

(Corrected)

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Parts 210, 228, 229, 230, 239, 240 and 249**

**[Release No. 33-8831; 34-56217; IC-27924; File No. S7-20-07]**

**RIN 3235-AJ93**

**CONCEPT RELEASE ON ALLOWING U.S. ISSUERS TO PREPARE FINANCIAL STATEMENTS IN ACCORDANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Concept release; request for comment.

**SUMMARY:** The Commission is publishing this Concept Release to obtain information about the extent and nature of the public's interest in allowing U.S. issuers, including investment companies subject to the Investment Company Act of 1940, to prepare financial statements in accordance with International Financial Reporting Standards as published by the International Accounting Standards Board for purposes of complying with the rules and regulations of the Commission. U.S. issuers presently prepare their financial statements in accordance with generally accepted accounting principles as used in the United States, referred to as U.S. GAAP.

**DATES:** Comments should be submitted on or before November 13, 2007.

**ADDRESSES:** Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/concept.shtml>); or

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-20-07 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper comments:

- Send paper submissions in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-20-07. The file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/concepts.shtml>). Comments also are available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Questions on this Concept Release should be directed to Gina L. Even, Business Associate, or Katrina A. Kimpel, Professional Accounting Fellow, Office of the Chief Accountant at (202) 551-5300; Sondra L. Stokes, Associate Chief Accountant, Division of Corporation Finance at (202) 551-3400; or Richard F. Sennett, Chief Accountant, Division of Investment Management at (202) 551-6918; U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

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## I. INTRODUCTION

The Commission has long advocated reducing disparity between the accounting and disclosure practices of the United States and other countries as a means to facilitate cross-border capital formation while providing adequate disclosure for the protection of investors and the promotion of fair, orderly and efficient markets. The Commission also has encouraged the efforts of standard setters and other market participants to do the same.<sup>1</sup> To those ends, as part of a 1988 Policy Statement, the Commission explicitly supported the establishment of mutually acceptable international accounting standards as a critical goal to reduce regulatory impediments that result from disparate national accounting standards without compromising investor protection.<sup>2</sup>

Further, in 1997, the Commission noted that for issuers wishing to raise capital in more than one country, preparing more than one set of financial statements to comply with differing jurisdictional accounting requirements increased compliance costs and created inefficiencies.<sup>3</sup> In the study prepared pursuant to a mandate from Congress, the Commission encouraged the efforts of the International Accounting Standards Committee (“IASC”), the international accounting standard setting body at the time, to develop a core set of accounting standards that could serve as a framework for financial reporting in cross-border offerings, and indicated the Commission’s intent to remain active in the development of those standards. These standards are now known as International Financial Reporting Standards (“IFRS”).

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<sup>1</sup> See “Integrated Disclosure System for Foreign Private Issuers” Securities Act Release No. 33-6360 (November 20, 1981) (the 1981 Proposing Release).

<sup>2</sup> See “Regulation of the International Securities Markets” Securities Act Release No. 33-6807 (November 14, 1988) (the 1988 Policy Statement).

<sup>3</sup> See “Pursuant to Section 509(5) of the National Securities Markets Improvement Act of 1996 Report on Promoting Global Preeminence of American Securities Markets” (October 1997) available at <http://www.sec.gov/news/studies/acctgsp.htm>.

In 2000, the Commission issued a Concept Release seeking input on convergence to a high quality global financial reporting framework while upholding the quality of financial reporting domestically.<sup>4</sup> The 2000 Concept Release sought comments as to the conditions under which the Commission should accept financial statements of foreign private issuers that are prepared using IFRS, and the use of the U.S. GAAP reconciliation of IFRS financial statements.

<sup>5</sup> The Commission has continued to monitor the international developments that were discussed in the 2000 Concept Release.

In October 2002, the Commission supported the announcement by the Financial Accounting Standards Board (“FASB”) and the International Accounting Standards Board (“IASB”), the successor of the IASC, of a Memorandum of Understanding, referred to as the Norwalk Agreement, to formalize their commitment to the convergence of U.S. and international accounting standards.<sup>6</sup> In this agreement, the two standard setting bodies acknowledged their joint commitment and pledged to use their best efforts to the development, “as soon as practicable,” of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting.<sup>7</sup> In addition to supporting the convergence efforts

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<sup>4</sup> See SEC Concept Release “International Accounting Standards,” Release No. 33-7801 (February 16, 2000) (the 2000 Concept Release) available at <http://www.sec.gov/rules/concept/34-42430.htm>.

<sup>5</sup> The term "foreign private issuer" is defined in Exchange Act Rule 3b-4(c) [17 CFR 240.3b-4(c)]. A foreign private issuer means any foreign issuer other than a foreign government except an issuer that meets the following conditions: (1) more than 50 percent of the issuer's outstanding voting securities are directly or indirectly held of record by residents of the United States; and (2) any of the following: (i) the majority of the executive officers or directors are United States citizens or residents; (ii) more than 50 percent of the assets of the issuer are located in the United States; or (iii) the business of the issuer is administered principally in the United States.

<sup>6</sup> See Financial Accounting Standards Board and International Accounting Standards Board, Memorandum of Understanding, “The Norwalk Agreement,” (September 18, 2002) (the Norwalk Agreement) available at <http://www.fasb.org/news/memorandum.pdf>.

<sup>7</sup> Id.

of the IASB and the FASB, we have long worked with each board on the development of their respective standards; however, the nature of our relationship with each board differs.

In 2005, the Commission adopted an accommodation to allow foreign private issuers that are first-time adopters of IFRS to file two years rather than three years of IFRS financial statements in their Commission filings.<sup>8</sup> Most recently, on June 20, 2007, the Commission approved for public comment a proposal to accept from foreign private issuers financial statements prepared in accordance with the English language version of IFRS as published by the IASB without the currently required accompanying reconciliation to U.S. GAAP.<sup>9</sup>

Almost 100 countries now either require or allow the use of IFRS for the preparation of financial statements by listed companies, and other countries are moving to do the same. This recent movement to IFRS outside the United States has resulted in an increase, from a relative few in 2005 to approximately 110 in 2006, of filings with the Commission of foreign private issuers that represent in the footnotes to their financial statements that their financial statements comply with IFRS as published by the IASB.<sup>10</sup> The Commission expects to see this number continue to increase in the future, particularly pursuant to Canada's announced move to IFRS, as there currently are approximately 500 foreign private issuers from Canada.<sup>11</sup>

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<sup>8</sup> See "First-time Application of International Financial Reporting Standards" Securities Act Release No. 33-8567 (April 12, 2005) (the 2005 Adopting Release) available at <http://www.sec.gov/rules/final/33-8567.pdf>.

<sup>9</sup> See "Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards without Reconciliation to U.S. GAAP" Securities Act Release No. 33-8818 (July 2, 2007) (the 2007 Proposing Release) available at <http://www.sec.gov/rules/proposed/2007/33-8818.pdf>.

<sup>10</sup> Another approximately 70 foreign private issuers filed financial statements that they stated were prepared in accordance with solely a jurisdictional variation of IFRS. Approximately 50 additional foreign private issuers that are incorporated in jurisdictions that have moved to IFRS included in their filings financial statements prepared in accordance with U.S. GAAP.

<sup>11</sup> See "Implementation Plan for Incorporating International Financial Reporting Standards into Canadian GAAP," available at [http://www.acsbcana.org/client\\_asset/document/3/2/7/3/5/document\\_8B452E12-FAF5-7113-C4CB8F89B38BC6F8.pdf?sfgdata=4](http://www.acsbcana.org/client_asset/document/3/2/7/3/5/document_8B452E12-FAF5-7113-C4CB8F89B38BC6F8.pdf?sfgdata=4).

