

**INTERNATIONAL ACCOUNTING STANDARDS:  
OPPORTUNITIES, CHALLENGES, AND GLOBAL  
CONVERGENCE ISSUES**

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**HEARING**  
BEFORE THE  
SUBCOMMITTEE ON  
SECURITIES AND INSURANCE AND INVESTMENT  
OF THE  
COMMITTEE ON  
BANKING, HOUSING, AND URBAN AFFAIRS  
UNITED STATES SENATE  
ONE HUNDRED TENTH CONGRESS

FIRST SESSION

ON

OPPORTUNITIES, ISSUES, DIFFERENCES AND CHALLENGES AS THE U.S.  
AND INTERNATIONAL COUNTRIES MOVE TOWARDS CONVERGENCE OF  
IFRS WITH U.S. GAAP ALONG WITH THE IMPACT OF THESE PRO-  
POSED EFFORTS ON STAKEHOLDERS, INCLUDING REGULATORS, IN-  
VESTORS, AUDITORS AND COMPANIES

WEDNESDAY, OCTOBER 24, 2007

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# **INTERNATIONAL ACCOUNTING STANDARDS: OPPORTUNITIES, CHALLENGES, AND GLOBAL CONVERGENCE ISSUES**

**WEDNESDAY, OCTOBER 24, 2007**

U.S. SENATE,  
SUBCOMMITTEE ON SECURITIES, INSURANCE, AND  
INVESTMENT,  
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,  
*Washington, DC.*

The subcommittee met at 2:01 p.m., in room SD-538, Dirksen Senate Office Building, Senator Jack Reed (Chairman of the Subcommittee) presiding.

## **OPENING STATEMENT OF CHAIRMAN JACK REED**

Chairman REED. Let me call the hearing to order, and I want to thank the witnesses, obviously. This afternoon, we are holding a hearing on International Accounting Standards: Opportunities, Challenges, and Global Convergence Issues.

In recent months, the Securities and Exchange Commission has been prioritizing a number of regulatory reforms aimed at providing foreign private issuers greater access to the U.S. securities market. The Commission's proposals on the elimination of reconciliation to U.S. GAAP for foreign private issuers who apply the International Accounting Standards Board's version of International Financial Reporting Standards by 2009 is one such proposal. The Commission also issued a concept release which raises the possibility of U.S. companies having the option of filing their financial statements using either IFRS or U.S. GAAP and the establishment of an advisory committee to examine complexities in the U.S. financial reporting system.

These proposals are part of an effort to establish a single set of global accounting standards. There is no doubt a single set of high-quality accounting standards would benefit the United States as well as global markets. However, there are a number of significant issues which should be seriously considered. Most importantly, we need to ensure that this new single set of globally accepted accounting standards continues to protect and provide enhanced transparency to investors while promoting market integrity. This effort should incorporate the best of both standards to build the strongest protections for investors. This hearing is an opportunity to discuss progress, opportunities, and challenges in achieving convergence, but also to understand the impact of the SEC's proposals on investors, regulators, auditors, and businesses.

Increased globalization of markets and wide adoption of IFRS have been significant drivers of convergence. In recognition of this trend, in 2002 the FASB and the IASB agreed on a framework to eliminate differences between the two standards and to collaborate on future ones. This process has set a good balance for moving ahead with new standards, mindful of eventual convergence.

However, it is also important to note that these efforts provide not only truly comparable transparency and accurate financial results to investors, but they must also ensure comparable enforcement, interpretation, and implementation by regulators.

To that end, it is clear that some countries using IFRS are tailoring these accounting standards to their needs, resulting in jurisdictional versions of IFRS. In its review of more than 100 foreign private issuers' filings, the SEC has found that, "The vast majority of companies asserted compliance with a jurisdictional version." As Sir David Tweedie has suggested, the butting of these jurisdictional versions and variances will ultimately make true convergence difficult.

There are also significant questions raised in the area of implementation and interpretation of IFRS. Again, the SEC's study of the filings of firms reported on an IFRS basis in the U.S. found problems with the implementation of IFRS, including in the area of the presentation of cash-flow statements, accounting for common control mergers, recapitalizations, and similar transactions. According to an Ernst & Young report, because IFRS standards generally include only broad principles, preparers and auditors may in good faith interpret company-specific facts differently, which may result in different accounting treatments for the same or similar transactions among companies.

The issue of timing should also be considered carefully. Many prominent investors and users of financial statements, including the CFA Institute and FASB's Investors Technical Advisory Committee, ITAC, conclude that it is premature for the SEC to eliminate the reconciliation requirement. Some have asked, with the projected convergence of U.S. GAAP with IFRS by 2011 or 2012, why there is such a rush before the frameworks are substantially harmonized.

Additionally, while this effort may ease the filing requirements on foreign private issuers, IFRS is still in its infancy and may, in fact, be dependent upon reconciliation with U.S. GAAP. Moreover, some companies, like S&P, have indicated that if reconciliation is eliminated, it will continue to ask companies to provide reconciliation as part of a package of non-public information credit rating agencies' requests. If companies will indeed need to continue to prepare reconciliation information for credit rating agencies, why shouldn't the SEC require companies to provide that information to public investors as well?

There are numerous other issues which I hope we can address today, including: Will the elimination of reconciliation lead to the abandonment of convergence? How prepared are we for the greater use of IFRS standards in the U.S. markets when there are virtually no accounting programs in our universities that teach accounting students IFRS standards? And shouldn't we be concerned about the lack of knowledge of IFRS standards by U.S. accountants

and CFOs? What does this mean for the future role of the SEC and the FASB in providing oversight of U.S. financial reporting? Another key question is: Will investors be served by this change?

These are challenging times for financial regulators. If done properly, convergence of international accounting standards can have positive impact on U.S. and global markets. However, the events of recent months remind us of the ever increasing complexity of financial products and the interconnectedness of our financial systems. We have learned that complex financial products, while spreading risk, can also hide that risk. Financial reporting and accounting standards play a critical role in decoding some of that complexity to investors and regulators, and we must push to further enhance transparency to restore confidence in our markets. With our uniquely large retail base of investors and millions of individuals investing their futures in our capital markets, it is critical that we get this right and make certain that there are no unintended consequences.

Thank you for allowing me—this is an important topic, and I wanted to be expansive, and I think I have accomplished that. But now, Senator Allard, do you have an opening statement?

#### **STATEMENT OF SENATOR WAYNE ALLARD**

Senator ALLARD. I do. You did not think I would turn down an opportunity to speak, did you?

Chairman REED. No.

[Laughter.]

Senator ALLARD. Thank you, Mr. Chairman. I would like to thank you for holding this hearing to examine the convergence of the global accounting standards. Although accounting standards might not seem like the most exciting topic to some, it is important to the economic vitality of the United States and its trading partners around the world. Clear, accurate, consistent, and reliable accounting standards are necessary for investors to have the information necessary to make decisions. The quality of decisions generally cannot be better than the quality of the information on which they are based. Credible information has been an important foundation for the success of our capital markets, just as bad information is often at the heart of market meltdowns.

As markets become increasingly global, we have begun to examine accounting standards in an international context. The credibility of information is critical, but even credible information is more useful when it is comparable. Accordingly, discussion turned to international convergence of accounting standards. Convergence of accounting standards holds many possibilities, including the prospect of better transparency through greater comparability, reducing costs, improving market confidence, and improving market competitiveness. All of the opportunities are predicated upon credible standards from a credible standard-setting body. Anything less will be a step backwards for U.S. markets.

It is also important that U.S. regulators are mindful of the practical details in moving toward a global standard. The industry infrastructure must be in place to ensure that the new standards can be applied accurately and rigorously. This is particularly important

with regards to the many small and medium-sized accounting firms and businesses.

We have an excellent line-up of witnesses today, and I am certain that they will be able to help us better understand the potential benefits of global convergence, as well as highlighting the issues that must be addressed first. Their testimony will be very helpful in increasing the Subcommittee's understanding of the issue.

Finally, I would like to take this opportunity to offer a special welcome to one of my constituents, Lynn Turner. Mr. Turner served as the Chief Accountant of the Securities and Exchange Commission from July 1998 to August of 2001. He has also been a professor of accounting in the College of Business and the director of the Center for Quality Financial Reporting at Colorado State University. Mr. Turner currently serves as the Managing Director of Research at Glass Lewis.

Again, welcome, Lynn, and, again, thank you, Mr. Chairman.  
Chairman REED. Thank you, Senator Allard.  
Senator Bennett.

#### **STATEMENT OF SENATOR ROBERT F. BENNETT**

Senator BENNETT. Thank you very much, Mr. Chairman, for holding this hearing. This is not a very sexy issue. I realized that as I walked in, walked down the hall. My first reaction was the hearing must have been canceled because there was no pile of lobbyists in the hall. I come into the room, there are enough people in the room to justify the kind of attention we are giving it, but it does not get the sort of headlines that we often see.

That does not mean it is not important. That just means that it is a little complex and does not lend itself to the kinds of quick headlines and 1-minute sound bite summaries that we get on television than some of the other issues are.

I have been interested in this ever since I became aware of the Merkel Initiative and got involved in that at the Brussels forum earlier this year. I understand that Gunter Verheugen and Al Hubbard are meeting weekly on this issue. Mr. Hubbard is known to us in the United States as the President's Domestic Adviser or all-around economic guru. And when I asked what Gunter Verheugen, if I am pronouncing his name correctly—if not, I apologize. When I asked what his counterpart role was, they said he is basically the Al Hubbard for the EU.

This is an essential area, however dry and difficult it is to get into, and we need to move forward on it if we are going to have the maximum benefit that will come out of international trade.

The shorthand version of the difference between the American system and the European system is that the American system is rule based and the European system is principle based. I am congenitally more interested in a principle-based system than I am a rule-based system because a principle-based system is usually easier to adapt to the situation on the ground than rules that have been adopted in one set of circumstances that then have to be twisted and distorted to deal with another. And I am encouraged by the comment of Secretary Paulson, who said, if I can quote him correctly, "Where practical, of moving"—consideration should be

given “where practical, of moving toward a principle-based system,” noting that added complexity and more rules are not the answer for a system that needs to provide accurate and timely information to investors in a world where best-of-class companies are continually readjusting their business models to remain competitive.

The other issue, which we probably will not get into today but that broods over us and that we should be aware of as we are talking about this, is the lawsuit that is moving forward in the Supreme Court, shorthand term is *Stoneridge v. Scientific Atlanta*, and it is over the question of whether or not we can open up a window to allow foreign firms—to allow U.S. trial lawyers to get at foreign firms who are doing business with American firms on a basis that I, a non-lawyer, find absolutely incredible.

As the former Chancellor of the Exchequer in the United Kingdom, Norman Lamont, wrote in the Wall Street Journal earlier this month, he said, “Currently in the U.S., a company must actually make statements that are fraudulent to be the target of a private securities lawsuit. This is a clear line that discourages the kind of speculative or predatory litigation that has become a feature of American law. Should the plaintiffs in *Stoneridge* prevail, any non-U.S. business, whether it be a law firm, accounting firm, buyer, banker, or seller, that has U.S.-listed companies as customers, suppliers, or clients, we risk being sucked into America’s security litigation vortex.”

I can think of nothing more chilling to international trade than the concept of the class action suits being brought against non-U.S. businesses simply because they have a customer or a supplier who has made some kind of statement that the lawyers decide could be challenged. Bill Durack is on his way to jail, but the virus of excessive litigation is still very much with us, and I think that concern is a parallel concern to getting the accounting standards right. If we have the accounting standards right, it will make it easier to do business, and it will also act as some kind of a firewall against the litigation storm that I hope never breaks over this part of international trade.

So, again, Mr. Chairman, thank you for holding the hearing, and I look forward to hearing what the witnesses have to say.

Chairman REED. Thank you, Senator Bennett.  
Senator Schumer.

#### **STATEMENT OF SENATOR CHARLES E. SCHUMER**

Senator SCHUMER. Thank you, Mr. Chairman. I want to thank you and Senator Allard and all of the witnesses for being here on a very important subject, which is the convergence of the international accounting standards, because we live in an era, of course, that is defined by globalization of capital markets, a trend that was documented in the report that Mayor Bloomberg and I issued. And you cannot have a global market and 22 different accounting standards. It is inefficient, at best, and fraught with peril, at worst.

Our report made a whole number of recommendations to help the United States maintain its historic role as the leader in global financial markets, and one of these was the accelerated convergence of U.S. Generally Accepted Accounting Principles, GAAP, with International Financial Reporting Standards, IFRS.

So in today's world, where a typical investment consists often of a Russian investor purchasing shares in a Japanese company listed on an American stock exchange, you just cannot have different auditing standards for different countries. Globalization will only continue to accelerated, making the need for this greater than ever before. And the fact that IFRS is well on its way to becoming the global language which the rest of the world uses means that we here in America have to get with it and try to do our best to integrate the standards.

When it comes to the way companies balance their books, Wall Street and the rest of the world should be on the same page. And IFRS will be the language of worldwide business for future generations. We have to start allowing it to be spoken in the U.S., and eventually U.S. businesses must be allowed to speak this language themselves. So I am glad to see FASB and the IASB working together toward the convergence of their accounting standards.

With that, Mr. Chairman, I will ask that the rest of my statement be read into the record, and I look forward to reading—I will not be able to stay, but reading the testimony of the witness.

Chairman REED. Without objection, all statements will be made part of the record.

Now, let me introduce the panel. First, Sir David Tweedie, Chairman of the International Accounting Standards Board. Thank you, Sir David.

Mr. Conrad Hewitt, Chief Accountant, Securities and Exchange Commission; Mr. John White, Director of the Office of Corporate Finance, Securities and Exchange Commission; and Mr. Robert Herz, who is the Chairman of the Financial Accounting Standards Board.

I want to specifically recognize Sir David for his strong leadership while serving as the Chairman of the International Accounting Standards Board during a very critical period. Also, thank you, Sir David, for the assistance you have given this Committee on numerous occasions. We thank you very much.

I also understand that this is Mr. Hewitt's birthday, so we are all going to resist the temptation to sing but wish you the best, and thank you for sharing some of your special day with us, Mr. Hewitt.

Sir David.

**STATEMENT OF SIR DAVID TWEEDIE, CHAIRMAN,  
INTERNATIONAL ACCOUNTING STANDARDS BOARD**

Mr. TWEEDIE. Thank you, Mr. Chairman, Ranking Member Al-  
lard, and Senators Bennett and Schumer.

As I said when I first appeared before the Banking Committee, it is a great privilege to be back here in the Colonies to continue my missionary work—

[Laughter.]

To discuss the relevance of international reporting standards in the United States and in the international markets in general. This week, we have just finished our second meeting of the year with the FASB. It went very well, probably one of our best ones, and we are looking very closely at the SEC's deliberations on the Proposed Rule and Concept Released.

I am very glad that Conrad Hewitt, Bob Herz, and John White are here with me because the FASB and the SEC were instrumental in forming the IASB. Its structure, governance, and independence are modeled on that of the FASB. And, in fact, if anything has gone wrong, it is entirely due to Lynn Turner, who was a major——

[Laughter.]

A major instrument.

