by the SEC. Historically the SEC has sought to eliminate differences in accounting treatment when these differences could be exploited by executives to place an interpretation on their financial disclosures or the results of their business which could potentially be misleading to investors. Here, in contrast, the different accounting treatments at issue are different systems or standards of accounting in different jurisdictions, and typically executives have had no option of reporting to the same authority under one among several available standards, depending upon their choice.

The former sort of lack of comparability needs to be eliminated for the “protection of investors,” that is, so that they are not exposed to being misled by an accounting treatment chosen precisely to favor, perhaps misleadingly, an interpretation favored by management. The latter sort of comparability has no such urgency as a matter involving the “protection of investors;” rather, if it is of concern, this is because it implies inefficiencies in the market and—assuming the costs of remedying it do not exceed the benefits—alleviating these inefficiencies would imply a slightly higher return on investment for investors. Needless to say, it would be silly to speak of “protecting investors” from the slightly lower return they can expect in a marginally less-efficient marketplace. Thus, the Roadmap cannot reasonably be defended in relation to the SEC’s historic aim of “protecting investors.”

This point needs emphasis for two reasons: first, so that it is clear that the Roadmap’s concern with comparability is distinct from the historic concern of the SEC involving comparability; second, because it turns out that in its concern to remedy the sort of non-comparability which *hasn’t* been the SEC’s historic concern, the Roadmap in fact favors a policy which risks introducing the sort of variety in accounting methods that *has* been the SEC’s historic concern.

In any case, I do not believe that even the remediation of this market inefficiency will be attained by adoption of the Roadmap, since there are three types of lack of comparability which, it seems, will not be eliminated through adoption of the Roadmap: (i) comparability of the financial statements of foreign private issuers with one another; and (iii) comparability of the financial statements of U.S. companies with one another.

(i) Comparability of the financial statements of foreign private issuers with one another.

Many other commentators have pointed out that the comparability of financial statements under IFRS is less compelling than how it may appear, due to jurisdictional differences, cultural differences, and greater room for individual discretion than allowed by U.S. GAAP. It is not necessary to reiterate these points here.[49] Rather, I am concerned here to point out that the Commission does not deny this problem in the Roadmap but rather attempts to ameliorate it with two replies—and yet neither reply is adequate.

The Commission replies, first, that "less prescriptive guidance may increase issuers' ability to account for transactions or events in accordance with their underlying economics."[50] That is, the Commission maintains that, in some circumstances, allowing greater discretion in the preparation of financial statements allows for a more accurate representation.

This is true, in the sense that it is theoretically possible. Yet the reply is weak, because experience shows that this theoretical possibility is unlikely in practice. In practice, as is well known, managers will wish to take advantage of "less prescriptive guidance" to give a particular slant or emphasis to financial statements, and accountants and auditors will frequently and perhaps unwittingly assist—which is exactly the sort of diversity in reporting that the SEC has historically been intent on minimizing. The Commission does not explain how it is possible to allow discretion for the theoretically possible good purpose while not also giving equal scope to the abuse of that discretion for all-too-common dubious purposes.

The Commission then argues, second, that the greater scope for discretion under IFRS is a consequence of IFRS admirably being more of a "principles-based" accounting standard than U.S. GAAP: "The Commission and its staff also have supported the increased use of objectives, outcomes and principles in accounting standards in contrast to detailed prescriptive guidance."[51] That is, the Commission argues that the greater scope for discretion is justifiable and offset by the desirable characteristic of IFRS in being more "principles-based." In a footnote to this remark, and presumably in support of this

[49] The argument is forcefully developed, for example, by Charles D. Niemeier, Board Member, PCAOB, "Keynote Address on Recent International Initiatives," 2008 Sarbanes-Oxley, SEC and PCAOB Conference, New York State Society of CPAs, New York City, September 10, 2008. "Calls for U.S. regulators to acknowledge that IFRS are not designed to achieve comparability have already begun," he writes (p. 5).

[50] Roadmap, p. 44.

[51] Roadmap, p. 45.

argument, the Roadmap refers the reader to the SEC's own magisterial study on principles-based accounting, the *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*.