This movement to IFRS also has begun to affect U.S. issuers, in particular those with a significant global footprint.<sup>12</sup> For instance, certain U.S. issuers may compete for capital globally in industry sectors in which a critical mass of non-U.S. companies report under IFRS. Also, U.S. issuers with subsidiaries located in jurisdictions that have moved to IFRS may prepare those subsidiaries' financial statements in IFRS for purposes of local regulatory or statutory filings.

In light of the ongoing convergence efforts of the IASB and the FASB and the movement outside the United States towards accepting financial statements prepared in accordance with IFRS, the Commission is seeking input in this Concept Release regarding the role of IFRS as published by the IASB as a basis of financial reporting in the U.S. public capital market by U.S. issuers. Specifically, the Commission is seeking input to better understand the nature and extent of the public's interest in giving U.S. issuers, including investment companies, the option to file with the Commission financial statements prepared in accordance with IFRS as published by the IASB.<sup>13</sup>

We appreciate that the U.S. public capital market has not experienced the co-existence of two sets of accounting standards for use by U.S. issuers. The Commission is issuing this Concept Release to gather input on the potential significance and effect of any such change to investors, issuers and market participants as well as to the accounting profession in general. Given the potential significance and complexity of permitting U.S. issuers to prepare financial statements in accordance with IFRS as published by the IASB for purposes of complying with

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<sup>12</sup> For purposes of this Concept Release, the term U.S. issuer encompasses any issuer other than a foreign private issuer reporting on Form 20-F or Form 40-F or filing a registration statement based on Form 20-F or Form 40-F. Form 20-F is the combined registration statement and annual report form for foreign private issuers under the Securities Exchange Act of 1934. It also sets forth disclosure requirements for registration statements filed by foreign private issuers under the Securities Act of 1933. Form 40-F is the combined registration statement and annual report form under the Exchange Act for Canadian foreign private issuers that file under the Multijurisdictional Disclosure System.

<sup>13</sup> The term "investment company" is defined in Section 3 of the Investment Company Act of 1940 [15 USC 80a-3].

the rules and regulations of the Commission, as contemplated in this Concept Release, we encourage all interested parties to provide comments.

## **II. THE EFFECT OF IFRS ON THE U.S. PUBLIC CAPITAL MARKET**

### **A. Financial Reporting in the United States**

The mission of the Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.<sup>14</sup> In carrying out this mission, the Commission historically has looked to private-sector bodies to provide standards for financial reporting by issuers in the U.S. public capital market. Since 1973, those standards have been set by the FASB, which is the independent, private-sector body whose pronouncements the Commission has recognized as “authoritative” and “generally accepted” for purposes of the federal securities laws, absent any contrary determination by the Commission.<sup>15</sup> Over time, this body of standards has commonly come to be referred to as U.S. GAAP.

The FASB is overseen by the Financial Accounting Foundation (“FAF”), which has responsibility for selecting the seven full-time FASB members.<sup>16</sup> The FAF is an independent, non-profit organization that is run by a sixteen-member Board of Trustees. The FASB derives its funding from fees paid by issuers and has oversight of the Emerging Issues Task Force (“EITF”), which is the interpretive body for U.S. GAAP. The FASB also is supported by the Financial

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<sup>14</sup> See U.S. Securities and Exchange Commission 2006 Performance and Accountability Report available at <http://www.sec.gov/about/secpar/secpar2006.pdf#sec1>.

<sup>15</sup> See “Statement of Policy on the Establishment and Improvement of Accounting Principles and Standards,” Accounting Series Release No. 150 (December 20, 1973) (expressing the Commission’s intent to continue to look to the private sector for leadership in establishing and improving accounting principles and standards through the FASB) and “Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter,” Securities Act Release No. 33-8221 (April 25, 2003) (the 2003 Policy Statement) available at <http://www.sec.gov/rules/policy/33-8221.htm>.

<sup>16</sup> See [http://www.fasb.org/facts/bd\\_members.shtml](http://www.fasb.org/facts/bd_members.shtml).

Accounting Standards Advisory Council (“FASAC”), which is responsible for consulting with the FASB as to technical issues on the FASB’s agenda and project priorities.

Consistent with the FASB’s objective to increase international comparability and the quality of standards used in the United States, the FASB participates in international accounting standard setting activities. This goal is consistent with the FASB’s obligation to its domestic constituents, who benefit from comparability of information across national borders.<sup>17</sup> The FASB pursues this objective in cooperation with the IASB, as discussed in more detail below, and with national accounting standard setters.

While the Commission consistently has looked to the private sector to set accounting standards, the federal securities laws, including the Sarbanes-Oxley Act of 2002,<sup>18</sup> provide the Commission with the authority to set accounting standards for public companies and other entities that file financial statements with the Commission.<sup>19</sup> The Commission oversees the activities of the FASB as part of its responsibilities under the securities laws. These oversight responsibilities include the Commission reviewing the FAF’s and the FASB’s annual budget and the FASB’s accounting support fee, providing views regarding the selection of FASB members, and, in certain circumstances, referring issues relating to accounting standards to the FASB or the EITF. The Commission and its staff do not, however, prohibit the FASB from addressing

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<sup>17</sup> See <http://www.fasb.org/intl/>.

<sup>18</sup> See Public Company Accounting Reform and Protection (Sarbanes-Oxley Act), Pub L. No. 107-204, 116 Stat. 745 (2002) (Sarbanes-Oxley Act) available at [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=107\\_cong\\_bills&docid=f:h3763enr.tst.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=107_cong_bills&docid=f:h3763enr.tst.pdf).

<sup>19</sup> See for example, Section 108(c) of the Sarbanes-Oxley Act, which states, “Nothing in this Act, including this section...shall be construed to impair or limit the authority of the Commission to establish accounting principles or standards for purposes of enforcement of the securities laws.”

topics of its choosing and do not dictate the outcome of specific FASB projects, so long as the FASB's conclusions are in the interest of investor protection.<sup>20</sup>

## B. Financial Reporting Outside the United States

Almost 100 countries now either require or allow the use of IFRS for the preparation of financial statements by listed companies. Countries that require or allow the use of IFRS by listed companies also may allow the use of IFRS for local regulatory or statutory financial reporting by non-listed companies. The European Union ("EU"), for example, has, under a regulation adopted in 2002, required companies incorporated in its Member States and whose securities are listed on an EU-regulated market to report their consolidated financial statements using endorsed IFRS beginning in 2005.<sup>21</sup> Other countries, including Australia<sup>22</sup> and New Zealand,<sup>23</sup> have adopted similar requirements mandating the use of IFRS by public companies. More countries have plans to adopt IFRS as their national accounting standards in the future, including Canada<sup>24</sup> and Israel.<sup>25</sup>

The Commission is aware of the transitions made by other countries to IFRS. For example, the vast majority of listed EU companies, including banks and insurance companies,

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<sup>20</sup> See the 2003 Policy Statement, supra note 15.

<sup>21</sup> See Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, Official Journal L 243, 11/09/2002 P. 0001-0004 available at [http://eur-lex.europa.eu/LexUriServ/site/en/oi/2002/l\\_243/l\\_24320020911en00010004.pdf](http://eur-lex.europa.eu/LexUriServ/site/en/oi/2002/l_243/l_24320020911en00010004.pdf).

<sup>22</sup> See Australia Financial Reporting Council, Bulletin 2002/4 (July 3, 2002) available at <http://www.frc.gov.au/bulletins/2002/04.asp>; Australia Financial Reporting Council, Bulletin 2004/3 (April 2004) available at <http://www.frc.gov.au/bulletins/2004/03.asp>.

<sup>23</sup> See Accounting Standards Review Board News Release "Stable Platform of Financial Standards Announced: NZ aligns with UK, Europe and Australia" available at <http://www.asrb.co.nz/documents/24Nov2004.doc>.

<sup>24</sup> See "Implementation Plan for Incorporating International Financial Reporting Standards into Canadian GAAP," supra note 11.