When I first appeared before the Committee, we had hardly been going for about a year, and there were very few countries that actually used our standards. But the objective which was set for us by the SEC and FASB was very clear. We had to come up with one single set of high-quality global standards, so it did not matter the transaction took place here in Washington or in Winnipeg, Warsaw, or Wellington. We should get the same answer. And, historically, that has not been the case.

The European Union started us off, 25 countries which previously had 26 different ways of accounting, because they used U.S. GAAP and international standards as well. And it told us how difficult it was to meld international standards together. Cultures are different. In Britain, everything is permitted unless it is prohibited. In Germany, it is the other way around; everything is prohibited unless it is permitted. In the Netherlands, everything is prohibited even if it is permitted. And in France, of course, everything is permitted especially if it is prohibited.

[Laughter.]

But now we have 108 countries that are using our standards. Australia, Hong Kong, New Zealand, and South Africa all joined Europe very early on. Brazil, China, India, and Russia have agreed to take our standards. And, similarly, Chile, Canada, Israel and Korea have all recently decided to make the tie, as has Japan, who did it just a month or so ago. So there is clear momentum toward having one single set of standards.

It is understandable that the U.S. was not among that group because you have a well-established and respected standard-setting body, a high degree of transparency in your standards that have been tested over a long period of time, and a high degree of acceptance internationally.

However, the world is changing. The realities of globalization, the integration of the capital markets, and the emergence of IFRSs as a viable and high-quality set of standards are changing the policy equation. Senator Schumer's report has documented these issues.

The U.S. requirement for reconciliation, as the Committee will be well aware, has caused resentment among non-U.S. companies forced to go through the reconciliation exercise. The hope of many of the registrants in using IFRS was that eventually it would become the passport to all markets, including that of the United States.

I obviously have a bias on what I would like the U.S. to do in this situation, but it is really for the SEC and Congress to decide that. But that is why we place such a high priority on convergence with the United States.

The benefits to the U.S. companies are similar to those in Europe. Many of their subsidiaries are already reporting in IFRS terms. All this has to be converted back to U.S. GAAP. For U.S. investors, they now will be more aware of the accounting in other countries. Previously, when you were faced with a myriad of different systems, it is very difficult. Now you should be faced with one major system worldwide.

For auditors, a single set of accounting standards helps training and helps people to understand, and for regulators, they, too, are dealing with just one set of standards rather than many.

One of the questions is that if we have competition in accounting standards, will there be a race to the bottom. I always think of John Glenn when I think of that. He always said, as he hurtled around space in his capsule, the thought that was ever prevalent in his mind was the fact that every single component in that capsule had been supplied by the lowest bidder. Well, we are not going to have a race to the bottom. In fact, that is why we are working together, and Bob's intention and mine with our boards is to have a "best of breed" convergence program.

Irrespective of the SEC decision, our convergence work will be undertaken. It is very important to us both. The early progress we made after Norwalk has gone into the Memorandum of Understanding, and we now have 11 major subjects that we are dealing with which are critical to the general well-being of financial markets: consolidations, post-retirement benefits, leasing and financial instruments, among others. This is a critical aspect of the financial infrastructure we have to fix.

Our joint efforts to produce joint standards on these issues signal a double win and—improved accounting for both of us in important areas and the elimination of differences between U.S. GAAP and international standards.

It is understandable that those affected by the standard-setting process will want to know how the future will look. We intend, Bob and I, to make sure our joint standards are different from our existing IFRS and U.S. standards. We want these to be principle based.

Basically, are they written in plain English? Can they be explained in a matter of a minute or so? Does it make intuitive sense? And does management believe it actually helps them manage their business?

These standards should eliminate anti-abuse provisions. A tough principle is very difficult to get around; whereas, if you have if A, B, and C happens, the answer is X. The financial engineers come up with B, C, and D and claim a different answer.

It will rely on judgment, and we will have to force people back to the core principles. We have to make sure we do not give too much guidance. Do we really need this guidance or can we actually rely on judgment?

That is the vision we have for the future of the convergence. It will not be easy. The Lord's Prayer has 57 words; the Ten Commandments, 297; the U.S. Declaration of Independence—big mistake that was—300 words; and the European Directive on the import of caramel products, 26,911 words.

[Laughter.]

I know several commentators have said if the reconciliation is removed, a major incentive of convergence goes. That is not the case. We have made an agreement with the SEC and the FASB we will converge on this program. We intend to keep that agreement. And if we did not, we would end up with two sets of standards. That is not in our constitution, and it is not our objective.

So I am optimistic, Mr. Chairman, about what is going to happen. There are some challenges ahead. We must resist countries' having national versions of IFRS, and we are working on that with the regulators to make sure we know exactly what they have done. We are trying to make sure that the interpretation is done through our Interpretation Committee, and the regulators are helping in that. And, finally, we want to try and ensure the enforcement is good. So the regulators are very important to us in this work.

We are at a crucial point in the development of IFRSs. The United States has played a huge part in encouraging the adoption of our standards throughout the world. The world's fastest growing economies are converging with IFRS. But this is no time to rest on our laurels. We recognize the effect of our work on the economy of the world, and we are delighted that U.S. policymakers are now considering options for the U.S. markets.

We appreciate, sir, your continued interest in international convergence, and we are committed to doing all we can to complete the work program in the MOU.

We are at an interesting stage. When I was at school, I played in goal for my school's soccer team, and in a cup semifinal, we were winning 1-0 with a few moments to go. One of the opposing forwards came through and hit the ball so hard, it went past me before I could move. But, fortunately, it hit a goalpost and rebounded to him, and he hit it again. And this time, I threw myself to the left and turned the ball around the post. And my teammates were ecstatic. What they did not realize was I was trying to save his first shot.

[Laughter.]

We will not get a second chance. This is our best chance ever, with Bob's help, to merge our two sets of standards and come up with the world's best. And that is what we are trying to do.

Thank you, sir.

Chairman REED. Thank you, Sir David.

Mr. Herz.

**STATEMENT OF ROBERT H. HERZ, CHAIRMAN,  
FINANCIAL ACCOUNTING STANDARDS BOARD**

Mr. HERZ. Thank you, Chairman Reed, Ranking Member Allard, and Members of the Subcommittee. I am Bob Herz, Chairman of the FASB, and thank you for asking us to participate in this hearing today. And thanks for throwing a little gathering to celebrate Con Hewitt's birthday with all his friends, too.

I would also like to take this opportunity to thank both the Banking Committee and this Subcommittee for your support over the years of the FASB, of independent accounting standard setting, and our international convergence activities.

Recent years have been marked by a clearly continuing, rapid, and accelerating globalization of capital markets, cross-border in-

vesting, and international capital-raising. We, therefore, agree with both the IASB and the SEC that a widely used single set of high-quality international accounting standards for listed companies around the world would greatly benefit the global capital markets and investors. The ultimate goal, we believe is a common, high-quality global financial reporting system across the capital markets of the world.

However, achieving the ideal system requires improvements and convergence in various elements of the infrastructure supporting the international capital markets, including a single set of common, high-quality accounting standards. But improvements in convergence are also needed in disclosure requirements; regulatory, enforcement, and corporate governance regimes; auditing standards and practices; and education of capital market participants.

In regard to accounting standards, the FASB, with the IASB and other major national standard setters, has been working for many years to improve and converge accounting standards. The pace of these convergence activities has increased significantly since the formation of the IASB in 2001, and there has been a clear movement in many parts of the world toward IFRS. Many jurisdictions around the world have mandated or permit the use of IFRS, and many others are planning to move in this direction. However, in some of these jurisdictions, the standards issued by the IASB have been modified, resulting in so-called as-adopted versions of IFRS, and also differences in implementation between countries have resulted in national variants of IFRS.

In the U.S., we at the FASB and IASB committed in 2002 to the goal of developing a set of high-quality, compatible standards. Our 2002 Norwalk Agreement described the plans for achieving that goal, including working together on major projects and eliminating more narrow differences in other areas. Our 2006 Memorandum of Understanding added specific milestones to that effort.

Since 2002, we have made steady progress toward convergence, but that effort is not yet complete, with work in process in a number of key areas. In addition, differences between U.S. GAAP and IFRS remain right now, which can result in significant differences in the reported numbers under the two sets of standards. Thus, it will likely take more years to reach the goal of full convergence using our current approach.

Accordingly, and in light of the growing use of IFRS in many other parts of the world, we believe that now may be the appropriate time to consider ways to accelerate the convergence effort and the movement in the U.S. toward IFRS. For to be truly international, any set of standards would need to be adopted and used in the world's largest capital market—the United States.

Thus, we believe that planning for a transition of U.S. public companies to an improved version of IFRS would be an effective and logical way forward to achieving the goal of a set of common, high-quality global standards.

However, a smooth transition will not occur by accident, and to plan for and manage this change, we suggest that a blueprint for coordinating and completing the transition should be developed and agreed to by all major stakeholders in the process. The blueprint should identify an orderly and cost-effective approach to

transitioning to an improved version of IFRS and should set a target date or dates for U.S. registrants to move the standards toward IFRS, allowing adequate time for making the many necessary changes.

The plan should also address needed changes on the international front, including those necessary to bolster the IASB as a global standard setter and to reduce or eliminate the as-adopted versions of IFRS that have emerged. And it should identify and establish timetables to accomplish the many changes to the U.S. financial reporting infrastructure that will be necessary to support the move to IFRS. Such changes will likely take a number of years to complete, during which time the FASB and the IASB will continue our joint efforts to develop common, high-quality standards in key areas where both existing U.S. GAAP and IFRS are currently deficient.

In other areas that are not the subject of those joint improvement projects, we envisage that U.S. public companies would adopt the IFRS standards as is based on an established timetable. We believe that this sort of well-planned approach would provide an orderly and effective transition of U.S. public companies into the global reporting system.

Let me now briefly turn to the two SEC releases relating to the reconciliation requirement and to the possible use of IFRS in the U.S. I commend the SEC for bringing forward these timely and important issues.

The SEC Concept Release seeks comments on whether U.S. issuers should be given a choice between U.S. GAAP and IFRS. We are generally opposed to allowing companies to elect different reporting regimes because of the added cost and complexity such choices create for investors and the added cost and complexity involved in developing a U.S. financial reporting and educational infrastructure to support a two-GAAP system for U.S. public companies.

Accordingly, instead of permitting U.S. companies an open-ended choice between IFRS and U.S. GAAP for an extended period of time, we believe it would be preferable to move all U.S. public companies to an improved version of IFRS over a transition period following the blueprint we are advocating be developed.

Finally, on the more imminent question of whether the SEC should remove the reconciliation requirement for foreign private issuers that use IFRS, we are aware of a variety of views on this issue. We believe that either way the decision in the near future whether or not to eliminate the reconciliation requirement will have important implications for the continued development of a global reporting system. On the one hand, we certainly acknowledge the concerns of those in the United States who believe that dropping the reconciliation would be premature and would result in a loss of information that some investors and other users clearly find important and useful. On the other hand, this change only relates to relatively small number of SEC registrants in relation to the overall size of our capital market. And maintaining the current reconciliation requirement could be viewed by many parties outside this country as a clear signal that the U.S. is not truly interested in participating in an international reporting system.

Conversely, we also believe that once the reconciliation requirement is eliminated, there are some parties in other countries who have viewed the convergence effort between the IASB and the FASB as the price of getting the SEC to eliminate the reconciliation, will see no further benefit in continued convergence between IFRS and U.S. GAAP, and will call for a cessation of further improvements to IFRS, particularly those designed to achieve convergence with U.S. So in removing the reconciliation requirements, we feel that it would be important to make it clear that getting to a single set of high-quality international standards remains the ultimate goal and that further convergence and improvement of standards is necessary to achieve that goal.

Last, we strongly agree with the SEC proposal that the reconciliation requirement only be eliminated for those foreign private issuers that fully apply IFRS as issued by the IASB and not for those who use an as-adopted version of IFRS. To do otherwise would, in our view, be inconsistent with the goal of getting to a single set of global accounting standards.

In conclusion, we are firmly committed to continuing to work with the IASB, the SEC, and others to achieve a single set of high-quality international accounting standards that will benefit investors and the capital markets domestically and across the world.

Thank you.

Chairman REED. Thank you very much, Mr. Herz.

Mr. Hewitt.

**STATEMENT OF CONRAD W. HEWITT, CHIEF ACCOUNTANT,  
SECURITIES AND EXCHANGE COMMISSION**

Mr. HEWITT. Chairman Reed, Ranking Member Allard, Senator Bennett, thank you for the opportunity to testify today, on my birthday, on behalf of the Securities and Exchange Commission concerning ongoing efforts to foster development and use of high-quality, globally accepted accounting standards. As the SEC's Chief Accountant, I advise the Commission on accounting and auditing matters.

The Commission has a long history of supporting the goal of high-quality, globally accepted accounting standards. The reason for the Commission's support is that the global accounting standards help investors to understand investment opportunities more clearly and increase access to foreign investment opportunities. Global accounting standards reduce costs for issuers, who no longer have to incur the expense of preparing financial statements using differing sets of accounting standards. Also, lower costs facilitate cross-border capital formation as well as benefit shareholders, who ultimately bear the burden of the entire cost of the financial reporting system.

The SEC has pursued the goal of high-quality, globally accepted accounting standards through a variety of international multilateral and bilateral venues. This includes the International Organization of Securities Commissions, a bilateral dialog with the Committee of European Securities Regulators, and with fellow securities regulators from countries that have moved to or are moving to IFRS reporting. The SEC's staff has also participated, in some cases on behalf of IOSCO, as an observer to the International Ac-

counting Standards Board's Advisory Council, its Interpretations Committee, and certain of its working groups.

Over 100 countries now either require or permit the use of IFRS for the preparation of financial statements by their domestic listed companies. Under a regulation adopted in 2002, the EU required its listed companies to report using endorsed IFRS beginning in 2005. Japan's accounting standard setter, with whom I met on Friday of last week, and the IASB have agreed to work to accelerate convergence between Japanese accounting standards and IFRS, with certain interim target dates in 2008 and 2011. Other countries, such as China, Israel, and India, have either begun to move toward the use of IFRS—that is, China and Israel—or have announced plans to do so—India's case. Closer to home, Canada has announced plans to move to IFRS reporting around 2011, while we understand Mexico is working to incorporate IFRS aligned content into Mexican accounting standards. The incentives and reasons for these national IFRS policy decisions, as well as the method and timing of the transition to IFRS reporting for companies in a particular country, are as varied as the profiles of the countries involved.

This summer, the Commission began a process to determine whether it is appropriate and timely to allow foreign and domestic registrants the alternative to submit for SEC filing purposes financial statements prepared in accordance with the International Financial Reporting Standards as published by the International Accounting Standards Board. I defer to my colleague John White to discuss these proposals in detail.

Given the increasing globalization of capital markets, it is imperative that the Commission be vigilant in keeping our regulatory standards up-to-date for the protection of investors, for the maintenance of efficient and orderly markets, and for the promotion of capital formation. Our ongoing work in the area of accounting and financial reporting is an important part of the Commission's wide-ranging efforts in this regard.

Thank you for the opportunity for me to appear before you today, and we will be pleased to respond to any of your questions.

Chairman REED. Thank you, Mr. Hewitt.

I understand, Mr. White, you are not going to make a statement but you are prepared for questions.