However, in that study the Commission reached the following key conclusions:

- a properly constructed accounting standard is not "principles-based" but rather "objectives-oriented;"
- it is misguided to draw a contrast between "principles-based" and "rules-based" standards, because a properly constructed accounting standard will contain *both* a stated objective (which the standard wishes to achieve) and detailed rules for achieving that objective;
- many standards in U.S. GAAP are already "objectives-oriented" in this sense; and
- IFRS is not superior to U.S. GAAP in this respect.

On this last point, the Commission asserted the following:

> Many have pointed to International Financial Reporting Standards ("IFRSs"), issued by the International Accounting Standards Board ("IASB") and selected for adoption in Europe by the European Commission ("EC"), as an example of a principles-based regime. We do not believe the line of demarcation to be quite so simple. As they currently stand, the IFRSs do not embody the objectives-oriented approach to principles-based accounting standard setting. Indeed, a careful examination of the IFRSs shows that many of those standards are more properly described as rules-based. Other IFRSs could fairly be characterized as principles-only because they are overly general. Accordingly, we reject the notion that IFRSs constitute a model for principles-based accounting standards.[52]

That is to say, the Roadmap's reply—that greater room for discretion in IFRS is desirable as being more an expression of "principles-based" accounting—is contradicted by the very SEC document that it cites in support of that reply.

The Roadmap's viewpoint is also contradicted by the Commission's Pozen Committee report. That report defines "complexity" of an accounting standard in such a way that it is inversely related to comparability, because complexity hinders comparability: "Incomparable reporting of activities within and across entities arises because of factors such as the mixed attribute model, bright lines, and exceptions to general principles."[53] As noted above, the Pozen Committee report affirms that there are numerous causes of such "avoidable complexity" in IFRS; thus the report by implication affirms incomparability.

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[52] See "Study," section I.F.

[53] *Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission* (August 1, 2008), p. 19. See the report's definition of "complexity" given on pp. 18-19, reflected frequently in the language of the report, e.g. "To decrease complexity and increase comparability," p. 5.

(ii) Comparability of the financial statements of U.S. companies with one another.

All of this so far is to point out that the comparability promised by IFRS is only superficial. But what are the sorts of lack of comparability that risk being created by the Roadmap itself, or which can be expected given the Roadmap? They may be enumerated as follows:

a) If the SEC mandates reporting under IFRS, this will apply only to public companies. If private companies continue to use U.S. GAAP, then the SEC will introduce a permanent source of lack of comparability among U.S. companies.
b) The Roadmap would permit some U.S. companies (in "IFRS industries") to begin filing next year under IFRS. The SEC admits that it may decide in 2011 that it will not mandate all companies to file under IFRS. Moreover, the SEC is not clear as to whether, if it decides not to mandate, it will require those companies that had filed under IFRS to convert back to U.S. GAAP.[54] Thus, on this scenario, after 2011 there will be less comparability than there is now, as a result of the Roadmap.
c) Even if the SEC requires those U.S. companies that choose to report under IFRS to report additionally under U.S. GAAP ("Proposal B"), since the U.S. GAAP figures will not be audited, there will be in that sense the introduction of a new lack of comparability, since audited statements are not strictly comparable with unaudited statements.[55]

In sum: mandatory reporting under IFRS will not increase comparability but rather diminish it; furthermore, it will increase divergence in financial reporting in precisely the way that has been a traditional concern of the SEC.

8. Moreover, even if greater comparability were attained, it would be short-lived.

Of course, all accounting standards develop over time, since a standard needs to be interpreted for particular circumstances, and new rules need to be set down to cover previously unseen developments. It may therefore be expected that the IFRS will develop differently for different jurisdictions over time.[56] In particular, if the SEC mandates IFRS, and the IASB becomes the standard-setter for U.S. financial reporting, it is certain that on many occasions the SEC will reject the determinations of the IASB, just as in the past it has rejected on many occasions the determinations of the CAP, the APB, and the FASB. The very first time the SEC thus dissents, U.S. accounting standards will diverge from IFRS and will not be

[54] "Were the Commission to determine not to continue to permit or require additional U.S. issuers to use IFRS, the Commission would determine whether to require U.S. issuers that had elected the early use of IFRS to revert back to U.S. GAAP," Roadmap, p. 74.