<sup>25</sup> See Israel Accounting Standard No. 29 "Adoption of International Financial Reporting Standards," stipulating that Israeli public companies that prepare their primary financial statements in accordance with Israeli GAAP are obliged to adopt IFRS unreservedly for years starting on January 1, 2008.

moved to IFRS in 2005 with the remainder transitioning in 2007. Australian-listed companies also moved to IFRS in 2005. Under these transition approaches, in essence all or almost all of the listed companies transitioned to IFRS at the same time. Some foreign regulators have published reports relating to the implementation of IFRS in their country. For example, the U.K. Financial Reporting Review Panel and the Autorité des Marchés Financiers of France have both published reports making observations on IFRS as applied in their jurisdictions.<sup>26</sup>

The actual process of adopting the evolving body of IFRS as published by the IASB in any country may be subject to a clearance process, which, in some instances, may involve regulatory or legislative approval. In some jurisdictions, the decision of policy makers has resulted in some requirements of IFRS as published by the IASB becoming optional. This results in a choice for issuers in these jurisdictions to use either their jurisdictional version of IFRS (e.g., titled “IFRS as adopted in Jurisdiction X”) or IFRS as published by the IASB; however, the two may not be mutually exclusive. In addition to adopting IFRS, policy makers also may choose to retain their national accounting standard setter to, among other things, establish standards for their local private capital market and to contribute to the IFRS standard setting work.

Other countries have chosen to continue to have their own national accounting standard setter establish accounting standards applicable to entities in their jurisdiction. The national accounting standard setter also may monitor and consider the standard setting work of the IASB and, as it considers appropriate, adapt national standards so as to conform to some portions or all of IFRS as published by the IASB. For example, in the United States, the FASB and the IASB

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<sup>26</sup> For the report of the U.K Financial Reporting Review Panel, see “Preliminary Report: IFRS Implementation” available at <http://www.frc.org.uk/images/uploaded/documents/IFRS%20Implementation%20-%20preliminary.pdf>. For the report of the AMF, see “Recommendations on accounting information reported in financial statements for 2006,” dated December 19, 2006, available at [http://www.amf-france.org/documents/general/7565\\_1.pdf](http://www.amf-france.org/documents/general/7565_1.pdf).

have adopted a best efforts convergence approach,<sup>27</sup> while Japan's accounting standard setter and the IASB have “. . . a joint project to reduce differences between International Financial Reporting Standards (IFRS) and Japanese accounting standards. . . .”<sup>28</sup>

### **C. The Possible Use of IFRS by U.S. Issuers**

The Commission's recent proposal to accept from foreign private issuers financial statements prepared in accordance with the English language version of IFRS as published by the IASB without a U.S. GAAP reconciliation raises the question of whether the Commission also should accept financial statements prepared in accordance with IFRS as published by the IASB from U.S. issuers. The Commission has identified at least two market forces that may provide incentives for some market participants to request in the future that the Commission accept financial statements prepared in accordance with IFRS as published by the IASB from U.S. issuers.

First, as a growing number of jurisdictions move to IFRS, more non-U.S. companies will report their financial results in accordance with IFRS. 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 to enable investors to compare U.S. issuers' financial results more efficiently with those of their competitors.

Second, as more jurisdictions accept financial statements prepared in accordance with IFRS for local regulatory or statutory filing purposes, U.S. issuers' subsidiaries based in these

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<sup>27</sup> See the Norwalk Agreement, *supra* note 6.

<sup>28</sup> Press Release, International Accounting Standards Board, “IASB and Accounting Standards Board of Japan Agree to Next Steps in Launching Joint Project for Convergence” (Jan. 21, 2005), available at <http://www.iasb.org/news>.

jurisdictions may be preparing and filing their local financial statements using IFRS as their basis of accounting. If U.S. issuers have a large number of subsidiaries reporting in this manner, then these U.S. issuers—most likely large, multinational corporations—may incur lower costs in preparing their consolidated financial statements using IFRS rather than U.S. GAAP. If an issuer can and does reallocate any financial statement preparation cost savings to higher earning opportunities and does not suffer a relatively greater increase in the cost of its capital as a result of using IFRS, investors will benefit in terms of a better rate of return.

The Commission anticipates that not all U.S. issuers will have incentives to use IFRS. For example, U.S. issuers without significant customers or operations outside the United States—which may tend to be smaller public companies—may not have the market incentives to prepare IFRS financial statements for the foreseeable future. Additionally, the Commission recognizes that there may be significant consequences to allowing U.S. issuers to prepare their financial statements in accordance with IFRS as published by the IASB. If the Commission were to accept financial statements prepared in accordance with IFRS as published by the IASB from U.S. issuers, then investors and market participants would have to be able to understand and work with both IFRS and U.S. GAAP when comparing among U.S. issuers because not all U.S. issuers are likely to elect to prepare IFRS financial statements. On a more practical level, a U.S. issuer may have contracts such as loan agreements that include covenants based upon U.S. GAAP financial measures or leases for which rental payments are a function of revenue as determined under U.S. GAAP. Similarly, U.S. issuers may use their financial statements as the basis for filings with other regulators and authorities (e.g., local and federal tax authorities, supervisory regulators) that may require U.S. GAAP financial information.

## **Questions**

1. Do investors, U.S. issuers, and market participants believe the Commission should allow U.S. issuers to prepare financial statements in accordance with IFRS as published by the IASB?
2. What would be the effects on the U.S. public capital market of some U.S. issuers reporting in accordance with IFRS and others in accordance with U.S. GAAP? Specifically, what would be the resulting consequences and opportunities, and for whom? For example, would capital formation in the U.S. public capital market be better facilitated? Would the cost of capital be reduced? Would comparative advantages be conferred upon those U.S. issuers who move to IFRS versus those U.S. issuers who do not (or feel they can not)? Would comparative advantages be conferred upon those investors who have the resources to learn two sets of accounting principles (IFRS and U.S. GAAP) as compared to those who do not?
3. What would be the effects on the U.S. public capital market of not affording the opportunity for U.S. issuers to report in accordance with either IFRS or U.S. GAAP? Specifically, what would be the resulting consequences and opportunities, and for whom? Would capital formation in the U.S. public capital market be better facilitated? Would the cost of capital be reduced? Alternatively, are there certain types of U.S. issuers for which the Commission should not afford this opportunity?
4. To what degree would investors and other market participants desire to and be able to understand and use financial statements of U.S. issuers prepared in accordance with IFRS? Would the desire and ability of an investor to understand and use such financial statements vary with factors such as the size and nature of the investor, the value of the investment, the market capitalization of the U.S. issuer, the industry to which it belongs, the trading volume of its securities, or any other factors?

5. What immediate, short-term or long-term incentives would a U.S. issuer have to prepare IFRS financial statements? Would the incentives differ by industry segment, geographic location of operations, where capital is raised, other demographic factors, or the aspect of the Commission’s filing requirements to which the U.S. issuer is subject?
6. What immediate, short-term or long-term barriers would a U.S. issuer encounter in seeking to prepare IFRS financial statements? For example, would the U.S. issuer’s other regulatory (e.g., banking, insurance, taxation) or contractual (e.g., loan covenants) financial reporting requirements present a barrier to moving to IFRS, and if so, to what degree?
7. Are there additional market forces that would provide incentives for market participants to want U.S. issuers to prepare IFRS financial statements?
8. Are there issues unique to whether investment companies should be given the choice of preparing financial statements in accordance with IFRS? What would the consequences be to investors and other market participants of providing investment companies with that choice?
9. Would giving U.S. issuers the opportunity to report in accordance with IFRS affect the standard setting role of the FASB? If so, why? If not, why not? What effect might there be on the development of U.S. GAAP?