Mr. WHITE. Actually, I had a statement.

Chairman REED. Well, then, please.

Mr. WHITE. I had a short statement to fill in the details than Conrad had laid out.

Chairman REED. Please fill in the details. Go ahead, sir.

**STATEMENT OF JOHN W. WHITE, DIRECTOR, DIVISION OF CORPORATION FINANCE, SECURITIES AND EXCHANGE COMMISSION**

Mr. WHITE. Thank you also for the opportunity to testify before you today. I am the Director of the Division of Corporation Finance, and we are the group at the SEC responsible for overseeing disclosures of domestic and foreign reporting companies in the United States. And what I wanted to do was describe the two releases that the Commission put out this summer regarding the po-

tential use in the U.S. capital markets of international reporting standards as published by the IASB. And I particularly underline as published by the IASB.

First, a proposal was issued in July to allow foreign private issuers to use IFRS financial statements without a U.S. GAAP reconciliation. Under the Commission's current requirements, foreign private issuers have two alternatives when preparing their financial statements. They can either prepare them under U.S. GAAP or, alternatively, they can prepare them under IFRS or under a national GAAP, and provide in either of those cases reconciling information to U.S. GAAP. That was the first release.

Second, in August, the Commission issued a concept release to explore a more far-reaching project, and that is the possibility of giving our own domestic issuers the alternative of preparing their financial statements using IFRS. Today, of course, domestic issuers may only use U.S. GAAP.

The comment period on the foreign private issuer proposal ended in late September. The comment period on the U.S. issuer concept release is actually still open and closes in mid-November.

These releases address the core policy issue of what role, if any, the use of IFRS should play in the U.S. public capital markets. And with any policy issue, any policy decision like this, a determination requires that we give due consideration at the Commission to both the benefits and the costs.

In all of the Commission's work to date, a consistent premise has been that investors are better served by having available high-quality financial information across issuers, regardless of their domicile. This obviously aids investors in making informed decisions in allocating their capital among competing alternatives. Investors also benefit if the costs of compliance are reduced for issuers entering and staying in our capital markets, as this opens up additional investment opportunities.

Of course, adjusting to a new set of accounting standards also presents issues to consider. With respect to the foreign private issuer proposal, investors would be required to work with IFRS financial statements directly without the benefit of U.S. GAAP reconciliation. But the impact of this loss of reconciliation depends both on the extent to which investors are currently using that reconciliation and also the extent to which U.S. GAAP and IFRS continue to differ.

The impact also depends on the number of issuers who are actually using the alternative. And just to give you a few numbers to work with as we proceed today, currently there are approximately 110 foreign private issuers who prepare their financial statements using IFRS as published by the IASB and, therefore, would be eligible for the proposal that was put out this summer. There are an additional 70 foreign private issuers that prepare their financial statements using a jurisdictional adaptation, a jurisdictional variation of IFRS. So it is that 110 and the additional 70.

The additional 70 would be eligible if they were able to state that their financial statements were prepared in accordance with IFRS as published by the IASB. But I suppose we should also look a little bit ahead because, between now and 2011, there are a couple of other jurisdictions who we expect will come online. We have 100

foreign private issuers from Israel and 500 from Canada, and as Conrad alluded to, they are coming online in the future.

So that is kind of the two proposals. I guess the only other thing to comment on is we have received 120 comment letters, which is actually quite a few, so far on the foreign private issuer release, and the comment letters are still coming in on the U.S. issuer concept release. We are actively in the process of analyzing those comment letters. They raise a lot of important issues. When we finish that review, Conrad and I will be developing a recommendation for the Commission, but we still have to finish—well, the letters all have to get in, and we have to finish that review.

So that is really where we stand on the two releases, and I and Conrad are ready to answer your questions.

Chairman REED. Thank you very much.

Let me begin by echoing the sentiment that Senator Bennett suggested initially. This is not drawing a huge crowd, a throng, but this is one of the most important issues that could be decided over the next several years because of the centrality of accounting in every major business transaction. Many times in transactions it is finally the accountant who makes the determination of what can be done and what cannot be done—not the lawyer, not even the business leader. And it is critical what you are doing, and we want to make sure it is done properly, and that is the purpose of this hearing today.

Let me follow up, Mr. White, with just the implication of your final point. So the universe of issuers that could potentially use IFRS without reconciliation, if it is dropped, is about on the order of, say, 700 or 800 or so. Is that—or, alternatively, do you see a big use of IFRS alone without reconciliation?

Mr. WHITE. Well, just in total numbers, there are about 1,100 foreign private issuers. I think our assumption would be that most foreign private issuers that were eligible to report without reconciliation would do so, although, in fact, we do have some companies that report in IFRS in their own jurisdictions and still report in U.S. GAAP in the United States.

Also, that 500 number from Canada, a large number of the Canadian companies report directly in U.S. GAAP and do not go through the reconciliation process today. I do not know that I would assume that they would switch.

Chairman REED. One of the issues of having accounting standards is comparability between issuers, and an obvious question is if you have some that are reporting in IFRS, which is not yet fully reconciled with GAAP, how much more difficult is it for investors and analysts to make judgments between companies that are reporting with different accounting schemes. I presume there would be some cases of material differences the way the accounting is treated.

Mr. WHITE. I mean, there certainly are today differences between IFRS and U.S. GAAP, but if we just kind of step back for a second, obviously the goal here is a single set of high-quality global standards.

What we are talking about in terms of eliminating the reconciliation requirement is having a period of time when there would be two sets of accounting standards for foreign private issuers in the

United States. They would both be high-quality standards, but there would be two different sets. The purpose, obviously, even though it applies to a pretty small group of companies, would be to allow U.S. investors to get familiar with IFRS directly to foster more understanding of it, and certainly I think to allow the infrastructure to build. There have been references, I think in your opening remarks, about the colleges and the schools and all. But, I mean, we are talking about initially less than 200 companies out of, you know, a total, I think, of 11,000 public companies that report in the United States would be doing this. So it is kind of an opening step.

Chairman REED. Let me ask a final question, and then I want the panel to comment on sort of the more general issues that we have been discussing. Would you consider any special disclosures—not full reconciliation but special disclosures for these companies that are now reporting exclusively in IFRS?

Mr. WHITE. One of the questions that was asked in the proposing release was whether if companies did not provide reconciliation, whether we should have additional disclosures about the differences, the principal differences. So that is one of the questions we have asked and we will get comment on and consider in the process.

Chairman REED. Let me just go down. Mr. Hewitt, there are a couple, I think, very obvious issues. One is the consequences of dropping reconciliation, both good and bad, or the costs and benefits, as Mr. White described them. And second would be the timing issue. I mean, there is a good deal of opinion that is saying this is a fine idea, once the convergence has been completed between the international accounting standards and GAAP standards, and that has not occurred yet.

So could you comment on your view of what the consequences, both good and bad, are and also the issue of timing?

Mr. HEWITT. Yes, Senator, I would be very happy to. Lifting the reconciliation, right now the foreign issuers, the information that they file with us on reconciliation items are approximately 7 months old. So it is not very timely information. And the sophisticated investors understand the differences between U.S. GAAP and IFRS when they analyze these 100-plus companies.

The timing difference, it will take some time for everybody to understand what is happening on lifting the reconciliation, but we believe that there is enough information and disclosure in these financial statements that an investor will be able to understand these differences. And we have differences within our own U.S. GAAP that investors, sophisticated investors, can understand those differences. The average retail investor probably cannot. So the differences are not that large, and eventually there will be convergence of these differences.

Chairman REED. Mr. Herz, the same two questions basically: your view of what the consequences are, both good and bad, for the elimination of reconciliation; and, also, is it a good idea but its time has not yet come?

Mr. HERZ. I think that the benefits are potentially bringing more people into our capital markets, more foreign companies, and that may be viewed as a very good thing in terms of the financial serv-

ices industry. It may be thought of as a good thing in bringing them into a system that is more investor protection oriented, as well as that. So if it does actually encourage more people to come to our markets, there would be that benefit.

I think it would have a benefit also, as John said, of people in this country beginning to learn a little bit more about IFRS. It would be the beginning of that effort. And I think the important thing is that if you go to other parts of the world that are supporting the convergence movement and the setting up of a global system, there are questions, have been questions outside of our convergence efforts as to whether the SEC is truly committed to having the U.S. go into a global system, because there have been many kind of starts around times, you know, back to the 1990's, a few other times, when it was deemed that it was too early. And I am not saying that now is definitely the right time, but people outside the U.S. have been skeptical as to whether or not, you know, we really truly want to become part of that system.

I think the costs of it are that there clearly are some investors and other users of information that do use that information. Even though it does arrive late, they do use it. That seems to be mixed among investors. There are some investors who are very comfortable already with IFRS, who already analyze global companies that are used to it and the like, and they do not need the reconciliation in their view. But there are others that want to see things put on an apples-to-apples basis. And as we have commented, there still are differences, and some of those differences can be significant to individual company results and the like.

I think that, as I said in my remarks, all three organizations here are clearly committed to continuing the road to get to a single set of high-quality standards across the world that, you know, blend the best of the two sets of standards, and sometimes we develop something new, often. But there are people in other parts of the world that, you know, for them the end of the road has been getting the reconciliation removed. They have viewed that as kind of, you know, the easier passport into our capital market, the most cost-effective one, and are not that keen on the convergence with the U.S. continuing, in part because they believe that the U.S. system—I am not going to make a normative judgment as to whether it is right or wrong with the litigation, everything else, you know, that we are almost like an infecting agent into a system that they would prefer versus our approach. I do not happen to agree with that, but that is a view, and you do hear it when you go over to certain parts of the world.

That is why I said in my comments that I think it is just important that it be made clear that this is not the end of the road. If the SEC does remove the reconciliation requirement, this is a move toward the end of the road, but there is a lot more work to be done to get to the ultimate goal.

Chairman REED. Thank you, Mr. Herz.

Sir David, I do want to ask the same question, but my time has expired, and I am going to call on Senator Allard. But we will have a chance at the end of his comments and Senator Bennett's comments.

Senator ALLARD. Thank you, Mr. Chairman.

I want to clarify. How many companies are currently subject to requirements to reconcile their statements to U.S. GAAP?

Mr. WHITE. There are about 1,100 foreign private issuers.

Senator ALLARD. Oh, 1,100.

Mr. WHITE. Yes. Now, some number of those in a number of countries already, they report in U.S. GAAP so that they have the option of reporting in a foreign GAAP or the U.S. GAAP.

Senator ALLARD. Right.

Mr. WHITE. I do not actually have that number—about 200 report directly in U.S. GAAP, so I guess it would be about 900 reconcile.

Senator ALLARD. Nine hundred that actually reconcile.

Mr. WHITE. Today.

Senator ALLARD. Well, how many new U.S. listings could we expect to see with the elimination of reconciliation? Do we have any idea—particularly given the fact that the EU has pushed back against the requirements to use international standards as written by IASB.

Mr. WHITE. I would not have thought that we were expecting any significant increase in the number of U.S. listings. One of the things we did last summer was adopt a de-registration provision that actually allowed foreign private issuers to de-register, and we have had, I think, about 70 foreign private issuers actually have de-registered since that rule went into effect in June, which got us down to the 1,100. I suppose the number could go up somewhat, but I would not have thought it would be—

Senator ALLARD. Have you or has anybody done an analysis on the elimination of the reconciliation requirement, what would happen, other than what you just stated? Have you gone any further than that?

Mr. WHITE. You mean an analysis of whether there would be additional listings.

Senator ALLARD. Yes.

Mr. WHITE. No, I do not believe we have. I mean, understand that certainly one of the benefits of eliminating reconciliation would be—could be either additional listings or companies not delisting. But our important drivers for this are not just that issue. What we are really focusing on is having the opportunity for U.S. investors to be able to look at foreign companies using a single set of—the ultimate goal of having a single set of accounting standards. And this is all driven toward the ultimate goal of one international set of standards.

Senator ALLARD. I understand that it is getting to this ultimate goal. That sounds great. But when we get there, then we could be giving foreign countries that understand this a choice of one system or another, where American companies may not have that choice. How would that impact behavior, particularly among American—I mean, do we create an unfair competition because one set of companies that are foreign can use maybe a lesser standard than what is required of American companies?

Mr. WHITE. Well, if the foreign company were still using—I do not know, I will call it Antartica GAAP, they would have to reconcile to U.S. GAAP. I mean, the only companies that we are talking about—

Senator ALLARD. Yes, but we are not talking about eliminating reconciliation—

Mr. WHITE. I am sorry. We are talking about eliminating reconciliation only with respect to companies that follow the IFRS standards as promulgated by the IASB.

Senator ALLARD. I see.

Mr. WHITE. Not foreign issuers that follow the GAAP of Antarctica or whatever their country is.

Senator ALLARD. So that would be a very limited number of companies that would be involved to start with, and those countries that have a modification of the international standards would not be included.

Mr. WHITE. Correct. The initial numbers I was giving there, today there are 110 companies that would be eligible. There are another 70 that follow IFRS with a jurisdictional adaptation.

Now, when they follow a jurisdictional adaptation, they may still be able to—they may still be following the IASB version so that they would be able to have their—they would be able to certify and have their auditors certify that what they actually did was the IASB version, so that some of those 70 may be able to come into the U.S. as well—excuse me, would be able to eliminate reconciliation as well. Is that clear or—

Senator ALLARD. I think we are getting you down on the record, and we may have more questions later on on that.

You know, I wonder about our educational requirements. In this country, accountants take a great deal of continuing education, and I do not know how other countries—what kind of requirements they have on their accountants and their continuing—and here in this country, a lot of that is licensing that falls under the various States and what-not, and then, again, do we currently have an educational infrastructure in place for a rapid switch to the IFRS?

Mr. WHITE. Since I am the only lawyer up here, maybe I should—we should ask the accountants.

Senator ALLARD. Well, yes, and I think on that question maybe everybody should try and answer that question and see. I want to see how our continuing education matches in, or are our accountants prepared to work with the new system, and those accounts in other countries, would they be prepared to go with our system, to know about our system.

Mr. HERZ. A couple of thoughts on that.

First, a lot of other countries have gone through this exercise, and a lot of materials have been developed in those countries, just on IFRS, a lot of it by institutes, by the IASC Foundation, by the major accounting firms. So I think that is available, but it has not yet been embedded in our educational system, and that is, again, one of the reasons that I think we need this blueprint and some timetable that is, you know, specific and also reasonable to get these kinds of things accomplished.

I think there is another issue and it kind of goes to Senator Bennett's comments about, you know, rules based versus principles based. While I do not completely accept that dichotomy, we do in this country like to have lots of guidance and lots of detail. And we have it, whether it comes from us or the SEC or the accounting firms or what else. And this will require a little bit of a cultural

and mind shift a little bit. That is one of the reasons that Con Hewitt and I were very much in favor of what has now become the SEC Advisory Committee on improving our financial reporting system to look at some of these issues in our own system as to what drives that perceived need for all sorts of rulings, detail, and the like. And that is also going to probably come up with some recommendations that may hopefully have some impact on our ability to be able to deal with a less detailed system of less specific guidance and the like. But it will be a challenge.