[55] See Roadmap, p. 72.

[56] "[I]ndividual jurisdictions' processes for incorporating IFRS into their markets may result in varying degrees of pressure placed on the IASB in the development of individual standards. For example, some jurisdictions adopt or endorse IFRS on a standard-by-standard basis unlike the historical approach in the United States to look to a standard setter to establish the body of accounting standards as a whole," Roadmap, p. 47.

identical with IFRS. Once these divergences become sufficiently numerous—as they inevitably will over time—then the situation of companies filing with the SEC will be no different in principle from the way it is now, when companies filing with the SEC need to file under U.S. GAAP instead of IFRS. That is to say, any putative gains in comparability will necessarily be short-lived.[57]

9. The SEC gives no objective evidence or substantive arguments that the costs of the Roadmap will not far outweigh the benefits.

The argument of the Roadmap is that mandatory reporting under IFRS will lead to greater comparability of financial statements, and therefore such a policy should be adopted. The Roadmap mentions and details some of the disadvantages of this policy, but it nowhere argues that the gain in comparability, even if this were attained, is either is necessary to protect U.S. investors, or is necessary for advancing the public interest, or is not offset by the expected disadvantages.

I have argued that the claim of increased comparability is spurious: divergences allowed within IFRS are at least as great as divergences between U.S. GAAP and IFRS, and, even if not, the gain in comparability from mandated conversion to IFRS, as mentioned, would be short-lived, since inevitably the SEC would dissent and diverge from IASB standards, leading to a distinction between U.S. and international reporting standards not unlike what now exists. Clearly it would be a great waste of resources for companies to convert to a single standard for the sake of a very short-lived gain in comparability.

Furthermore, it is not clear how a marginal increase in the comparability of financial statements would be necessary for the protection of U.S. investors, or even for advancing the public interest—although often the argument is advanced that the change would benefit "the capital markets."[58] On the other hand, I have provided much evidence that the public interest will be harmed by the disruption of the longstanding partnership between the SEC and the U.S. accounting profession, which has historically been fruitful for both parties, as well as for American institutions and the American public.

[57] The Commission gestured toward these difficulties but failed adequately to address them in its earlier Concept Release on convergence: "Because it is likely that not everyone will apply accounting standards consistently or appropriately, securities regulators are developing infrastructure to identify and address the application of IFRS globally," SEC Concept Release 33-8831, *On Allowing U.S. Issuers to Prepare Financial Statements in Accordance with International Financial Reporting Standards* (August 7, 2007), p. 34. The Roadmap similarly fails to address these difficulties.

[58] "For many years there has been a dedicated group of practitioners, standard setters, business leaders and others from around the world who have worked to establish a single set of globally accepted accounting standards *for the benefit of the capital markets*. The primary driver behind the significantly expanded use of IFRSs is a decision made by the European Parliament and the Council of the European Union that all listed European Union companies (including banks and insurance companies) must prepare their consolidated financial statements in accordance with IFRSs, generally from 2005 onward. In the U.S. capital markets *many, like me, are anxious to capitalize on the benefits of having a widely used set of accounting standards accepted and in place*," in Donald T. Nicolaisen, Chief Accountant of the SEC, "A Securities Regulator Looks at Convergence" (my emphasis).

Moreover, under the current Roadmap, the SEC and the U.S. accounting profession could well end up with a result dictated by the flawed thoughts of well intentioned IASB representatives or the political influences of foreign governments that could put U.S. companies and investors at a serious and unnecessary disadvantage.

I conclude this comment with two small but pertinent logical points.

This first is this: since the Roadmap does not make a definite decision about mandatory IFRS reporting, but rather it merely sketches a policy which, if followed, *might* result in an SEC decision to mandate IFRS reporting, the Roadmap requires, strictly, not a "cost-benefit" analysis, but rather an "expected cost—expected benefit" analysis, where the cost of following the Roadmap is represented by the following sum:

[(costs of following the Roadmap/IFRS is not mandated) X Probability (IFRS is not mandated)]

+

[(costs of following the Roadmap/IFRS is mandated) X Probability (IFRS is mandated)]

This sum should then be subtracted from expected benefits and compared with those that are involved in not following the Roadmap at all and keeping the *status quo*.