#### **D. Convergence of IFRS and U.S. GAAP**

In October 2002, the FASB and the IASB announced the Norwalk Agreement, which formalized their commitment to the convergence of U.S. and international accounting standards.<sup>29</sup> In the Norwalk Agreement, the two bodies acknowledged their “best efforts” commitment to the development, “as soon as practicable,” of high quality, compatible

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<sup>29</sup> See the Norwalk Agreement, *supra* note 6.

accounting standards that could be used for both domestic and cross-border financial reporting and to the coordination of their future work programs to ensure that, once achieved, compatibility is maintained. In a 2006 Memorandum of Understanding, the FASB and the IASB indicated that a common set of high quality global standards remains the long-term strategic priority of both the FASB and the IASB and set out a work plan covering the next two years for convergence with specific long- and short-term projects.<sup>30</sup> Thus, convergence is the approach that for the last five years has been at work to align the financial reporting of U.S. issuers under U.S. GAAP with that of companies using IFRS. If there is a robust and active process in place for converging IFRS and U.S. GAAP, then it is likely that the current differences between them will be minimized in due course.

As part of their commitment to convergence, both the IASB and the FASB are working together on several major projects and have coordinated agendas so that major projects that one board takes up also may be taken up by the other board. Also, both boards have been working on “short-term convergence,” under which convergence will occur quickly in certain areas. This process allows for incremental improvements and the opportunity to eliminate differences without rethinking an issue entirely. If the IASB and the FASB conclude that a short-term convergence project is not sufficient, they will consider a broader standard setting project. The Commission fully supports continued progress on convergence.

If U.S. issuers were permitted to prepare IFRS financial statements, then some could conclude that the 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. Consequently, there is a risk

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<sup>30</sup> See “A Roadmap for Convergence between IFRS and U.S. GAAP – 2006-2008 Memorandum of Understanding between the FASB and the IASB”, February 27, 2006 (the 2006 Memorandum of Understanding) available at [http://72.3.243.42/intl/mou\\_02-27-06.pdf](http://72.3.243.42/intl/mou_02-27-06.pdf).

that constituents of the two boards may not continue to support convergence efforts if financial statements prepared by U.S. issuers in accordance with IFRS as published by the IASB are accepted by the Commission. If convergence does not occur, the future work of the IASB and the FASB may result in standards that are significantly different or that are not timely in their development.

### **Questions**

10. What are investors', issuers' and other market participants' opinions on the effectiveness of the processes of the IASB and the FASB for convergence? Are investors and other market participants satisfied with the convergence progress to date, and the robustness of the ongoing process for convergence?
11. How would the convergence work of the IASB and the FASB be affected, if at all, if the Commission were to accept IFRS financial statements from U.S. issuers? If the Commission were to accept IFRS financial statements from U.S. issuers, would market participants still have an incentive to support convergence work?
12. If IFRS financial statements were to be accepted from U.S. issuers and subsequently the IASB and the FASB were to reach substantially different conclusions in the convergence projects, what actions, if any, would the Commission need to take?

### **III. GLOBAL ACCOUNTING STANDARDS**

#### **A. The Case for a Single Set of Globally Accepted Accounting Standards**

The Commission recognizes 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. To date, the efforts in the United States have encompassed convergence, which involves the content of IFRS and U.S. GAAP coming together.

Key forces favoring a single set of globally accepted accounting standards include, but are not limited to, the continued expansion of the capital markets across national borders, and the desire by countries to achieve strong, stable and liquid capital markets to fuel economic growth. 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.

The use of a single set of accounting standards in the preparation of financial statements could help investors understand investment opportunities better than the use of multiple differing sets of national accounting standards. Without a single set of accounting standards, global investors must incur time, costs and effort to understand companies' financial statements so that they can adequately compare investment opportunities. In addition, presenting investors with financial information that varies substantially depending on which set of accounting standards is employed can cause confusion about the actual financial results of a company and result in a correspondingly adverse effect on investor confidence and cost of capital. Investor confidence in financial reporting also is likely to be stronger if the accounting standards used have been subject to appropriate due process and have gained wide acceptance in practice.

Embracing a common set of accounting standards also can lower costs for issuers. When companies access capital markets beyond their home jurisdiction, they incur additional costs if they must prepare financial statements using different sets of accounting standards. These include the costs for company personnel and auditors to learn, keep current with and comply with the requirements of multiple jurisdictions. In addition to issuers facing lower costs, standard setters collectively worldwide also may incur lower costs because the use of resources dedicated to standards writing can potentially be reduced if fewer separate accounting models are pursued.

### **Question**

13. Do investors, issuers and other market participants believe giving U.S. issuers the choice to prepare financial statements in accordance with IFRS as published by the IASB furthers the development of a single set of globally accepted accounting standards? Why or why not, and if so, how?

### **B. The International Accounting Standard Setter**

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. The IASB is based in London and is a stand-alone, privately funded accounting standard setting body established to develop global standards for financial reporting.<sup>31</sup> It is committed to “developing, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world’s capital markets and other users make

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<sup>31</sup> For more information on the structure and operation of the IASB, see [www.iasb.org](http://www.iasb.org).

economic decisions.”<sup>32</sup> The IASB assumed accounting standard setting responsibilities from the IASC in 2001 as the culmination of a reorganization of the IASC.<sup>33</sup> The IASC had issued 41 standards through December 2000. Upon its formation, the IASB recognized those standards and thus they form part of the body of IFRS.

The IASB is overseen by the International Accounting Standards Committee Foundation (“IASC Foundation”). The IASC Foundation is based in London and is a stand-alone, not-for-profit organization, incorporated in Delaware. It is responsible for the activities of the IASB and other work that centers on IFRS, such as initiatives related to translation of IFRS from the English language, education about IFRS and the development of Extensible Business Reporting Language (“XBRL”) taxonomies for IFRS. The IASC Foundation is governed by 22 trustees (“IASC Foundation Trustees”) whose backgrounds are geographically diverse.

To date, the IASC Foundation has financed IASB operations largely through voluntary contributions from companies, accounting firms, international organizations and central banks. Original commitments were made for the period 2001-2005 and have been extended for an additional two years through 2007. In June 2006, the IASC Foundation Trustees agreed on four elements that should govern the establishment of a funding approach designed to enable the IASC Foundation to remain a stand-alone, private-sector organization with the necessary resources to conduct its work in a timely fashion. The IASC Foundation Trustees determined that characteristics of the new scheme for 2008 would be:

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<sup>32</sup> IASC Foundation Constitution, Paragraph 2a (2005) available at <http://www.iasb.org/About+Us/About+the+Foundation/Constitution.htm>.

<sup>33</sup> For more information on the reorganization, see [http://archive.iasb.org.uk/uploaded\\_files/documents/8\\_210\\_swp\\_rep.pdf](http://archive.iasb.org.uk/uploaded_files/documents/8_210_swp_rep.pdf).

- Broad-based: Fewer than 200 companies and organizations participate in the current financing system. A sustainable long-term financing system must expand the base of support to include major participants in the world's capital markets, including official institutions, in order to ensure diversification of sources.
- Compelling: Any system must carry with it enough pressure to make free riding very difficult. This could be accomplished through a variety of means, including official support from the relevant regulatory authorities and formal approval by the collecting organizations.
- Open-ended: The financial commitments should be open-ended and not contingent on any particular action that would infringe on the independence of the IASC Foundation and the International Accounting Standards Board.
- Country-specific: The funding burden should be shared by the major economies of the world on a proportionate basis, using Gross Domestic Product as the determining factor of measurement. Each country should meet its designated target in a manner consistent with the principles above.<sup>34</sup>

The IASC Foundation Trustees continue to make progress in obtaining funding that satisfies those elements.

The IASC Foundation Trustees select members of the IASB to comprise “a group of people representing, within that group, the best available combination of technical expertise and diversity of international business and market experience in order to contribute to the development of high quality, global accounting standards.”<sup>35</sup> The fourteen members of the

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<sup>34</sup> <http://www.iasb.org/About+Us/About+the+Foundation/Future+Funding.htm>.