Senator ALLARD. You know, when we went through this period where we had a number of companies have accounting problems that began to impact the markets, you know, the Congress felt like they needed—in particular, this Committee I think felt they needed to do something, at least this one member did, felt we needed to do something to try and bring confidence back to the market.

I am one who does not like to see a lot of rules and regulations. I like to rely on the professional. But in this particular case, the professional fell short. At least in a few instances, it kind of reflected totally on the whole profession as well as the attitudes on the market.

I would like to see us get more to the general concept, but, you know, it seems like consumer confidence rests much more on rules and regulations than perhaps we have, you know, had to in the past prior to those instances.

How do we ensure that movement does not outpace the ability of the accounting industry to keep up? How do we ensure that? Do we make sure we put the schedule in with plenty of leeway in it, or what have you got in mind on that?

Mr. HERZ. I am just calling for a plan to be put together, to get the right people together and put the plan together and agreed to, and think about it, you know, in an orderly, complete way. You know, I could probably think of 10 or 15 broad things that need to get thought about as we contemplate this move, and there are probably other people from their point of view in companies, in the accounting industry, who would say we also need to think about this and that.

So I am always good at calling for plans. I am not so good at developing them.

Senator ALLARD. My time is running out here. Would you list for me, and response back to the Committee, you know, 10 or 15 things, broad things that you would consider? Unless you have got—

Mr. HERZ. Yes, there are a lot of them in my detailed written testimony.

Senator ALLARD. OK. We have got it. Good.

Chairman REED. Thank you very much.

Senator Bennett.

Senator BENNETT. Thank you, Mr. Chairman.

Let's get practical now for just a minute. I am an investor and I have interest in a company, and I get two sets of books—one under GAAP and one under is it fair to say. What is the first thing I am going to notice in terms of the differences between the two?

Mr. HEWITT. I will start this. When you get your annual report or they file them at the SEC, if it is in IFRS, it will be reconcile-

ment of all the differences, material differences, although some companies put immaterial differences in their reconciliation. Sometimes there may be only two items of reconciliation items, sometimes there may be a dozen items. And those reconciliation items are explained as they pertain to U.S. accounting standards. And when you get done with those reconciliation items, you are going to end up with a different number for the net income or loss than you started with under IFRS. However—

Senator BENNETT. Is it going to be higher or lower?

Mr. HEWITT. Sometimes both. I have reviewed a number of these, and sometimes they are both ways. And over a period of time, if you take a snapshot today and look at it today, because of the differences in how a company uses capitalized items versus expensed items, over a period of time, 5 years, there may not be any difference. If you just take 1 year, yes. If you go over a number of years, those differences tend to come out to zero, just as they do in U.S. GAAP when a company has different alternative methods of depreciation or anything else.

Senator BENNETT. OK. So it will be the allocation of long-term costs, appreciation and amortization. Let's talk about cash-flow. One of the things that I want to look at is EBITDA. Will EBITDA be different?

Mr. HEWITT. EBITDA would be different since that is earnings before depreciation, interest, and taxes, and the recording of those items under IFRS may be different than they do under U.S. GAAP. So you may have a different EBITDA, yes.

Senator BENNETT. OK. And it may be higher and it may be lower?

Mr. HEWITT. May be lower. But over a period of time, I personally think they equate out.

Senator BENNETT. All right. U.S. taxes, we have seen examples where the books kept for tax purposes are different than the books kept for reporting purposes. And that was part of the fight we had over the issue of expensing stock options and how you value that. That continues to be a very fertile field for accountants and lawyers to earn their fees.

How would the IFRS deal with U.S. taxes differently than GAAP?

Mr. HERZ. The two current standards are very close. The basic principles are the same. The problem is we have had a few exceptions in each standard, but they have been different exceptions, and we now have a project which we are close to issuing a document on that either eliminates the exceptions or has the common one, so the standards will be the same.

Senator BENNETT. OK. Stepping back from the particulars, if Sir David has formed a company and puts out a prospectus and it is in both forms, and I start looking at that prospectus, assuming that his superior management will be there on both forms, am I likely on the one form to say this is a good deal and on another form to say, gee, I better not put my money in it? Or will you come close enough in both of them that you will arrive at basically the same decision?

Mr. TWEEDIE. Well, since this is my company, perhaps I should answer this one. Basically, we know what the differences are be-

tween U.S. GAAP and international standards, and that has been the whole thrust of our program, and we took them from the reconciliation. That is how we started off under the Norwalk Agreement. We listed all the major issues, income taxes. There were others such as the fair value option, joint ventures, and so on. We worked right the way through, and what we did to start with is we just eliminated the differences. That was going to take a huge amount of time if we went through every single detail, down to 2015.

And then what I thought was a real inspiration from the SEC, when we called this together about 2005, 2006, we thought, well, how can we do this faster? And we decided what we would do, there were certain things that we could change very quickly. Basically the standards were the same, but there was some principle that was not quite the same. Well, why don't we just take the better principle and we would do it? So that locks another lot out, and we have done that more quickly.

We were then left with ten areas where sometimes there are differences and sometimes there are not, but we know exactly where they are. And we can highlight that, and we can explain what the policy is. For example, in consolidation, internationally we base it on control. If you control something, you consolidate. The U.S. tends to be more do you have majority equity shares. Well, we think it is broader than that, and that is part of the issue that we are working with FASB on.

Leasing, for example, the good news is that we have very similar standards. The bad news is they do not work. They are hopeless.

[Laughter.]

And nothing is on the balance sheet if it is leased. One of my big ambitions is to fly an airplane. It is actually on an airlines balance sheet. And the reason it is not is because the standard really was written 20-odd years ago and does not reflect the economics. You know, if you have a legal commitment to pay, that is a liability. And when you think leases a year ago amounted to \$582 billion, and that is just for 1 year, and most of that is off balance sheet. Now, Bob—

Senator BENNETT. It sounds like Enron.

Mr. TWEEDIE. Well, it has been there for years, but, you know, that is one actually we both get exactly the same answer, which is nonsense. And what we are trying to do now is work a joint standard, and we were discussing that just yesterday. We will come out with a joint standard when we will move from not showing any leases to showing almost all of them on balance sheet.

So while we have ten major differences between us, some of them really—not so much ten major differences. Ten major projects. Some of them do not lead to differences, and the other ones we know exactly what the differences are caused by, and that can be disclosed. So there is, if you like, a flag for the investor.

Senator BENNETT. So the bottom line—this is what I am driving toward. The bottom line is an analyst or an investor who tries to do his own analysis can, in fact, understand enough about the differences so that he or she will come to basically the same decision regardless of which set of accounting terms looking at—the educational process that you have been talking about necessary to

equip the analyst with the skills to dig into a corporation under IFRS are not that difficult to acquire, and the analyst will be able, with a little bit of study to say, OK, it is a slightly different pattern, but I can get the same information I want if I am focused on EBITDA, I know what it will mean; if I am focused on some other aspect or valuation of what the market cap really ought to be, I can get those data out of this new set without having to go back to school for 2 or 3 years in order to understand it.

Is that a safe assumption?

Mr. TWEEDIE. You will not get exactly the same data in the sense without doing the accounts twice, but what you will get is you will get very similar answers, which are getting more and more similar as time goes by. And the second thing you will know is the fact there may be a difference in this area. Take, for example, consolidations. One of the big issues that we have had—and Enron was a classic—was special purpose entities, and now with the credit crunch we have got conduits. How do we handle those things? The U.S. handles it in a rather different way from us. We look at do you control this.

In the aftermath of Enron, the U.S. brought out 46R, which is a method of looking at what are the benefits you are getting out of this thing. Well, we think that is worth exploring, too.

So we are trying to produce a joint standard which will look at maybe the central theory should be control. But what happens if you do not control? Can we make sure you get it?

So you will not yet get exactly the same answers, but that does not mean to say that the IASB answer is better than FASB's. It is in some situations and maybe not quite so good in others. But the idea is we merge and get the best of both worlds, and that is actively going on at the moment. So it is going to get less and less, the differences.

Analysts in Europe must have had quite a job because, while IFRS and U.S. standards are similar, when you looked at some of the continental European standards, they were totally different. So there was a complete mind-set's change from looking at tax accounts or accounts based for creditors to accounts based for the equity markets, which is the way we do it and the way FASB does it.

So I think the differences are not as bad as people think they are. The U.S., in fact, will be better equipped than most countries to deal with this.

Senator BENNETT. Thank you.

Chairman REED. Thank you, Senator Bennett, and let's take a brief second round.

Sir David, you pointed out the butting of jurisdictional versions as a potential difficulty in reconciling and totally converging. And even within the EU, most of the countries are not—or all of those countries are not using the precise standards promulgated by the International Accounting Standards Board. Is that correct? There are some changes that they have mandated?

Mr. TWEEDIE. Well, it is very small. It is about seven paragraphs of one standard in 2,000 pages of standards.

I think what has happened, we are a rather unusual organization in the sense we are modeled on the FASB, we are inde-

pendent, we can issue standards as we decide upon them. That is not normally the way we deal internationally with treaties and laws. People like yourself, sir, would meet with opposite numbers in different countries, and you would come to an iterative compromise, and that would be the international rule.

We do not do that. We just listen to the arguments and say that is what we think the answer is. And we do give—after we have issued the standards, we then give—2 years later there is still lots of antagonism toward it. We will look at it again, but do not necessarily agree to change it.

Now, one of the things then is that jurisdictions are suddenly saying, well, wait a minute, these people are actually passing laws and we are having to take them and what right have we to say this.

So I think what is starting to happen is an issue of is the present structure suitable without giving, say, the U.S. a say in the composition of our trustees or Europe. At the moment you have not. The trustees, like FASB trustees, are self-elected. They replace themselves, their successors, and it is geographic. But, nonetheless, as far as jurisdictions are concerned, there is no actual direct influence. And one of the big questions then is: Should there be some governance body that actually helps to appoint the trustees and representatives from different countries and so on, so that people have more say—but not to control the standards, because otherwise we will get, if I may say so, political influence into the standards, and that would be an appalling thing, as I am sure you would agree, sir. This is the—

Chairman REED. That is why we have FASB.

Mr. TWEEDIE. This is the issue I think that has still to be discussed.

Chairman REED. So there is a simultaneous effort to really make this work, is to get all countries to adopt the version promulgated by the International Accounting Standards Board, and that has to go on, too, because as Mr. White and everyone has pointed out, the jurisdictional varieties will not qualify for special treatment under the proposal.

Mr. WHITE. Yes, that is correct. Just to clarify, if you remember, I mentioned 110 and 70. The category of companies that are in the category of the 70, they are not in most cases—in fact, I think in all cases, they are not required under the jurisdictional adaptation to follow that jurisdictional adaptation. There tend to be more different options that they can follow. But they can follow the IASB version. And so if they—they can still report—they can still eliminate reconciliation and come here if they certify that they are following the IASB version.

Chairman REED. Right. Just a final point, and Sir David brought up in terms of in the aftermath of Enron, there was special attention to what is described as variable interest entities now. And I understand—and going back to the whole issue of reconciliation—that that is one of the items that is included in a reconciliation by a filer who is using international antitrust standards. Is that correct? Mr. Herz?

Mr. HERZ. There are a few areas of difference. We have a standard interpretation of 46R that has principles and then has below

it a bunch of guidance, as we do, that is an approach that basically says if nobody seems to control that entity, because one of these vehicles that has been set up, you have to do an analysis of all the arrangements and decide based on that whether there is a party that gets a majority of the risk and/or reward. And then if you cannot do that qualitatively, it lays out a quantitative approach to doing that. The international standard is based more on control, although they do have some risk and reward type backstops in it, but it is a lot less specific.

On the other hand, we have significant differences in the accounting for securitization transactions; whereas, I would argue theirs are actually tougher than ours in order to get something off the balance sheet than ours. So I think the things could go either way depending upon the particular transaction and structure. But it is something we are—it is on our hit list of things—

Chairman REED. Well, I think it should be, and just two final points. First, Senator Bennett talked about looking at, you know, apples and oranges and saying, well, I know it is an apple, I know it is an orange, and I feel good about making my investment. The problem is looking at an apple and discovering later on you have got bananas that you did not think of.

Mr. HERZ. You know, I said on balance I support the SEC dropping the reconciliation, but there are pros and there are cons to it, and one of the cons for some investors—and I think you may hear this in the next panel from some of the people—is they do use that information, and it will force them to either do more work or they may not be able to quite put apples to apples without a lot more work.

Chairman REED. Well, I think the goal is one that we all can embrace, which is convergence of standards, transparency, all of the—but I think this panel has very adroitly and elegantly indicated that there are some significant steps along the way that have to be taken before we are quite there. Again, we will participate, we hope, in that process in a positive way.

Senator Allard.

Senator ALLARD. Thank you. I just have three brief areas I want to bring up. I want to finish my discussion a little bit about regulation and everything. There are a lot of medium-sized firms in the State that I represent, and I think, you know, if they are interested in growing their business, the next step is into a larger firm. And they are concerned about how this is ever going to get to be a large firm. Will these provisions that we are talking about here make it more difficult for those medium-sized firms to transition into a larger accounting firm, wherever that bright line is? Anybody want to comment on that?

Mr. TWEEDIE. I wonder if perhaps I could just mention something briefly. When people switch to IFRSs, they tend to use IFRS for listed companies. And then comes the question of—

Senator ALLARD. Those are large companies?

Mr. TWEEDIE. Large companies. For Europe, for example, there are 8,000 listed companies which use IFRS—that is compulsory—of which, I may say, only about 30 use the carveout that is existent. The rest all use pure IFRS.

What we have done for the smaller companies is we have taken the standards and then sort of said, well, if we were a small company, how could we apply this? And we are putting out—we have got a draft out at the moment on what we call IFRS for small and medium enterprises, and it is probably about 15 percent of the size of the full standards. We have really slashed them down.

On the other hand, if you do grow, you are basically obeying the same sort of principles but in a simplified form, so there is not a massive cliff that you go off when you reach the listing, or whatever. And that is up to the jurisdiction how far they push it. Some will push IFRS down into the medium size, others will not. But there is an alternative coming up, which is derived from the main standards, and that is what is going to be used in many countries of the world.

Senator ALLARD. Thank you, Sir David.

The other subject I wanted to participate in here, the Congress has charged several agencies with specific rights and responsibilities—the SEC, the PCAOB, and FASB—and we also designate the fees to support the setting of accounting standards.

Now, do you have any concerns that convergence will involve deferring some of those responsibilities or fees to foreign organizations? And do you believe that you will need congressional authorization to make any of these changes? This is to the whole panel.

Mr. HEWITT. That is a very interesting question because the support fees of FASB are paid by the registrants and then also the—

Senator ALLARD. But set by the Congress—no, no, I am sorry. Yes, we designate the fees.

Mr. HEWITT. That is true. And I believe that there will be no decreases in fees because of lifting the reconciliation, that type—I do not see any material effect at all upon both standard setters, PCAOB and FASB, in terms of fees.

Senator ALLARD. Yes?

Mr. HERZ. I think that is right. I think long term, you know, one of the things that David mentioned is that their trustees are trying to put in place a mandatory funding scheme for them across the world, which would, I think, you know, give them more security financially and be able to bolster their staff and the like. And, you know, ultimately if we are going to be part of this system, I think we would want to also bear our fair share of that, whether that would be by taking some of our fees, saying, you know, that is directed to you working with the IASB, which we do already, or it is a separate fee and, of course, ultimately what our organization would look like, you know, down the road might change as well.