The point is that there are considerable costs involved in following the Roadmap if IFRS is *not* mandated at the end of the road.[59] These costs are ignored in the analysis given in the Roadmap. Yet they need to be included, because the probability that the SEC will mandate IFRS reporting if the Roadmap is adopted is less than 1.

The second point to be considered is that a sound cost-benefit analysis of a proposed change needs to compare the expected costs and benefits result from the change not only with (a) keeping the *status quo*, but also with (b) other reasonable changes that might be introduced besides the proposed change which is under consideration. If a change in policy is to be justified, it must be shown to be a better policy than both the *status quo* and all the reasonable alternatives. Yet in the Roadmap the Commission does not raise the question of whether there are reasonable alternatives to the substitution of IFRS for U.S. GAAP.

For example, the Roadmap overlooks the suggestion given in the report of the SEC's own Pozen Committee. That report considers what should happen "if the convergence of U.S. GAAP and IFRS does not occur within a few years." In that case, the Pozen Committee report suggests, there should be "a systematic rethinking of U.S. GAAP in a second codification project" along the lines recommended by the report.[60] This "rethinking" would improve U.S. GAAP such that it would potentially become a "high

[59] Indeed, that is why one might reasonably be concerned that the SEC could regard itself as "forced" to adopt IFRS if the Roadmap is followed—because the costs of going back to the *status quo ante* would be too great.

[60] *Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission* (August 1, 2008), p. 70. Again, "If U.S. GAAP will continue to be in use for an extended period of time, the FASB and the SEC should consider systematically revisiting U.S. GAAP in a second phase of the codification project," p. 71. See also page 69 and the section found on p. 72, "Second Phase of Codification."

quality" standard, in which avoidable complexity were eliminated, and which satisfied the other criteria mentioned above which must be met by a truly "high quality" standard. I see no argument or cost-benefit analysis in the Roadmap which shows convincingly that this alternative would not be preferable to substitution of IFRS for U.S. GAAP.

10. In light of the above mentioned shortcomings, the SEC should return to the *status quo* and continue on a path of convergence only through the instrumentality of the FASB.

The starting point for the SEC's deliberation about international accounting standards should be an affirmation that it has a responsibility to act in the "national public interest" of the United States, and that, furthermore, its actions in regulating financial reporting can never be unilateral, but must proceed through its historical partnership with the U.S. accounting profession. What this means concretely is that the SEC is not free to endorse and promote harmonization or international standards, except through the instrumentality of its partnership with the U.S. accounting profession, which concretely takes the form of cooperative engagement with the FASB.

In the present case what this implies is a return to the policy of the Norwalk Agreement and subsequent memoranda. The SEC should resist efforts or trends to absorb U.S. accounting interests into IASB, and it instead it should proceed on the premise that it will not recognize international standards, except insofar as these are arrived at and maintained through a common and continuing effort of FASB and IASB cooperating as equal partners.[61]

Much of the massive economic and investor disruption that has taken place over the past decade can be traced back to deficiencies in accounting standards both in the U.S. and abroad. In such circumstances, the only reasonable road is that which leads the accounting profession, U.S. and foreign regulatory bodies, and U.S. and foreign standard setters together to work in concert toward a "third and better standard." But that was the very road we were on, prior to the seemingly inexplicable and hasty change of course represented by the Roadmap.

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I appreciate this opportunity to address the Commission on these important matters. I would be pleased to discuss my comments with the Commission or its staff at your convenience. I may be

[61] This is on the intuitive principle that "partners of partners are partners." The SEC can enter into the correct relationship with IASB only through its partnership with FASB. The Pozen Committee report's typical language for this seems to capture the correct relationship nicely, e.g. "… the SEC should recommend that any new projects undertaken jointly or separately by the FASB should …," *Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission* (August 1, 2008), p. 10 and *passim*.

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Very truly yours,

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