<sup>35</sup> IASC Foundation Constitution, Paragraph 19 (2005) available at <http://www.iasb.org/About+Us/About+the+Foundation/Constitution.htm>.

IASB—twelve full-time and two part-time—serve five-year terms subject to one re-appointment. They are required to sever all employment relationships and positions that may give rise to economic incentives that might compromise a member’s independent judgment in setting accounting standards. The IASB members come from eight countries and have a variety of backgrounds (e.g., auditors, users, preparers, and academics). In selecting IASB members, the IASC Foundation Trustees ensure that the IASB is not dominated by any particular constituency. Member selection is not based on geographic representation.

The IASB is free to choose and conduct projects necessary to promote convergence and develop high quality standards. The IASB solicits views and seeks input from the public throughout the standard setting process from selecting items for its agenda to developing and publishing a discussion paper and/or exposure draft and issuing a final standard. This input is derived from discussions at its project working group and roundtable meetings as well as written submissions from constituents. The IASB’s meetings are open to public observers. Comment letters, summaries of comments received on discussion papers and exposure drafts are made publicly available on the IASB website.<sup>36</sup> This transparent process is intended to enable the IASB to obtain relevant views from interested parties, and at the same time to conclude on final standards based on its own deliberations, and without undue external pressure. The IASB has an advisory council—the Standards Advisory Council (“SAC”)—that is composed of approximately 40 geographically diverse individuals drawn from countries that use IFRS and also those that do not. The IASB is assisted on IFRS interpretive matters by its International Financial Reporting Interpretations Committee (“IFRIC”).

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<sup>36</sup> See IASC Foundation Due Process Handbook for the IASB available at <http://www.iasb.org/NR/rdonlyres/7D97095E-96FD-4F1F-B7F2-366527CB4FA7/0/DueProcessHandbook.pdf>.

The Commission and its staff have for many years been involved in the IASB standard setting efforts and development of the interpretive guidance of IFRIC. The Commission through its staff serves as an Observer to the SAC.

The Commission staff directly participates in the development of IFRS primarily through the work of the International Organization of Securities Commissions (“IOSCO”) whose membership regulates more than 90% of the world's securities markets. IOSCO is the world's largest international cooperative forum for securities regulatory agencies.<sup>37</sup> IOSCO has taken and continues to take an active role in the standard setting process undertaken by the IASC and now the IASB. Through membership in IOSCO's Standing Committee on Multinational Disclosure and Accounting, the Commission staff assists in writing IOSCO comment letters on exposure drafts of standards published by the IASB and serves as one of the IOSCO representatives on several of the IASB project working groups. As one of two IOSCO representatives, the Commission staff serves as a non-voting Observer to IFRIC.

### **Questions**

14. Are investors, U.S. issuers and other market participants confident that IFRS have been, and will continue to be, issued through a robust process by a stand-alone standard setter, resulting in high quality accounting standards? Why or why not?
15. Would it make a difference to investors, U.S. issuers and other market participants whether the Commission officially recognized the accounting principles established by the IASB?
16. What are investors', U.S. issuers' and other market participants' views on how the nature of our relationship with the IASB, a relationship that is different and less direct than our

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<sup>37</sup> For more information about IOSCO, see <http://www.iosco.org>.

oversight role with the FASB, affects the Commission's responsibilities under the U.S. securities laws?

### C. The Commission's Previous Consideration of International Accounting Standards

For the past several decades the Commission has been actively promoting the development of a set of international accounting standards. In the 1981 Proposing Release, revisions to Form 20-F were proposed and the Commission expressed its support for the work of the IASC in formulating guidelines and international disclosure standards.<sup>38</sup> As part of the 1988 Policy Statement, the Commission urged "securities regulators and members of the accounting profession throughout the world [to] continue efforts to revise and adjust international accounting standards with the aim of increasing comparability and reducing cost" and reaffirmed its commitment to working with securities regulators around the world to achieve the goal of an efficient international securities market system.<sup>39</sup>

In a 1994 amendment to Form 20-F, the Commission accepted from foreign private issuers cash flow statements prepared in accordance with International Accounting Standards ("IAS") No. 7, Cash Flow Statements, without reconciliation to U.S. GAAP. In proposing that amendment, the Commission noted that "while there are differences between a cash flow statement prepared in accordance with IAS 7 and one prepared in accordance with U.S. GAAP...the Commission believes statements prepared in accordance with IAS 7 should provide an investor with adequate information regarding cash flows without the need for additional information or modification."<sup>40</sup>

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<sup>38</sup> See the 1981 Proposing Release, supra note 1.

<sup>39</sup> The 1988 Policy Statement, supra note 2.

<sup>40</sup> The Commission proposed these amendments in Release No. 33-7029 (November 3, 1993) and adopted them in Release No. 33-7053 (April 19, 1994) (the 1994 Adopting Release). Other examples in which the Commission

The Commission more closely examined efforts to develop high quality, comprehensive global accounting standards in a 1997 report undertaken at the direction of Congress.<sup>41</sup> In that report, the Commission noted that for issuers wishing to raise capital in more than one country, compliance with differing accounting requirements to be used in the preparation of financial statements increased compliance costs and created inefficiencies. As a step towards addressing these concerns and to increase the access of U.S. investors to foreign investments in the U.S. public capital market, the Commission encouraged the IASC’s efforts to develop a core set of accounting standards that could serve as a framework for financial reporting in cross-border offerings, and indicated an intent to remain active in the development of those standards. In that report, the Commission indicated that its evaluation of IASC core standards would involve an assessment of whether they constituted a comprehensive body of transparent, high quality standards that could be rigorously interpreted and applied.

In February 2000, the Commission issued a Concept Release on International Accounting Standards, seeking public comment on the elements necessary to encourage convergence towards a high quality global financial reporting framework while upholding the quality of financial reporting domestically.<sup>42</sup> In that release, the Commission described high quality standards as consisting of a “comprehensive set of neutral principles that require consistent, comparable, relevant and reliable information that is useful for investors, lenders and creditors, and others who make capital allocation decisions.”<sup>43</sup> The Commission also expressed the view that high

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amended its requirements for financial statements of foreign issuers to permit the use of certain IASC standards without reconciliation to U.S. GAAP are described in the 2000 Concept Release, *supra* note 4.

<sup>41</sup> See “Pursuant to Section 509(5) of the National Securities Markets Improvement Act of 1996 Report on Promoting Global Preeminence of American Securities Markets,” *supra* note 3.

<sup>42</sup> See the 2000 Concept Release, *supra* note 4.

<sup>43</sup> *Id.*

quality accounting standards “must be supported by an infrastructure that ensures that the standards are rigorously interpreted and applied.”<sup>44</sup>

In 2003, the Commission staff issued a study on the adoption of a principles-based accounting system, as mandated by Congress in the Sarbanes-Oxley Act.<sup>45</sup> The conclusion of that study was that an optimal approach to accounting standard setting would be based on a consistently applied conceptual framework and clearly stated objectives rather than solely on either rules or principles, one benefit of which would be the facilitation of greater convergence between U.S. GAAP and international accounting standards. By taking an objectives-based approach to convergence, the study noted, standard setters would be able to arrive at an agreement on a principle more quickly than would be possible for a detailed rule. The Commission staff’s report to Congress interpreted convergence as a “process of continuing discovery and opportunity to learn by both U.S. and international standard setters,” the benefits of which include greater comparability and improved capital formation globally.<sup>46</sup>

In 2004, a Deputy Chief Accountant joined a team of experienced professionals within the Office of the Chief Accountant, all devoted full-time to international work. The Commission staff tracks developments in IFRS similar to the manner in which it follows the work of the FASB and the EITF.

In 2005, the Commission adopted amendments to Form 20-F to permit foreign private issuers—for their first year of reporting under IFRS as published by the IASB—to file two years

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<sup>44</sup> Id.