So whether that would—I do not know whether that would take, you know, you all having to do something with Section 109 basically of the Sarbanes-Oxley Act or something that the SEC could do regulatorily, I am rapidly getting out of my depth as a non-lawyer.

[Laughter.]

Mr. TWEEDIE. Just on that point, perhaps I could mention that the program of funding for the IASB, when we started, we were very fortunate to have Paul Volcker as the Chairman of our trustees, and saying no to Paul is very difficult. And he certainly asked many companies to contribute on an individual basis for the first

5 years, but that was unsustainable. And what we are doing now is the trustees are working out a funding program which is based on the GDP, and the countries are being asked to provide their share. Now, they are doing it in different ways. The U.K. and the Netherlands I think are doing it very similarly to you in the United States by sort of a listing fee. In Australia, they are collecting money for the national standard setter and diverting some to us. Japan simply is approaching individual companies, but as an organization and then passing money up to it. So it has been done in various ways, but the idea is to make thousands of companies involved in this rather than as it was before, 200 or 300.

Senator ALLARD. Yes, I think there was some concern or conflict of interest when you go to those people you are trying to regulate to support you financially.

Mr. White.

Mr. WHITE. Just to answer your question directly, we do not believe there would be any required legislative changes to do the things we are discussing. And, also, the SEC will continue to be the organization that is responsible for all of the financial reporting by foreign and domestic issuers in the U.S.

Senator ALLARD. Thank you.

Mr. Chairman, that concludes my questions.

Chairman REED. Thank you, Senator Allard.

Gentlemen, thank you very much, and there might be additional questions which we would direct to you in writing, and we would ask for your responses in a timely manner. Thank you very much.

I will call forward the second panel.

Our first witness is Mr. Jack Ciesielski, who is the owner of R&G Associates, Inc., an investment research and portfolio management firm located in Baltimore. He is the publisher of the Analyst Accounting Observer, which is an accounting advisory service for security analysts. He is currently a member of the FASB's Emerging Issue's Task Force, and a member of FASB's Investor Technical Advisory Committee.

From 1997 to 2000, he served as a member of the Financial Accounting Standards Advisory Council, which is the advisory body that consults with the FASB on practice issues and advises FASB on setting its agenda.

Ms. Teri Yohn is an Associate Professor at the Kelley School of Business at Indiana University. Prior to joining Indiana University in the fall of 2007, she served on the faculty of Georgetown University for 15 years. Ms. Yohn also serves as the Academic Fellow in the Office of the Chief Accountant at the Securities and Exchange Commission in 2005 and 2006 and on the faculty of the University of Massachusetts at Amherst in 2006 and 2007.

Mr. Charles Landes is Vice President, Professional Standards and Services for the American Institute of Certified Public Accountants. In this capacity, he oversees the technical activities of the Auditing Standards Board, Accounting and Review Services Committee, Accounting Standards Executive Committee, and the PCPS Technical Issues Committee.

Mr. Landes is a former member of the Auditing Standards Board and is a former chairman of the Peer Review Committee of the Private Companies Practice Section.

Mr. Lynn Turner serves as a Senior Advisor to Kroll Zolfo Copper, a firm specializing in corporate advisory and restructuring and forensic and litigation. He was appointed by the Department of Treasury to the Advisory Committee on the Auditing Profession. Mr. Turner served as the Chief Accountant of the SEC from July 1998 to August 2001. As Chief Accountant, Mr. Turner was the principal advisor to the SEC Chairman and Commission on auditing and financial reporting and disclosure by public companies in the U.S. capital markets as well as the related corporate government matters.

Thank you all for your willingness to join us today and for your testimony. Your testimony will be made part of the record, your written testimony. So feel free, in fact I would encourage you, to summarize your comments and see if we can approach the 5-minute mark.

Mr. Ciesielski, please.

**STATEMENT OF JACK CIESIELSKI, PRESIDENT,  
R&G ASSOCIATES**

Mr. CIESIELSKI. Thank you, Chairman Reed, Ranking Member Allard, members of the subcommittee—

Chairman REED. I think you have to turn the microphone on.

Mr. CIESIELSKI. That is better.

Chairman Reed, Ranking Member Allard, and members of the subcommittee, I am pleased to be offering testimony today on the subject of international accounting standards.

From the start, I would like to commend the SEC for trying to move the world's two leading accounting standard setters closer together. The two have made a remarkable amount of progress in the last 5 years, since they announced their intention to work together on converging their standards and coordinating their efforts on future projects.

It is the SEC that is an agent provocateur, however, by issuing its proposal to eliminate the IFRS to GAAP reconciliation and its proposal to allow U.S. companies to choose between U.S. GAAP and IFRS. While convergence has progressed well in the last 5 years, these proposals have such broad implications that they force all players to rethink what is possible or not possible in the current environment and in the near future.

That said, I view the SEC's proposals as the right questions at the wrong time. Much high quality information about the state of accounting standard convergence is available from SEC filings. The SEC has proposed to eliminate the reconciliations which provide quantifiable evidence about the GAAP and the results produced by the two reporting systems. Much can be learned about the state of convergence from the differences shown in those reconciliations for U.S. registrants and targets could then be set for eliminating the differences in the relevant standards.

There is no indication in either of the SEC's proposals that there has been an examination of the existing evidence. Instead, the SEC is relying heavily on the fact that there is a process in place for convergence to occur in the future without objectively assessing how far the convergence of the two systems have progressed.

I would not smoke three cigarettes a day because there is a process in place for discovering a cure for lung cancer. It seems a little bit—maybe that is an exaggeration, but it is relying heavily on an outcome that has not been determined yet to make sure that everything is OK today.

I support the convergence efforts of the two standard setters and I believe that the investors and capital markets would benefit enormously from a single set of high quality standards. At this time, however, I do not believe there is sufficient convergence between the two sets to warrant either the elimination of the IFRS to GAAP reconciliation or to allow U.S. registrants the choice of which accounting standards to use.

I urge the Commission to isolate the past differences arising from non-converged standards having long effects on the future reporting and to develop the proper disclosure for such differences. I also urge the Commission to examine the other differences produced by the application of the two sets of accounting standards, identify the accounting literature responsible for those differences, and work with the IASB and the FASB to set realistic deadlines for working out those differences through the convergence process.

That concludes my prepared remarks.

Chairman REED. Thank you very much.

Mr. Landes, please.

**STATEMENT OF CHARLES LANDES, VICE PRESIDENT,  
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS**

Mr. LANDES. Thank you, Chairman Reed, Ranking Member Al-lard. My name is Chuck Landes and, on behalf of the 340,000 members of the AICPA, the National Association for Certified Public Accounts, it is my pleasure to testify today, and thank you for holding his hearing.

I want to state as directly as possible that the AICPA supports the goal of a single set of high quality, comprehensive accounting standards, to be used by public companies in the preparation of transparent and comparable financial reports throughout the world.

The debate or question should no longer be whether we move to convergence of high quality accounting standards, but how soon we can accomplish convergence. The FASB and the IASB have made tremendous strides in harmonizing accounting standards and the SEC has demonstrated U.S. leadership in expediting this process. But let's recognize that convergence is not, nor will it be, without challenges and issues. So there is still hard work to be done.

Will there be bumps in the road as we take this journey? Absolutely. But it is a journey that must be taken.

Accounting is often referred to as the language of business and there is a need for a common global business language, a common set of accounting standards. In today's global economy, that one common accounting language will benefit all participants in the capital markets. It will first benefit investors because it will facilitate the comparison of financial results of reporting entities domiciled in different countries. It will also benefit U.S. public companies because it will allow them to present their financial statements in the same language as their international competitors.

And it will benefit audit firms who audit public companies because it will allow them to train their staff around one core set of accounting standards.

The AICPA supports the SEC's proposed rule regarding the elimination of the reconciliation to U.S. GAAP by foreign private issuers and the SEC's concept release that would give U.S. issuers an option to prepare financial statements in accordance with IFRS. We believe these are both important steps in the process toward the acceptance of a single set of high quality globally accepted accounting standards.

That is not to say all differences between GAAP and IFRS have been resolved. But despite these differences, both U.S. GAAP and IFRS promote transparency and are designed to protect investor interest. With respect to the SEC, the AICPA fully supports their role of protecting U.S. investors. We encourage the SEC to continue to provide input during the IASB standard setting process and to solicit user feedback to understand whether these standards meet investor needs.

The AICPA also encourages the SEC to work with other regulators around the world to agree on an appropriate framework for the acceptance of IFRS and to work with those regulators to encourage robust enforcement of IFRS. The challenge will be balancing the needs of investors and the needs of the security regulators with one set of global accounting standards.

In the end, any activity to remove organizational barriers and avoid geographical differences ultimately will aid in achieving one set of international accounting standards. While this hearing is to deal with the acceptance of IFRS financial statements in the SEC's filing of foreign private issuers and granting of an IFRS option to U.S. public companies filing with the SEC, the AICPA believes that the SEC should view international convergence holistically. That is if IFRS are to serve as a basis for U.S. issuers' financial reporting, there will also need to be changes in auditing, regulatory, and legal environments.

With respect to auditing, the SEC, along with the PCAOB, should explore convergence of PCAOB auditing standards with international standards on auditing.

With respect to regulatory, because IFRS currently are less detailed than U.S. GAAP, a decision by the SEC to permit an IFRS option should carry with it an expectation by regulators and investors that the use of reasoned, professional judgment may yield different outcomes in similar circumstances more often under IFRS than U.S. GAAP.

Additionally, working from less detailed standards and less interpretive guidance may result in more second guessing by regulators and users and thereby result in unwarranted increased legal liability for preparers and auditors of financial statements. As a result, the SEC should work with Congress and other governmental agencies to explore this potential increased risk and work to mitigate this risk when preparers and auditors have applied reasoned professional judgment.

At the international level, continued progress toward high quality international accounting standards requires an improved fund-

ing mechanism for IASB that will allow them to remain independent and objective.

And finally, we acknowledge that we need to fulfill a number of responsibilities to make convergence to a single set of global accounting standards for public companies a success. Rest assured that we, the AICPA, will meet our responsibilities.

On behalf of the AICPA, we would like to thank you for the opportunity to appear here today and we would be happy to answer any questions that you may have.

Chairman REED. Thank you very much. Ms. Yohn.

**STATEMENT OF TERI YOHN, KELLEY SCHOOL OF BUSINESS,  
UNIVERSITY OF INDIANA**

Ms. YOHN. Mr. Chairman, Ranking Member Allard, good afternoon.

I appreciate the opportunity to appear before you today to provide testimony on issues related to the international convergence of accounting standards and the potential elimination of the IFRS-U.S. GAAP reconciliation requirement for foreign private issuers. The views that I represent today are primarily based on my interpretation of academic research on these issues.

Most, but not all of the academic literature supports the notion that convergence of accounting standards is a laudable goal to which U.S. standard setters and regulators should strive. In general terms, the purpose of Regulation S-X is to provide U.S. investors with inter-temporally consistent information that is comparable across registrants. To the extent that internationally converged accounting standards increase the comparability of financial information, convergence is in the best interest of U.S. investors and other stakeholders.

Convergence of standards is occurring through the joint standard setting activities of the IASB and FASB. And academic research suggests that IFRS possesses the characteristics of a high quality set of standards. Research has documented that IFRS and U.S. GAAP are equally value relevant for non-U.S. companies in non-U.S. markets. However, the quality of IFRS in foreign markets is not the most important factor in determining whether or not the reconciliation requirement should be eliminated in the U.S. Rather, the informational needs of U.S. investors should drive this decision.

Logically, any proposal to eliminate the reconciliation requirement must be based on the premise that U.S. GAAP and IFRS are informationally equivalent or that investors can reconstruct comparable U.S. GAAP summary accounting measures from IFRS financial information. Neither of these two criteria appears to hold at this point in time. Academic studies have documented that material reconciling items currently exist between IFRS and U.S. GAAP and that the reconciliation is value relevant and used by U.S. investors, suggesting that U.S. GAAP is more value relevant than IFRS in U.S. markets.

In addition, without the reconciliation, it would be difficult, if not impossible, to reconstruct U.S. GAAP income and equity from IFRS-based financial statements and footnotes. Furthermore, it does not appear that U.S. stakeholders have the necessary expertise in IFRS to understand the differences between the two sets of

standards. Universities are still attempting to fully integrate IFRS into their curricula, and even the largest accounting firms have revealed concerns about the lack of IFRS expertise within their domestic professional staff.

The existence of significant reconciling items and the value relevance and use of the reconciliation by U.S. investors, as well as the inability to reconstruct the reconciliation from public information and the lack of expertise in IFRS by U.S. stakeholders suggests that the elimination of the reconciliation requirement is premature. It would perhaps be prudent to revisit the issue on a regular basis and to reconsider eliminating the required reconciliation where the differences are immaterial and when U.S. investors appear to view IFRS and U.S. GAAP as providing equivalent information.

Deferring the elimination of the reconciliation requirement will also allow regulators to address some of the major challenges of convergence. Academic research has documented that institutional differences lead to differential implementation of even uniform accounting standards across countries. In addition, while the U.S. has the reputation for providing the strictest enforcement of securities markets, evidence on SEC enforcement has concluded that the SEC rarely acts to enforce the law against cross-listed firms and that there are legal and institutional obstacles to private litigation against foreign firms in the U.S.

Differential implementation of standards across countries and differential enforcement of domestic and cross-listed firms diminishes the comparability of financial statements, even with converged standards. Whether or not the reconciliation requirement mitigates these issues remains an open question that should be addressed.

An argument for eliminating the required reconciliation is that it would reduce the cost of foreign firms of listing on U.S. markets. Research has concluded that U.S. cross-listing provides benefits to foreign firms in the form of greater access to capital and improved information environment, greater investment protection, and evaluation premium. Despite these benefits, some are concerned that the U.S. securities markets have lost their competitiveness in recent years due to onerous requirements. However, existing evidence on the New York versus London stock exchanges does not support this argument and suggests that the newly cross-listed firms on foreign exchanges tend to be small and unlikely candidates for cross-listing in the U.S. The research also suggests that the net benefit of listing on a U.S. exchange has not eroded in recent years.

In summary, most of the academic research suggests that the convergence of accounting standards is beneficial to U.S. investors and is therefore a laudable goal. The research also suggests, however, that the elimination of the IFRS–U.S. GAAP reconciliation requirement is premature because it will reduce the comparability of financial statements across registrants and will leave U.S. investors with a diminished set of relevant information for decision-making.

Thank you.

Chairman REED. Thank you, very much. Mr. Turner, please.

**STATEMENT OF LYNN TURNER, MANAGING DIRECTOR,  
GLASS, LEWIS & CO.**

Mr. TURNER. Let me just start by thanking Senator Allard for those kind and generous remarks at the beginning. I know that in the future you will be leaving the Senate. As a citizen of Colorado, I know you have done tremendous public service for us and have made tremendous personal sacrifice, including your wife, in being back here. So thank you very much for all you have done for us as a State.

My only regret in being here, actually, today is that tonight on the plane ride home I am going to miss the Colorado Rockies first World Series win.