<sup>45</sup> See 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 (July 25, 2003) available at <http://www.sec.gov/news/studies/principlesbasedstand.htm>.

<sup>46</sup> Id.

rather than three years of statements of income, changes in shareholders' equity and cash flows prepared in accordance with IFRS, with appropriate related disclosure.<sup>47</sup> The Commission recognized that these amendments would reduce costs to foreign private issuers and encourage their continued participation in the U.S. public capital market, which would benefit investors by increasing investment possibilities and furthering the efficient allocation of capital.

In February 2006, Chairman Cox reaffirmed his commitment to the "Roadmap" that was first described by a former Chief Accountant of the Commission in April 2005.<sup>48</sup> The Roadmap sets forth the goal of achieving one set of high quality, globally accepted accounting standards and suggested several considerations that could affect the achievement of that goal. It also discusses the possibility for the co-existence of financial statements prepared pursuant to IFRS and U.S. GAAP in the U.S. public capital market.

In March 2007, the Commission staff held a Roundtable discussion to seek input on the potential effects of the co-existence of IFRS and U.S. GAAP financial statements in the U.S. public capital market.<sup>49</sup> In particular, the Roundtable participants discussed the potential effect on the U.S. public capital market if foreign private issuers have the choice to file with the Commission financial statements prepared in accordance with IFRS as published by the IASB without reconciliation to U.S. GAAP.

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<sup>47</sup> See the 2005 Adopting Release, supra note 8.

<sup>48</sup> See SEC Press Release No. 2006-17, "Accounting Standards: SEC Chairman Cox and EU Commissioner McCreevy Affirm Commitment to Elimination of the Need for Reconciliation Requirements" (Feb. 8, 2006) (SEC Press Release No. 2006-17) available at <http://www.sec.gov/news/press/2006-17.htm>.

<sup>49</sup> The transcript of this SEC Roundtable is available at <http://www.sec.gov/spotlight/ifrsroadmap/ifrsroadmap-transcript.txt>

As previously discussed, on June 20, 2007, the Commission voted to issue a proposal to accept from foreign private issuers their financial statements prepared in accordance with IFRS as published by the IASB without reconciliation to U.S. GAAP.<sup>50</sup>

#### **IV. IFRS IMPLEMENTATION MATTERS FOR U.S. ISSUERS**

A move to a financial reporting environment in the U.S. public capital market in which U.S. issuers may provide investors with financial statements prepared in accordance with IFRS as published by the IASB would be a complex endeavor. There are many elements forming the infrastructure underpinning U.S. GAAP that keep it viable and functioning effectively. As is the case with U.S. GAAP, these underpinnings also would be relevant to keep IFRS viable and functioning effectively.

Although both the 2007 Proposing Release and this Concept Release relate to the use of IFRS as published by the IASB in Commission filings, our consideration of the use of IFRS by foreign private issuers and U.S. issuers gives rise to some differing issues.<sup>51</sup> For example, many foreign private issuers already have experience with the application of IFRS in practice because the use of IFRS is either required or permitted in their home market. Due to their experience, they are already confronting the potential difficulties that might face U.S. issuers, including for example, education and training of the accounting and auditing profession and other specialists such as actuaries and valuation experts.

##### **A. Education and Training**

The use of IFRS by U.S. issuers would create the need for effective training and education. U.S. issuers would likely use IFRS only if they and their auditors had been thoroughly trained in IFRS and if their investors and other users of their financial statements,

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<sup>50</sup> See the 2007 Proposing Release, *supra* note 9.

<sup>51</sup> *Id.*

such as analysts and rating agencies, understood IFRS. However, the education of most accountants in the United States—be it collegiate or continuing education—includes a comprehensive curriculum around U.S. GAAP but does not include a similar curriculum around IFRS. Most specialists, such as actuaries and valuation experts, who are engaged by management to assist in measuring certain assets and liabilities likely were not taught IFRS.

Consequently, all parties would likely need to undertake comprehensive training on IFRS. Professional associations and industry groups would need to integrate IFRS into their training materials, publications, testing and certification programs. Colleges and universities would need to include IFRS in their curricula. Furthermore, eventually it may be appropriate to include IFRS in the Uniform CPA Examination.

### **Questions**

17. In what ways might the Commission be able to assist in improving investors' ability to understand and use financial statements prepared in accordance with IFRS?
18. What are the incentives and barriers to adapting the training curricula for experienced professionals to address both IFRS and U.S. GAAP? Separate from ongoing training, how long might it take for a transition to occur? How much would it cost?
19. What are the incentives and barriers relevant to the college and university education system's ability to prepare its students for a U.S. public capital market in which U.S. issuers might report under IFRS? What are the incentives and barriers relevant to changing the content of the Uniform CPA Examination? How should the Commission address these incentives and barriers, if at all?

## **B. Application in Practice**

To provide effective financial reporting for investors, it is important that IFRS is properly applied in practice. In its considerations about the use of IFRS by foreign private issuers, the Commission has highlighted that proper application encompasses not only faithful adherence to the requirements of the standards, but also understandable standards such that across the spectrum of issuers those requirements are consistently understood and applied. As U.S. issuers do not file with us in IFRS today, in allowing U.S. issuers to do so, we would not have direct experience to assess the extent to which IFRS would be properly applied by U.S. issuers. Rather, we would make this assessment based upon the infrastructure that is in place in the United States to foster the high quality application of IFRS as well as, indirectly, the Commission's experience with the application of IFRS by foreign private issuers.

The Commission's practical experience with IFRS began with the foreign private issuers that have reported on this basis in their filings with the Commission for several years. Further, as previously discussed, during the course of 2006, approximately 110 foreign private issuers filed with the Commission annual reports on Form 20-F that contained financial statements representing that they comply with IFRS as published by the IASB. This representation may have accompanied a representation that the financial statements comply with a jurisdictional version of IFRS. The Commission staff has conducted reviews of those IFRS financial statements as part of its normal function of reviewing the periodic reports of publicly registered companies, consistent with its practice in reviewing filings from U.S. issuers and from foreign private issuers pursuant to the provisions of the Sarbanes-Oxley Act. In conducting its reviews

of IFRS financial statements, the staff made a number of comments regarding the application of IFRS, which have been brought to the attention of issuers through the comment process.<sup>52</sup>

In certain limited areas in which the IASB has yet to develop particular industry standards or in which IFRS permits disparate options, we have noted that the level of diversity that IFRS allows has manifested itself in the reporting practices of foreign private issuers. For example, there are two industry areas that have been identified by the IASB as lacking standards: insurance contracts and extractive activities. The IASB is in the process of developing a standard for insurance contracts to supplement IFRS 4, Insurance Contracts. IFRS 6, Exploration for and Evaluation of Mineral Resources, provides only limited guidance with respect to the accounting for exploration and evaluation activities undertaken by oil and gas and mining companies. On both of these projects, the IASB continues to make progress towards developing standards. Further, the body of IFRS does not have standards on the accounting for common control mergers, recapitalizations, reorganizations, acquisitions of minority interests and similar transactions.

With respect to investment companies, there are particular differences between IFRS and U.S. GAAP that would result in different presentations in practice. For example, IFRS does not require a schedule of investments or financial highlights; however, U.S. GAAP requires this information in an investment company's financial statements. As another example, IFRS does not provide an exemption from consolidation of subsidiaries in an investment company, whereas

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<sup>52</sup> See [http://www.sec.gov/divisions/corpfin/ifrs\\_staffobservations.htm](http://www.sec.gov/divisions/corpfin/ifrs_staffobservations.htm) for a link to the comment letters the staff issued on 2005 IFRS filings as well as a report outlining some of the staff's observations about those comments.