Chairman REED. I will refrain.

[Laughter.]

Mr. TURNER. Anyway, high quality financial reporting has been the lifeblood our capital markets, as noted by former SEC Chairman Levitt. I could not agree with those remarks more. It is this information that provides investors with the ability to make informed judgments as to where they should allocate their capital, thus resulting in allocations where there is higher returns with lower risk. And that attracts a tremendous supply of capital to any capital market. When the quality of this information, however, is lowered, markets do pay a price as we have seen throughout this decade, both here and abroad.

Based on my experience, I believe maintaining that high quality financial reporting is important to the competitiveness of the U.S. markets. As a former CFO and business executive, I know it is important that you strive not just to match what the other markets or competition is doing, but to beat their product.

U.S. markets will not maintain their current prominence if they simply become the equal of other markets, employing the same strategies and approach to business. Certainly, the fallout from the subprime fiasco and structured investment vehicles, the SIVs, around the globe is a classic example of this as we saw in August when foreign investors pulled billions, tens of billions of dollars out of the U.S. capital markets over that situation.

I would also like to clarify what true convergence is, in terms of financial reporting. It is a single set of high quality financial reporting and disclosure standards that result in companies reporting the true economics of the transactions they enter into. I seriously doubt if what is known as the SIV IFRS-lite standards are going to come up and meet that goal.

They are standards that result in consistent reporting methods from period to period and comparable reporting by companies who enter into comparable transactions. A couple of the Senators today have already highlighted the importance of investors being able to compare from one company to the other. Without that, you do not have an efficient market.

They are a complete set of standards covering all the significant industries, including in industries like the extractive mining, oil, and gas, which is important to my State, financial services including insurance.

They are transactions being reported in the financial statements and not left off the balance sheet and out of the income statement,

as investors have seen time and time again in recent years the special purpose entities, the SIVs, and off balance sheet financing of securitizations and other assets. And this is an area where, quite frankly, today I think it would be difficult for the public to buy that we have high quality standards either in the U.S. or international standards. I have a number of e-mails from foreign investors complaining about even their standards in this area.

I also note that in 2002 Senator Allard exhibited great leadership when he wrote a letter to the FASB on off balance sheet vehicles, encouraging them to fix this problem and bring it back on balance sheet. So he certainly had the foresight. Unfortunately, 5 years later we still have not gotten there.

Convergence is effective audits that ensure claim compliance has been achieved. And it is authorities with the expertise and experience to globally enforce these accounting standards and audits wherever they are used in reporting to investors. As we just heard from Ms. Yohn, that unfortunately is a situation that does not exist globally today as many of these conditions do not. In fact, no regulators and governments have fully committed themselves to this effort, to fund it and to provide it with adequate resource. And no time table has been set among all the countries internationally to fully achieve the changes needed to ensure complete and timely convergence.

Instead, the efforts are, at best, being done in a piecemeal, haphazard fashion. And as such, we are moving these safeguards and protections such as the reconciliation before we get there does run the risk of creating significantly more scandals and problems for investors.

In striving to achieve convergence, I think it is important that there are a few key points worth noting. These are all laid out in the written testimony and I would ask, Senator, that the entire written testimony and appendix be included in the record.

But in striving to achieve convergence, which I do think is important, having been one of the people that led the effort to create the IASB as we know it today in the first place, convergence on high quality standards will be best achieved through the private sector standard setting process, not one influenced by outside specialist interest, overbearing regulators, and a lack of direct involvement. We are on the right path today, letting Mr. Herz, Mr. Tweedie and their organizations take care of the reconciliation by eliminating the differences in a reasonable fashion and thereby letting them eliminate the reconciliation. It should not be the SEC doing it.

There needs to be assurance that the necessary supporting infrastructure set forth the SEC concept release in 2000 is, in fact, put in place. And it was interesting that in their proposing release, the SEC almost totally ignores that infrastructure and whether or not it exists.

There are concerns regarding the independence of IASB and lack of meaningful representation of investors as members of its board. There is no meaningful representation from the investor community on the voting board members or on the trustees whatsoever. It is an issue that in March of this year Chairman Levitt pointed out as a serious shortcoming.

Comparability and consistency in reporting by companies has been a hallmark of high quality financial reporting by investors and the FASB's conceptual framework for several decades. Negatively impacting that will have consequences for investing public around the globe.

And finally, in the U.S. there is a lack of resources, skills, and training to make an orderly transition to IFRS anytime soon. And I do fear that to require a change in the near term would disadvantage many small auditing firms and result in significant costs for smaller companies at a time when those of us on the Treasury Committee are looking for ways to make the smaller auditing firms more competitive.

With that, I will conclude my remarks and take any questions.

Chairman REED. Thank you very much. Thank you all for your excellent testimony. Let me start, Mr. Turner, with a question.

Under Section 108 of the amendments to Sarbanes-Oxley, there was the setting out standards for—recognizing accounting standards. There is a question, at least, and I think the previous panel suggested that they have concluded that they have the authority. But there is a question, at least, whether they would have the authority without a statutory change to recognize these standards without reconciliation.

Do you have a view on that?

Mr. TURNER. Yes. Actually, having been involved with the drafting of that, I personally think that they would need to come back to Congress and get Congress's approval to do that. I do not recall, in any of the conversations at the time, that there was a notion that FERC funds, for example, would be diverted from the FASB to the IASB. So I clearly do not think it was the intent of Congress to open it up like that. So I would say the SEC does need to come back to Congress.

Chairman REED. Thank you.

I want to go back to Mr. Ciesielski and Mr. Landes and Professor Yohn also, in that the discussion in the previous panel, trying to sort of determine what the difference is between international standards company reporting and company reporting under U.S. GAAP. There was a suggestion that they are similar but not identical.

But then there is a view that there could really be material missing information. So Mr. Ciesielski, could you sort of give us a comment and maybe an example to flesh out this discussion?

Mr. CIESIELSKI. I would be glad to.

Chairman REED. Can you turn your microphone on, please?

Mr. CIESIELSKI. I am sorry.

Chairman REED. That is quite all right.

Mr. CIESIELSKI. I go back to the last panel, I believe Mr. Herz thought there were 11 areas that needed to be reconciled between the current body of literature of the FASB and Mr. Tweedie believed there were 10. Close, they are similar. They are not exactly the same.

There are projects in the literature that they are working on that will be prospectively smoothed out. And I am confident that the convergence process will work on that.

But in the meantime, there are differences in the literature that has not been addressed—excuse me, that is being addressed, that produces current differences in the area of taxes, pensions, and also what I refer to as legacy differences.

If you go back to prior to 2002, there were differences in the GAAP literature and the IASC literature that have an effect at the time a transaction is consummated. My favorite example is business combination accounting. There are some companies, and we cite some in our report which is part of the record, where there were business combinations that took place that did not qualify for what was called pooling of interest accounting in the United States at the time. There was a comparable procedure called uniting of interests in the IASC literature, which was adopted by the IASB. Because it did not meet the criteria in the United States for pooling of interests, it had to be reported in the reconciliation as a purchase, which is what we use in the United States all the time now.

Those differences can have lingering effects on income that last into the decades. And if the reconciliation is removed, those differences will never be known to investors. There are examples, again, of that in the report that is filed as part of the testimony. Those differences, often, I recall, were favorable in terms of producing income figures that were higher under IFRS than under U.S. GAAP. There is no way that analysts could go back and recreate that information.

I like to say that analysts and investors are reviewing the company from 30,000 feet when they are reading the financial statements. Those kinds of transactions occur at ground level. They do not have visibility into those transactions to try and estimate for themselves how they affect current report. And even if they did have access to much of that information, it would still be an estimate. I think a lot of that information would be lost for good and it would create an unlevel playing field.

And also, I would point out that I believe it was Con Hewitt pointed out that the information is old and stale by the time it reaches analysts. I think that is a great argument for saying it should be reported more frequently to iron out those differences as U.S. companies report.

One final remark, I believe there is a perception that analysts and investors do not use the reconciliation. I would disagree. I think they use it in much the same way they use other information that is contextual, like the business description part of every 10K filing. If you are picking up a foreign company for the first time that is filing an IFRS and you do not know much about them, but you do understand U.S. reporting, this provides a context and a reason to understand why they are different in terms of U.S. reporting versus IFRS reporting. This does lay it out.

I would also mention that a lot of U.S. analysts are just passably familiar with U.S. GAAP. When they look at this reconciliation they are getting, I would say, prima facie evidence of what they do not know. And they do have a way of putting it into context in U.S. terms and they can follow up and build their knowledge if they want to.

Chairman REED. Thank you.

Mr. Landes, your comments on the same issues of is this just similar information or is there missing information perhaps?

Mr. LANDES. Well, Senator Reed, we certainly acknowledge that eliminating the reconciliation would result in a loss of information. We, however, look at this a little differently. We believe that the elimination shows that the U.S. is willing to put some skin in the game, to use a golf term or perhaps even a poker term. Sir David mentioned that there are some foreign filers who look at the reconciliation and are offended by that. And so we think that this is a way for the U.S. to step up and say yes, we are serious about convergence.

I have some personal experience, not on the accounting side but actually on the auditing side, where the AICPA's Auditing Standards Board has been working very hard now for three or four, almost 5 years on converging U.S. auditing standards for non-issuers with international auditing standards. And what we found was that the day that we publicly remarked that we are working toward convergence, we were embraced in a different way by the international community.

Prior to that, when we would try to make arguments, they would look and say that is all well and good. But you all do not use international auditing standards, so why should we care? And we see the elimination of the reconciliation as a first step in the process of telling the world we do care about international convergence. And we actually believe that the elimination may speed up the convergence. And we know that that is a view not shared by others but nevertheless, from our own personal experience, what we have found on the auditing side.

Chairman REED. Thank you. Professor Yohn, please.

Ms. YOHN. I think the academic literature is focused on what is the impact and the use of the reconciliation for U.S. investors. And like I said earlier, it seems that there are material differences, even looking as recently as 2004–2005. There are material differences. The average, I think, reconciling difference was about—the mean was 13 percent of stockholder's equity. And that the investors use this. That if you control for the IFRS earnings, the difference between IFRS earnings and U.S. GAAP explains changes in stock prices. So it suggests that the investors do use the information and it makes material differences.

Chairman REED. Thank you. Senator Allard.

Senator ALLARD. In your testimony, Mr. Landes, you made the statement that AICPA supports the goal of the single set of high quality comprehensive accounting standards to be used by public companies. Does the association or the institute feel that the United States has the best set of accounting standards?

Mr. LANDES. We would all love to believe that what we have in the United States is the best, whether it be accounting standards, whether it be auditing standards, regulatory processes. What we have found is that we may not always have the best answers. I have, if I may—

Senator ALLARD. Can you give me some examples where the international accounting standards might be superior to what we have in the United States?

Mr. LANDES. Well, I believe that one of the items that Sir David talked about was prior to the FASB's issues of FIN 46, where they had some consolidation standards that may actually have been better than the U.S. standards at the time. So I do not—

Senator ALLARD. That is where you talked about the majority, as opposed to controlling interest?

Mr. LANDES. That is correct. That is correct, Senator Allard. I do not have any specifics that I could give you today. I am not prepared to offer specifics where I think one is necessarily better than the other. That is a debate that we personally do not believe is one that we should be having. We believe—and I believe Senator Reed mentioned, and perhaps you alluded to it, as well—that we should not be looking at whether one set is better than the other. But what we ought to be doing is looking at them both and saying how can we draw the best answer out of both of those standards to create one set of high quality standards.

Senator ALLARD. And that is what I am driving at, is for that clarification. Because when I looked at that statement, oh my gosh, it sounds to me like he would not be in favor of convergence. But you are in favor of convergence, working with other foreign countries to come up with a common standard?

Mr. LANDES. Absolutely, Senator.

Senator ALLARD. In some cases, we might have to give a little bit to accept a foreign standard.

Mr. LANDES. That is correct. That is part of the convergence process.

Senator ALLARD. Now there are some—well, let me drop that right there. Mr. Turner, let me get back to you and it is kind of along the same lines I was talking to him.

You are obviously very familiar with the Enron, Global Crossing, other firms, those problems there that we had that Congress ended up enacting Sarbanes-Oxley. And we did that to raise our corporate governance standards. What we found out, what this committee has begun to hear over the last couple of years, is that this higher—although we expected the higher standards to help our markets, when we raised those standards, many companies seem to have fled our stock markets, going to Tokyo. That is the report back to the committee—the Tokyo, London markets, and Toronto, I believe, is where the other markets are.

When we try and level out and reach a convergence like Mr. Landes talked about, some of the European countries have carved out exceptions. How can we be assured that we will not have a similar adverse impact on our businesses here in this country?

Mr. TURNER. Actually, at this point in time, I do not think you can be assured of that because the process is young and we do not know how it is going to work out. As I mentioned earlier, I do get concerned about competitiveness between one and the other. Some people would say oh, let's just look like the Europeans. Well, if your product all looks alike, I can guarantee you as a former businessman you are not going to be the one selling most of the product.

And right now, quite frankly, we are selling the most. Our capital markets still, to this day, have the best risk premium on them for investors. Those companies that have gone to the London market, for the most part, would not meet the listing requirements of

the New York Stock Exchange or NASDAQ, regardless of what is SOX. So SOX has nothing to do with it.

As Goldman Sachs, probably a premier firm if not the premier firm, has truly shown and demonstrated, it is not anything to do with the regulatory regime that has caused people to think about going elsewhere. It is either typically most people do like to list in their home country. And you know that is not a novel idea here. Most companies here like to list here, as well.

It is because of the GDP growth in some of the emerging Asian markets like India and China are growing at three to five times our GDP. Their businesses are growing. That provides much greater opportunity for growth in the businesses and that is where the investment returns are going to be higher.

In fact, I serve on a mutual fund and we are reallocating to some of the foreign markets more money because those are the ones where they are going to generate the most return.

So it is not the regulatory scheme that is getting us down. It is not the litigation that is getting us down. So I think those are misnomers. What the focus really has to be on is how do we make our markets different such that they are going to give investors the higher returns?

And unfortunately, one of the things that foreign investors, the largest pension funds in Europe and around the globe, Australia, have written to the Commission and said is that if they continued to be denied the same shareholder rights that they have in their home countries like the U.K. and those, if they continue to be denied those rights, they are going to withdraw their money from the U.S. capital markets. And that should concern us. It should concern us that we are not looking for those opportunities to get better.

Senator ALLARD. Thank you, Mr. Chairman.

Chairman REED. Thank you. I have one other area I would like to touch on with Ms. Yohn and Mr. Landes. And that is this would cause a sea change, I think, in the accounting profession in terms of the practice, the routine, the rules, whatever. And I have just had the experience, my godson went through and passed all the tests for his CPA spending hours, excruciating hours, late late at night, learning GAAP. And is that all for naught? Maybe that is the best question.

But it would seem to me that this would be a huge cultural change in the accounting profession. And are we prepared for that? And not just in the profession itself but in academic, those who prepare the accounts.

So Ms. Yohn, on this final point, unless Senator Allard has different questions, if you could comment and then Mr. Landes, on this whole issue of education and cultural change, how long will it take, and whatever?

Ms. YOHN. I do not think that the educational system is ready now for a move to IFRS. I know that universities have been trying to incorporate IFRS into the classes, into the accounting programs, and they are doing so. But they are trying to figure out the best way to do so and they are doing it slowly.

And so I do not think right now we are ready. And I know that some representatives of the auditing firms have come to the univer-

sities and said can you help us because we are concerned about the lack of expertise in IFRS within our offices in the U.S. So they see it as a big issue, as well.

So I agree, it would be a big sea change that I do not think we are ready for.

Chairman REED. Mr. Landes.

Mr. LANDES. Senator Reed, when you become a CPA one of the things that you learn very quickly is that you have committed yourself to a lifetime of learning. And even under our existing GAAP structure, things change.

When I think back to the time when I passed the CPA exam, there were five standards, five accounting standards. Now there are 159. There were only 30 auditing standards and now there are 140-some, excuse me 114.

And so what we are talking about here is part of a continuing process of education. I would agree that we are not ready today. But that does not mean that we should not start.

The AICPA has a course. We have several courses on IFRS. They are not the best sellers today but I suspect that they will gain traction over the next months and years as more CPAs become engaged in IFRS and the whole international convergence process.

But we recognize our responsibility to educate our members, to do what we need to do to bring them along, to help them walk that journey that will be the new accounting environment of the future. And that includes working with those folks in academic, working with textbook authors, our own CPA exam to make sure that it begins to change. And certainly, and I know both of you have expressed some concern, and rightfully so, with members from smaller companies or smaller CPA firms, who again may feel very overburdened with just the number of new standards that are out there today just in our own system.

And so one argument for moving to one core set is that you do not have to learn two, that you can begin simplifying and learning one. Will it take time? Absolutely. Are we absolutely—are we ready to turn the light switch on tomorrow? No, we are not. But I do not think anybody is saying we should turn the light switch on tomorrow.

Senator ALLARD. I do not have any more questions. I just would thank the panel for their testimony. I appreciate your comments.

Chairman REED. I would concur. Thank you all very much for making time out of your very busy schedules to join us today.

There may be additional written questions by my colleagues or members of the staff. If you could respond before Wednesday, October 31st for my colleagues. We will get the questions to you as quickly as we can.

Thank you very much. The hearing is adjourned.

[Whereupon, at 4:17 p.m., the hearing was adjourned.]

[Prepared statements and responses to written questions supplied for the record follow:]

**PREPARED STATEMENT OF SENATOR CHARLES E. SCHUMER**

Good afternoon, Chairman Reed and Ranking Member Allard. Thank you for holding today's hearing on the convergence of international accounting standards. We live in an era that has been defined by the increasing globalization of capital markets—a trend that was well documented in a report issued earlier this year by New York City Mayor Bloomberg and myself.

Our report made a number of recommendations to help the U.S. maintain its historical role as the global leader in financial markets, but one of the most important of these was the accelerated convergence of U.S. Generally Accepted Accounting Principles—GAAP—with International Financial Reporting Standards—IFRS.

In today's world, where a typical investment often consists of a Russian investor purchasing shares in a Japanese company listed on an American stock exchange, it simply makes no sense to have different auditing standards for different countries. As the trend of globalization continues to accelerate, it is critical that we establish one common language for reporting financial results to investors.

The fact is that IFRS is well on the way to becoming the global language which the rest of the world uses. More than 100 countries throughout the world, including all of the major financial centers outside of the U.S., already use IFRS. Furthermore, as all of you today acknowledge, IFRS standards are robust and high quality accounting principles that serve investor interests well. Therefore, the U.S. requirement that non-U.S. companies must reconcile their financial results to GAAP is a very costly, and in my view, unnecessary one, and is a deterrent for many foreign companies that might otherwise choose to list in the United States.

The requirement that foreign companies reconcile their accounting results to GAAP is, in my opinion, a key factor in the decline of the preeminence of U.S. capital markets, which have seen their market share decline from 57% of global IPO proceeds in 1999 to just 18% last year. Last year, only 3 of the top 25 IPOs chose to list in the U.S. We must reverse this trend, and recognizing IFRS is absolutely critical to doing this. **When it comes to the way companies balance their books, Wall Street and the rest of the world should be on the same page.**

**IFRS will be the language of worldwide business for future generations and we must start allowing it to be spoken in the U.S. And eventually, U.S. businesses must be allowed to speak this language themselves, which is why I am glad to see FASB and IASB working together towards the convergence of their accounting standards. We must ensure that American entrepreneurs and investors can communicate freely and openly on the international stage.**

But we must also be judicious in how we proceed with the convergence of accounting standards. This should not be a race to the bottom, nor should the historical role of FASB be ignored. I am pleased to hear that FASB and the IASB are working together to try to come up with a "best of breed" approach to converging GAAP and IFRS. It is imperative that the United States, which has been the nexus of the world's financial markets, continue to act as a leader in establishing the future of capital markets.

I think it is also quite critical that in considering how future accounting standards will be set, we make sure that individual national political considerations do not poison the well. In this country, we have fortunately had a historical tradition of having an independent accounting board—FASB—which politicians have been loath to try to influence for short-term political gain. It is absolutely necessary for any accounting system that hopes to serve the best interests of investors to be similarly independent from the political considerations of individual nations. And so I would ask FASB, IASB, and the SEC to consider measures to strengthen the independence of IASB from the political considerations of member nations as this debate goes forward.

I would like to thank all of the witnesses appearing today. This is a project that many of you have been working tirelessly upon for quite a long time, and I look forward to hearing your thoughts on the convergence issue. I am also quite eager to hear from the SEC in particular, to learn more about the status of this convergence proposal in the United States.

I thank you Mr. Chairman and I also thank the witnesses for all their hard work on this obviously complicated and important subject.

STATEMENT OF SIR DAVID TWEEDIE  
CHAIRMAN, INTERNATIONAL ACCOUNTING STANDARDS BOARD,  
BEFORE THE  
SUBCOMMITTEE ON SECURITIES, INSURANCE AND INVESTMENT  
OF THE  
UNITED STATES SENATE

Washington, DC, USA—24 October 2007

Mr Chairman and Members of the Subcommittee

I welcome this opportunity to appear before the Subcommittee to discuss the progress of the International Accounting Standards Board (IASB) and the relevance of International Financial Reporting Standards (IFRSs) to the United States and international capital markets more generally. The hearing is particularly timely. The IASB and the Financial Accounting Standards Board (FASB) just concluded their second joint meeting of the year yesterday, when we had the opportunity to review the progress of our convergence efforts. We at the IASB are also closely following the SEC's deliberations on its Proposed Rule and Concept Release regarding the use of IFRSs in the United States.

I am delighted that Conrad Hewitt, John White, and Bob Herz are here with me today, because the SEC and the FASB have been important partners in the effort to develop a single set of high quality international standards. Indeed, the SEC and the FASB were deeply involved in the establishment of the restructured IASB, and the structure, governance and independence of the IASB are largely modelled on the FASB's.

While it is my first time before this particular subcommittee, I have appeared three times previously before the Senate Banking Committee. The IASB greatly appreciates the continued support that the Senate Banking Committee has offered to the cause of convergence of accounting standards and the development of IFRSs. It was in the aftermath of Enron in

February 2002 when the Chairman of the Trustees at that time, Paul Volcker, and I first met the Committee. In the development of the Sarbanes-Oxley Act, the Committee acknowledged the potential benefits of international convergence and principle-based accounting standards. I am pleased to report that much progress has been made in those areas since that first meeting with the Committee.

#### **A long way in a short time**

At the time of my first appearance before the Banking Committee in 2002, the IASB had been in existence for less than a year. At our outset, we were established as a private sector, independent accounting standard-setter, based in London and comprising 14 members with a straightforward objective—to develop a set of high quality accounting standards that could be used in the world's capital markets.

Before the IASC Foundation was reconstituted in 2000 from a part-time body to the structure existing today, only a handful of countries throughout the world were using international standards. We have come a long way in a short time.

A lot of attention has been given to the European Union's adoption of IFRSs, and rightly so. The European Union's decision to adopt an internationally recognised set of standards, rather than create a uniquely European accounting system, provided the necessary encouragement for other countries to adopt a similar approach. The rationale behind the EU's decision was simple. Europe wanted to create a common capital market, and there were more than 25 different methods of accounting in today's EU Member States. In a world where business depends on capital from private and institutional investors, the lack of a common, well-respected financial

reporting language in Europe was an impediment to economic growth and the development of capital markets to rival other areas of the world.

The movement towards IFRSs is truly global and extends well beyond Europe's borders. More than 100 countries throughout the world—108 according to the latest Deloitte IASPlus survey—require or permit the use of IFRSs. From our discussions with regulators and standard-setters, we expect this number to rise substantially within a relatively short time. As I said, the EU's adoption served as a catalyst. Australia, Hong Kong, New Zealand, and South Africa all joined Europe as early adopters. The major emerging and transition economies of the world—Brazil, China, India, and Russia—are adopting or considering the adoption of IFRSs, not US GAAP, in an effort to become integrated in the world's capital markets and attract the investment necessary to finance their development. Similarly, Canada, Chile, Israel and Korea, economies with significant ties with the United States, have all recently announced their planned abandonment of national standards for IFRSs. Recently, I was in Japan where the Accounting Standards Board of Japan announced its convergence programme with a target date of 2011.

There is clear momentum towards accepting IFRSs as a common financial reporting language throughout the world. But our success is incomplete, and there are a number of countries that are still notably absent from the list of IFRS-applicants, including the United States.

#### **The United States and IFRSs**

Wherever I go, I am always asked whether the United States will accept IFRSs. It is understandable that the United States is not among the first wave of IFRS adopters. The United

States has a well-established and respected standard-setting body in the FASB. US GAAP has served US capital markets well and is a system of accounting that provides a high degree of transparency, has been tested over a long period of time, and has had a high degree of acceptance internationally.

However, the world is changing. New centres of international capital formation are emerging, and companies and investors have a broader range of options. The realities of globalisation, the integration of the world's capital markets, and the emergence of IFRSs as a viable and high quality set of international standards are changing the policy equation. A number of studies, including the report commissioned by Senator Schumer and Mayor Bloomberg, have documented these trends.

As members of the Subcommittee know, the US requirement for non-US companies to reconcile to US GAAP has caused resentment among non-US companies forced to go through the reconciliation exercise. The hope of many foreign registrants is that their use of IFRSs will serve as a passport to markets throughout the world, including the United States. At the same time, US companies operating in multiple jurisdictions are now facing the costs associated with complying with both US GAAP and IFRSs in jurisdictions that have local filing requirements.

It is here that I must confess a bias on the topic of IFRS use in the United States. As I mentioned earlier, the objective of the IASB is to have a single set of high quality, principle-based standards used worldwide. Clearly, a system will not be truly global if the United States does not participate. It is for this reason the IASB has placed such high priority on convergence with US GAAP.

Nevertheless, I do not want to pass judgement on the value of the reconciliation or the likelihood of the United States accepting IFRSs as an alternative to US GAAP. I will leave that to the SEC. I will, however, attempt to provide some insights on how I view the convergence process and its potential benefits to the United States and to answer any questions that you may have regarding the IASB's operations.

The benefits for US companies are very similar to those already achieved in Europe. US multinational companies are now complying with different accounting standards in the jurisdictions in which they operate. As the use of IFRSs spreads, the accounts of those foreign subsidiaries are more often based on IFRSs. Permitting the use of IFRSs in the United States would reduce the compliance costs associated with consolidating the accounts of foreign subsidiaries and the potential for error associated with the conversion and consolidation exercise.

US investors are increasingly seeking investment opportunities overseas. A common financial language, applied consistently, will enable investors to compare more easily the financial results of companies operating in different jurisdictions and provide more opportunity for investment and diversification. The removal of a major investment risk—the concern that the nuances of different national accounting regimes have not been fully understood—should open new opportunities for diversification and improved investment returns. This point is particularly relevant at a time when companies, countries and individuals are increasingly dependent upon capital markets to provide a secure retirement for employees.

For auditors, a single set of accounting standards should enable international audit firms to standardise training and provide better assurance of the quality of their work on a global basis. An international approach for accounting should also permit international capital to flow more

freely, enabling audit firms and their clients to develop consistent global practice to accounting problems and thus further enhance consistency. Finally, for regulators such as the SEC, the time and cost associated with needing to understand various reporting regimes would be reduced.

It is in this context that I believe that IFRSs and the process of international convergence offer an opportunity for the United States. The risk of any discussion of competition when it gets into regulatory issues is always the potential for a race to the bottom. However, the convergence process is aimed at avoiding such a situation, and early evidence suggests that countries that have adopted IFRSs from existing national standards have benefited.<sup>1</sup> Accounting standard-setting is a field of international co-operation in which the United States, through the FASB and the SEC, is encouraging a 'best of breed' approach to regulation and is improving the development of international capital markets.

#### **Pursuing the joint work programme with the FASB**

As I suggested, both the FASB and the SEC have been actively engaged in our work from the very beginning, and the FASB and the IASB have established joint work programmes. At the IASB, irrespective of any SEC decision on the future of the reconciliation requirement or the adoption of IFRS for some companies in the United States, we are committed to continuing working on our joint work programme with the FASB, which was most recently set out in our February 2006 Memorandum of Understanding (MOU).

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<sup>1</sup> See Armstrong, Barth, Jagolinzer, and Riedel, "Market Reaction to IFRS Adoption in Europe," January 2007.

Our joint work represents an effort that began five years ago with the Norwalk Agreement. Our goal from the outset has been more ambitious than just eliminating differences in existing standards. Our aim is to improve quality of financial reporting worldwide by developing new solutions to accounting issues when standards have failed to provide sufficient transparency to make informed economic judgements. This strategy has yielded results, and both boards have made changes in their standards, bringing them closer into line.

I believe that our early progress following the Norwalk Agreement gave the SEC confidence in our processes that encouraged it to lay out the 'roadmap', which set out steps required to eliminate the need for companies using IFRSs to reconcile to US GAAP by no later than 2009 and is now in the form of a proposed rule.

From the standard-setting standpoint the SEC roadmap was significant. The IASB and the FASB would no longer need to concentrate on a possibly endless series of changes to get the reconciliation removed. In consultation with the SEC and the European Commission, the IASB and the FASB agreed that trying to eliminate differences between two standards that are both 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 was in this context that in February 2006 the FASB and the IASB agreed on the new MoU that described their joint work programme for the coming years. (The MoU is attached as an appendix.) The FASB and the IASB agreed that convergence work should proceed on the following two tracks:

- First, the boards will reach a conclusion about whether major differences in focused areas should be eliminated through one or more short-term standard-setting projects, and, if so, the goal is to complete or substantially complete work in those areas by 2008.
- Second, the FASB and the IASB will seek to make continued progress in other areas identified by both boards where accounting practices under US GAAP and IFRSs are regarded as candidates for improvement, culminating in common standards.

The majority of topics in the first area are now either completed or near to completion. The eleven topics on our longer-term joint work programme—the second track of the MoU—include items identified as part of SEC report on off balance sheet items and as part of a recent study by the Committee of European Securities Regulators, such as consolidations, post-retirement benefits, leasing and financial instruments, including dereognition. We also have joint projects on financial statement presentation and the accounting for revenue recognition, fair value measurement, derecognition, and intangible assets. We have just completed a joint project on business combinations.