U.S. GAAP provides exemptions from consolidating subsidiaries in certain areas which could result, for example, in different treatment for master-feeder funds.<sup>53</sup>

### **Questions**

20. What issues would be encountered by U.S. issuers and auditors in the application of IFRS in practice within the context of the U.S. financial reporting environment?
21. How do differences between IFRS and U.S. GAAP bear on whether U.S. issuers, including investment companies, should be given the choice of preparing financial statements in accordance with IFRS?
22. What do issuers believe the cost of converting from U.S. GAAP to IFRS would be? How would one conclude that the benefits of converting justify those costs?

### **C. Auditing**

The use of IFRS by U.S. issuers would affect the audit firms that are engaged both to audit a U.S. issuer's financial statements and to report on the effectiveness of its internal controls. The use of IFRS would arguably affect both the strategic decisions of those firms as well as the quality control systems that those firms employ to conduct their audits.

From a strategic perspective, audit firms would need to determine whether it would be economically desirable to make the initial and ongoing investment necessary to ensure that audits of financial statements prepared in accordance with IFRS would be competently delivered and adequately supervised. This may be particularly challenging for smaller audit firms, which would need to balance the cost of the investments necessary to provide these services with the effects on their reputation that might result if they are unable or unwilling to do so.

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<sup>53</sup> A master-feeder fund is a two-tiered arrangement in which one or more "feeder" funds hold shares of a single "master" fund in accordance with Section 12(d)(1)(E) of the Investment Company Act of 1940.

For audit firms that believe the benefits of the investment outweigh the associated costs, elements of their systems of quality control such as their practices related to hiring, assigning personnel to engagements, professional development and advancement activities would need to be adjusted. Because U.S. auditors have less experience with IFRS than with U.S. GAAP, in the short-term, audit firms may encounter challenges in establishing policies and procedures to provide them with reasonable assurance that their personnel possess knowledge appropriate to perform audits of U.S. issuers that apply IFRS. Even with appropriate systems of quality control, however, additional auditing guidance still may be necessary for auditors to appropriately address issues related to the transition to reporting on IFRS financial statements.

Additionally, for the U.S. firms that are members of global audit networks, systems of quality control need to foster the high quality and consistent application of IFRS across national borders. If U.S. issuers were to apply IFRS, the U.S. firms of these global audit networks could be affected more than they are presently by the use of IFRS by audit clients of their foreign affiliates and by U.S. subsidiaries of those clients.

### **Questions**

23. Would audit firms be willing to provide audit services to U.S. issuers who prepare their financial statements in accordance with IFRS? How, if at all, would allowing U.S. issuers to prepare IFRS financial statements affect the current relative market shares of audit firms?
24. What factors, if any, might lead to concern about the quality of audits of IFRS financial statements of U.S. issuers?
25. Would any amendments or additions to auditing and other assurance standards be necessary if U.S. issuers were allowed to prepare IFRS financial statements?

26. How could global consistency in the application of IFRS be facilitated by auditors of U.S. issuers?

#### **D. Regulation**

The prospect of a single set of globally accepted accounting standards must occur within the reality that securities regulators all have national—as opposed to global—mandates for carrying out their work. As a result, U.S. issuers with listings in multiple securities markets could find more than one securities regulator commenting upon their IFRS financial statements, as many other securities regulators would have substantial experience in working with IFRS financial statements. 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. This infrastructure, which starts with IOSCO, is designed to foster the consistent and faithful application of IFRS around the world. Through its work, IOSCO continues to support the implementation and consistent application of IFRS in the global financial markets. In January 2007, IOSCO’s database for cataloguing and sharing securities regulators’ experiences on IFRS application around the world became operational.<sup>54</sup>

Further, on a bilateral basis, the Commission and the European Commission (“EC”) have agreed that regulators should endeavor to avoid conflicting conclusions regarding the application and enforcement of IFRS.<sup>55</sup> To this end, the Commission and the Committee of European Securities Regulators (“CESR”), which the EC has charged with evaluating the implementation of IFRS in the EU, published a work plan in August 2006.<sup>56</sup> This work plan covers information

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<sup>54</sup> See IOSCO Press Release “Regulators to Share Information on International Financial Reporting Standards” available at <http://www.iosco.org/news/pdf/IOSCONEWS92.pdf>.

<sup>55</sup> See SEC Press Release No. 2006-17, *supra* note 48.

<sup>56</sup> See “SEC and CESR Launch Work Plan Focused on Financial Reporting” SEC Press Release 2006-130 (August 2, 2006) available at <http://www.sec.gov/news/press/2006/2006-130.htm>.

sharing regarding IFRS implementation in regular meetings of the Commission staff and CESR-Fin, the group within CESR focused on financial reporting. The SEC-CESR work plan also contemplates the confidential exchange of issuer-specific information between CESR members and the Commission, with implementing protocols. In addition, CESR has established among its members a forum and a confidential database for participants to exchange views and share experiences with IFRS.<sup>57</sup> These mechanisms will allow securities regulators to endeavor to avoid conflicting decisions on IFRS application matters; nonetheless, each securities regulator retains the responsibility, and accordingly the right, to make its own final decisions.

Despite these mechanisms, a question arises as to what should be done, if anything, in circumstances where neither the IASB nor IFRIC has addressed a particular IFRS accounting issue that causes significant difficulties in practice. A securities regulator, including the Commission, may find it necessary as an interim measure to state a view on such an accounting issue. This is not new, as securities regulators have long been involved in resolving issues related to national accounting standards. If such a view were stated, the securities regulator subsequently could refer the accounting issue to the IASB or IFRIC for resolution of the issue for all constituencies. Any view expressed by the regulator may be rescinded upon the IASB or the IFRIC establishing authoritative literature addressing the issue. As referenced in the 2007 Proposing Release, if the Commission and the staff were to state a view on such an accounting issue, we would not expect it to be inconsistent with IFRS as published by the IASB, the interpretations provided by IFRIC, or the definitions, recognition criteria and measurement concepts in the IASB's Framework.

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<sup>57</sup> See "CESR publishes key information from its database of enforcement decisions taken by EU National Enforcers of financial information (IFRS)" CESR/07-163 (April 2007) available at <http://www.cesr-eu.org/index.php?page=groups&mac=0&id=13>.

## **Question**

27. Do you think that the information sharing infrastructure among securities regulators through both multilateral and bilateral platforms will improve securities regulators' ability to identify and address inconsistent and inaccurate applications of IFRS?

### **E. Integration with the Commission's Existing Requirements**

The Commission has contemplated the operational considerations with respect to accepting financial statements prepared in accordance with IFRS from foreign private issuers and described these considerations in the 2007 Proposing Release.<sup>58</sup> These operational considerations may be relevant to U.S. issuers if the Commission were to undertake rulemaking to accept financial statements prepared in accordance with IFRS as published by the IASB from U.S. issuers. However, the use of IFRS by U.S. issuers may give rise to additional issues. Additionally, the operational considerations applicable to investment companies may differ from those applicable to other entities, including foreign private issuers.

One area of consideration relating to the potential acceptance of IFRS financial statements would be how to address requirements for a foreign issuer that does not meet the definition of a foreign private issuer. A foreign issuer that is not a foreign private issuer (and is not a sovereign entity) is generally treated the same as a U.S. incorporated issuer under our rules and therefore must follow disclosure requirements applicable to U.S. issuers. If such a foreign issuer is subject to disclosure laws in another jurisdiction, it may find that it is required to prepare both IFRS financial statements for purposes of the other jurisdiction and U.S. GAAP financial statements for purposes of filings with the Commission.

Another area of consideration relates to Regulation S-X. The Commission did give consideration to the application of the provisions of Regulation S-X in the 2007 Proposing

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<sup>58</sup> See the 2007 Proposing Release, *supra* note 9.

Release, and we proposed that Regulation S-X would continue to apply to filings from foreign private issuers that include financial statements prepared in accordance with IFRS with the exception of the form and content portion of its financial statement requirements. For example, under Article 11 of Regulation S-X, issuers are required to prepare unaudited pro forma financial information to give effect as if a particular transaction, such as a significant recent or probable business combination, had occurred at the beginning of the period. In the 2007 Proposing Release, a foreign private issuer using IFRS would prepare the pro forma financial information by presenting its IFRS results and converting the financial statements of the business acquired (or to be acquired) into IFRS.

Currently U.S. issuers are subject to Regulation S-X. For example, a U.S. issuer applies Article 4 and either Article 5, 6, 7 or 9 of Regulation S-X, as applicable, in determining the form and content of its financial statements. These requirements provide a substantial degree of specificity around the items to be presented on the balance sheet and income statement. IFRS does not provide specific conventions as to the format or content of the income statement.<sup>59</sup>

Investment company financial statements have unique disclosure requirements. For example, Regulation S-X contains specific disclosure requirements for investment companies relating to investments in unaffiliated issuers, investments in affiliates, securities sold short, open option contracts written and investments other than securities.<sup>60</sup> Also, Rule 6-05 of Regulation S-X permits investment companies to include a Statement of Net Assets in lieu of the balance sheet if at least 95 percent of the investment company's total assets are represented by

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<sup>59</sup> IAS 1, Presentation of Financial Statements, provides guidance regarding minimum required line items and provides examples to which entities may refer.

<sup>60</sup> See Rules 12-12 through 12-14 of Regulation S-X [17 CFR 210.12-12, 12-12A, 12-12B, 12-12C, 12-13 and 12-14.]

investments in securities of unaffiliated issuers. The non-financial statement portion of an investment company’s shareholder report may require disclosures that are based on financial statement information. For example, investment companies must include an expense table and a graphical representation of holdings.<sup>61</sup> If investment companies were to prepare IFRS financial statements, questions related to these requirements would be relevant.

Regulation S-K contains the disclosure requirements for the non-financial statement portion of filings made with the Commission. Several non-financial statement disclosure items required by Regulation S-K make reference to specific U.S. GAAP pronouncements, including Financial Accounting Standards and interpretations thereof. For example, U.S. issuers are required to provide disclosure of off-balance sheet arrangements under Item 303(a)(4) of Regulation S-K, which expressly refers to FASB Interpretations. If U.S. issuers were to prepare IFRS financial statements, the Commission would need to consider questions related to the application of these provisions of Regulation S-K.

The Commission has provided its views and interpretations with respect to financial reporting in Accounting Series Releases (“ASRs”) and Financial Reporting Releases (“FRRs”). The SEC staff has given financial reporting guidance in various forms, including Staff Accounting Bulletins (“SABs”); Industry Guides; and Staff Frequently Asked Questions Publications. If U.S. issuers were to prepare IFRS financial statements, companies may find reference to these ASRs, FRRs, SABs, Industry Guides and other forms of U.S. GAAP guidance

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<sup>61</sup> See Items 22(d)(1), (2) of Form N-1A.

useful in the application of IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors.<sup>62</sup>

### **Questions**

28. If the Commission were to consider rulemaking to allow U.S. issuers to prepare IFRS financial statements, are there operational issues relative to existing Commission requirements on which additional guidance would be necessary and appropriate? Would it be appropriate to have differing applicability for U.S. issuers of the form and content provisions of Regulation S-X depending on whether they use IFRS in preparing their financial statements? Are there operational or other issues unique to investment companies? In preparing and auditing IFRS financial statements, should U.S. issuers and their auditors consider the existing guidance related to materiality and quantification of financial misstatements?
29. Should there be an accommodation for foreign issuers that are not foreign private issuers regardless of whether the Commission were to accept IFRS financial statements from U.S. issuers? Should any accommodation depend upon whether the foreign issuer is subject to the laws of another jurisdiction which requires the use of IFRS, or if the issuer had previously used IFRS financial statements in its filings with the Commission?

### **F. Transition and Timing**

The Commission has not set out a path of the steps to any possible acceptance of financial statements from U.S. issuers prepared in accordance with IFRS as published by the IASB, nor the potential timing of any such steps. Rather, with this Concept Release, the

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<sup>62</sup> Under IAS 8, in the absence of an IFRS standard or interpretation that specifically applies to a transaction or event, management should use its judgment in developing and applying a relevant and reliable accounting policy and look to other pronouncements in applying that judgment.

Commission seeks input to identify what would be necessary to reach an appropriate level of acceptance and understanding if the Commission were to allow U.S. issuers to prepare their financial statements in accordance with IFRS as published by the IASB. The U.S. public capital market has experienced neither the wide co-existence of financial statements prepared under two sets of accounting standards, nor a change of a group of U.S. issuers from reporting under one set of accounting standards to another. The closest we have come is experiencing the change that occurs when amendments to U.S. GAAP necessitate that all U.S. issuers change their accounting for a particular area. However, this type of change is of a lesser magnitude as it is limited to one topical area. A U.S. issuer's change to IFRS may affect many topical areas, depending upon the degree to which financial statements prepared under IFRS differ from financial statements prepared under U.S. GAAP for that U.S. issuer's facts and circumstances. A U.S. issuer's assessment and reporting of the effectiveness of its internal controls over financial reporting also would likely need to be adjusted to encompass the preparation of financial information in accordance with IFRS.

At a more detailed level, the Commission seeks input on U.S. issuers' potential first-time adoption of IFRS. Under such a change, a U.S. issuer's first set of IFRS financial statements would reflect the application of IFRS 1, First-Time Adoption of IFRS. IFRS 1 provides the requirements for transition from the prior basis of reporting, in this case U.S. GAAP, to IFRS including the restatement of and reconciliation from prior years' financial statements and the related disclosures.

### **Questions**

30. Who do commenters think should make the decision as to whether a U.S. issuer should switch to reporting in IFRS: a company's management, its board of directors or its

shareholders? What, if any, disclosure would be warranted to inform investors of the reasons for and the timing to implement such a decision? If management were to make the decision to switch to IFRS, do investors and market participants have any concerns with respect to management's reasons for that decision?

31. When would investors be ready to operate in a U.S. public capital market environment that allows the use of either IFRS or U.S. GAAP by U.S. issuers? When would auditors be ready? How about those with other supporting roles in the U.S. public capital market (e.g., underwriters, actuaries, valuation specialists, and so forth)? Is this conclusion affected by the amount of exposure to IFRS as it is being applied in practice by non-U.S. issuers?
32. Should the Commission establish the timing for when particular U.S. issuers could have the option to switch from preparing U.S. GAAP to IFRS financial statements? Should market forces dictate when a U.S. issuer would make the choice to switch from U.S. GAAP to IFRS financial statement reporting? If the former, what would be the best basis for the Commission's determination about timing?
33. Should the opportunity, if any, to switch to IFRS reporting be available to U.S. issuers only for a particular period of time? If so, why and for what period? At the end of that period of time, could commenters foresee a scenario under which it would be appropriate for the Commission to call for all remaining U.S. issuers to move their financial reporting to IFRS?
34. What difficulties, if any, do U.S. issuers anticipate in applying IFRS 1's requirements on first-time adoption of IFRS, including the requirements for restatement of and reconciliation from previous years' U.S. GAAP financial statements?
35. Would it be appropriate for U.S. issuers that move to IFRS to be allowed to switch back to U.S. GAAP? If so, under what conditions?

## **V. GENERAL REQUEST FOR COMMENTS**

In addition to the areas for comment identified above, we are interested in any other issues that commenters may wish to address and the benefits and costs relating to investors, issuers and other market participants of the possibility of accepting financial statements from U.S. issuers prepared in accordance with IFRS. Please be as specific as possible in your discussion and analysis of any additional issues. Where possible, please provide empirical data or observations to support or illustrate your comments.

By the Commission.

Nancy M. Morris  
Secretary

Dated: August 7, 2007.