Importantly, the topics in the second track would have been the ones that both boards would address independently of convergence. They are the challenging conceptual issues of the day. Our joint efforts could therefore signal a double win—improved accounting in important areas and the elimination of differences between US GAAP and IFRSs. It is in these areas that we have the ability to shape the financial reporting landscape to one that can cope with the complexity of today's financial markets.

The result of the convergence process, as outlined by the MoU, should lead to a situation where US GAAP and IFRSs have broadly converged by 2011 or 2012. This time frame makes allowance for the due processes of the IASB and the FASB, which are similar and require extensive public consultation and transparency.

I should say that the convergence programme with the US FASB will not produce totally identical financial statements in the short term. But it will result in close alignment of the accounting for the same transactions and those that are in essence the same.

It is understandable that those affected by the standard-setting process will want to know how the future will look. My hope is that the standards emerging from the FASB-IASB work programme will be very different from the style of many existing IFRSs and US standards. The IASB is firmly wedded to a principle-based approach to standard-setting, and I personally believe that the convergence programme will be useful in driving US GAAP away from the body of prescriptive rules that constituents have requested from the FASB. While it is a misnomer to say that US GAAP is rule-based, few would deny that the level of guidance in its accounting standards and the multiplicity of additional interpretations of that guidance have proliferated under US GAAP.

This is where convergence with IFRSs can help. As part of our MoU work, the FASB and the IASB are seeking another way forward—future joint standards have not only to be principle-based but should contain only a minimum of additional guidance. Going forward, we will demand that a good principle-based standard must pass four tests:

- (i) Is the standard written in plain English? (This is also important to allow easy translation of our standards.)
- (ii) Can the standard be explained simply in a matter of a minute or so? If not, why does it take longer? (Put another way, can only specialists understand it or can most accountants use it?)
- (iii) Does it make intuitive sense?
- (iv) Do managements believe that it helps them to understand and describe the underlying economic activity?

The use of principles should eliminate the need for anti-abuse provisions. It is harder to defeat a well-crafted principle than a specific rule that financial engineers can by-pass. A principle followed by an example can defeat the ‘tell me where it says I can’t do this mentality’. If the example is a rule then the financial engineers can soon structure a way round it. For example, if the rule is that, if A, B and C happens, the answer is X, the experts would restructure the transaction so that it involved events B, C and D and would then claim that the transaction was not covered by the standard.

A principle-based standard relies on judgements. Disclosure of the choices made and the rationale for these choices would be essential. If in doubt about how to deal with a particular issue, preparers and auditors should relate back to the core principles. The basis for conclusions (the rationale underlying a particular standard and published with it) should also include, in particular, the question of whether there is only a single view to tackle the economics of the situation. Often there are competing views—is one regarded as more relevant? If so, the reasons for choosing that particular view should be explained in the basis for conclusions and the reasons for rejecting the others clearly outlined.

All application guidance and examples to understand the principles have to be questioned. Would anything be missed if they were deleted? If guidance is necessary, is the principle sufficiently clearly stated? Does the standard include bright lines and arbitrary limits? Why are these necessary? Does the transition to the new standard follow the normal pattern? If not, why is a change proposed?

This is the vision that I have for the convergence of US GAAP and IFRSs, one that is achievable in a relatively short time.

I know that several commentators have voiced their concern that the elimination of the reconciliation requirement by the SEC would remove an important incentive for future convergence. I disagree. The IASB's objective is to have a single set of accounting standards used through out the world. The strategy laid out in the MoU provides a sensible approach for doing so, and my colleagues and I are committed to continuing these efforts. It is my personal opinion that the elimination of the reconciliation requirement would be a demonstration of the United States' commitment to IFRSs and will help solidify support for our work on the MoU internationally.

#### **Ensuring consistent implementation of IFRSs**

As you can tell, I am optimistic about the prospects for convergence and the implementation of IFRSs throughout the world. The implementation of IFRSs in Europe and elsewhere has gone relatively smoothly, and a new wave of countries are now adopting IFRSs. Adding a growing commitment from the United States towards IFRSs is an important element of

the IASB's strategy, and the SEC's proposals have caught the imagination of those who doubted the motivations of the United States in the standard-setting process.

Of course, there are a number of challenges before we can state with confidence that a single set of common, high quality accounting standards is being used worldwide. Clearly, the implementation and enforcement of our standards will be important in determining our success. Commentators on the SEC's proposed rule on the reconciliation requirement have rightly understood the need for consistent application of IFRSs. Helping ensure the consistency and protecting the IFRS brand is a leading priority of the organisation. First and foremost, we are encouraging countries to resist the temptation of creating national flavours to IFRSs. As you know, the IASB cannot force anyone to take its standards; they have to be accepted by jurisdictions the world over. It is our job to convince national bodies that our consultation process is robust and that the outcomes merit the respect of the markets. We seek to do so through a rigorous due process. We are also engaging in our work policymakers, such as members of this subcommittee, and those parties affected by accounting standard-setting.

Second, the IASB has an interpretative body, the International Financial Reporting Interpretations Committee (IFRIC), which is similar to the FASB's Emerging Issues Task Force in structure. Overseen by the IASB, the IFRIC should remain the venue to resolve questions regarding the interpretation of standards.

Third, the IASB is working with securities regulators at the International Organization of Securities Commissions (IOSCO) and audit regulators, such as the International Audit and Assurance Standards Board (IAASB), to require clear statements regarding the implementation of IFRSs. We are in the process of proposing an amendment to the existing standards to help

clarify such statements. This is not necessarily our preferred approach to the problem, but we wished to raise the profile of the issue. We will continue to be open to input on this important issue.

Lastly, I believe that the enforcement of standards will be an important key to the ultimate success of IFRSs, and securities regulators will therefore play a leading role. This role for the regulator will not go away if the SEC chooses to eliminate the reconciliation requirement, and to some extent the SEC might be better positioned to encourage consistent practices among US foreign registrants using IFRSs, and to co-operate with IOSCO and other regulatory groupings on consistent policy related to IFRS application, if IFRSs were accepted in the United States.

#### **Work to be done**

We are at a crucial point in the development of IFRSs. The United States has played an important role in encouraging the adoption of IFRSs throughout the world. More than 100 countries and growing are using IFRSs and are working hard to ensure their consistent application. The world's fastest growing emerging economies are converging with IFRSs.

This is no time for the IASB to rest on its laurels. We are certainly not complacent. The IASB recognises the relevance of its work to the world's economy and the wide range of interests at stake. It is up to us to make sure that we operate in a transparent and accountable manner, engage with and inform the main stakeholders on a timely basis, and develop standards that are of high quality, reflect economic reality, and are broadly respected.

It is understandable that the US policymakers are now considering the options for US markets regarding IFRSs. We appreciate this subcommittee's continued interest in IFRSs and international convergence, and the IASB is committed to working closely with the FASB to complete the work programme described in the MoU. At the same time, the IASB and our oversight Trustees are discussing ways in which we can strengthen our ties with the regulatory community.

We are close to creating a financial reporting infrastructure appropriate for the global modern economy. Let's work together to finish what has been started.

I look forward to hearing your views and answering any questions that you may have.

**APPENDIX – Memorandum of Understanding****A Roadmap for Convergence between IFRSs and US GAAP—2006-2008****Memorandum of Understanding between the FASB and the IASB**

27 February 2006

After their joint meeting in September 2002, the US Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued their Norwalk Agreement in which they 'each acknowledged their commitment to the development of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. At that meeting, the FASB and the IASB pledged to use their best efforts (a) to make their existing financial reporting standards fully compatible as soon as is practicable and (b) to co-ordinate their future work programmes to ensure that once achieved, compatibility is maintained.'

At their meetings in April and October 2005, the FASB and the IASB reaffirmed their commitment to the convergence of US generally accepted accounting principles (US GAAP) and International Financial Reporting Standards (IFRSs). A common set of high quality global standards remains the long-term strategic priority of both the FASB and the IASB.

The FASB and the IASB recognise the relevance of the roadmap for the removal of the need for the reconciliation requirement for non-US companies that use IFRSs and are registered in the United States. It has been noted that the removal of this reconciliation requirement would depend on, among other things, the effective implementation of IFRSs in financial statements across companies and jurisdictions, and measurable progress in addressing priority issues on the IASB-FASB convergence programme. Therefore, the ability to meet the objective set out by the roadmap depends upon the efforts and actions of many parties—including companies, auditors, investors, standard-setters and regulators.

The FASB and the IASB recognise that their contribution to achieving the objective regarding reconciliation requirements is continued and measurable progress on the FASB-IASB convergence programme. Both boards have affirmed their commitment to making such progress. Recent discussions by the FASB and the IASB regarding their approach to the convergence programme indicated agreement on the following guidelines:

- Convergence of accounting standards can best be achieved through the development of high quality, common standards over time.
- 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.
- Serving the needs of investors means that the boards should seek to converge by replacing weaker standards with stronger standards.

Consistently with those guidelines, and after discussions with representatives of the European Commission and the SEC staff, the FASB and the IASB have agreed to work towards the following goals for the IASB-FASB convergence programme by 2008:

**Short-term convergence**

The goal by 2008 is to reach a conclusion about whether major differences in the following few focused areas should be eliminated through one or more short-term standard-setting projects and, if so, complete or substantially complete work in those areas.

Topics for **short-term convergence** include:

To be examined by the FASB	To be examined by the IASB
Fair value option*	Borrowing costs
Impairment (jointly with the IASB)	Impairment (jointly with the FASB)
Income tax (jointly with the IASB)	Income tax (jointly with the FASB)
Investment properties**	Government grants
Research and development	Joint ventures
Subsequent events	Segment reporting
<i>FASB Note:</i> *On the active agenda at 1 July 2005 ** To be considered by the FASB as part of the fair value option project	<i>IASB Note:</i> Topics are part of or to be added to the IASB's short-term convergence project, which is already on the agenda.

Limiting the number of short-term convergence projects enables the boards to focus on major areas for which the current accounting practices of US GAAP and IFRSs are regarded as candidates for improvement.

#### Other joint projects

The goal by 2008 is to have made significant progress on joint projects in areas identified by both boards where current accounting practices of US GAAP and IFRSs are regarded as candidates for improvement.

The FASB and the IASB also note that it is impractical, when factoring in the need for research, deliberation, consultation and due process, to complete many of the other **joint projects** by 2008. The two boards understand that during this time frame measurable progress on such projects, rather than their completion, would fulfil their contribution to meeting the objective set forth in the roadmap.

Furthermore, it is noted that the strategy regarding other joint projects and the goals described below should be consistent with one of the IASB's objectives of providing stability of its standards for users and preparers in the near term.

After consultations with representatives of the European Commission and the SEC staff and consistently with existing priorities and resources, the FASB and the IASB have expressed the progress they expect to achieve on their convergence project in the form of a list of 11 areas of focus. It is noted that these projects will occur in the context of the ongoing joint work of the FASB and the IASB on their respective Conceptual Frameworks. As part of their Conceptual Framework project, the FASB and the IASB will be addressing issues relating to the range of measurement attributes (including cost and fair value) to enable a public discussion on these topics to begin in 2006.

After considering the complexity of those topics and consultation requirements, the boards set the following goals for 2008 for convergence topics already on either their active agendas or the research programmes:

<b>Topics already on an Active Agenda</b>			
<b>Convergence topic</b>	<b>Current status on the FASB Agenda</b>	<b>Current status on the IASB Agenda</b>	<b>Progress expected to be achieved by 2008</b>
1. <b>Business combinations</b>	On agenda – deliberations in process	On agenda – deliberations in process	To have issued converged standards (projected for 2007), the contents and effective dates of which to be determined after taking full account of comments received in response to the Exposure Drafts.
2. <b>Consolidations</b>	On agenda – currently inactive	On agenda – no publication yet	To implement work aimed at the completed development of converged standards as a matter of high priority.
3. <b>Fair value measurement guidance</b>	Completed standard expected in the first half of 2006	On agenda – deliberations in process	To have issued converged guidance aimed at providing consistency in the application of existing fair value requirements. <sup>2</sup>
4. <b>Liabilities and equity distinctions</b>	On agenda – no publication yet	On agenda (will follow FASB's lead)	To have issued one or more due process documents relating to a proposed standard.
5. <b>Performance reporting</b>	On agenda – no publication yet	Exposure draft on a first phase	To have issued one or more due process documents on the full range of topics in this project.
6. <b>Post-retirement benefits (including pensions)</b>	On agenda – deliberations underway on the first phase of multi-phase project	Not yet on the agenda	To have issued one or more due process documents relating to a proposed standard.
7. <b>Revenue recognition</b>	On agenda – no publication yet	On agenda – no publication yet	To have issued one or more due process documents relating to a proposed comprehensive standard.

The objective of the goals set out above is to provide a time frame for convergence efforts in the context of both the objective of removing the need for IFRS reconciliation requirements by 2009 and the existing agendas of the FASB and the IASB. The FASB and the IASB will follow their normal due process when adding items to the agenda. Items designated as convergence topics among the existing research programmes of the boards include:

<b>Topics already being researched, but not yet on an Active Agenda</b>			
<b>Convergence topic</b>	<b>Current status on the FASB Agenda</b>	<b>Current status on the IASB Agenda</b>	<b>Progress expected to be achieved by 2008</b>
1. <b>Derecognition</b>	Currently in the pre-agenda research phase	On research agenda	To have issued a due process document relating to the results of staff research efforts.
2. <b>Financial instruments (replacement of existing standards)</b>	On research agenda and working group established	On research agenda and working group established	To have issued one or more due process documents relating to the accounting for financial instruments.

<sup>2</sup> The fair value guidance measurement project will not extend requirements for the use of fair value measurements, and any proposals regarding increasing the use of fair value accounting will be addressed in the context of the Conceptual Framework and other projects on the FASB's and IASB's respective agendas.

<b>3. Intangible assets</b>	Not yet on agenda	On research agenda (led by a national standard-setter)	To have considered the results of the IASB's research project and made a decision about the scope and timing of a potential agenda project.
<b>4. Leases</b>	Pre-agenda research underway	On research agenda (led by a national standard-setter)	To have considered and made a decision about the scope and timing of a potential agenda project.

In setting out the projects for both the short-term convergence topics and the major joint topics, the FASB and the IASB recognise that with respect to its foreign registrants the SEC staff will undertake an analysis of their 2005 IFRS financial statements across companies and jurisdictions. This analysis may reveal the need for additional standard-setting actions by one of the boards or both. Furthermore, the FASB and the IASB note that their work programmes are not limited to the items listed above, but remain committed to fulfilling their contribution to meeting the objectives set out by the roadmap.

The FASB and the IASB also recognise the need to undertake this work in a manner that is consistent with their established due process, including consultation with interested parties on their ongoing joint efforts before reaching conclusions.



**Testimony of**  
**Robert H. Herz**  
**Chairman**  
**Financial Accounting Standards Board**  
**Before the**  
**Subcommittee on Securities, Insurance, and Investment**  
**Committee on Banking, Housing, and Urban Affairs**  
**October 24, 2007**  
**International Accounting Standards:**  
**Opportunities, Challenges and Global Convergence**

**FORMAL STATEMENT*****The FASB***

The Financial Accounting Standards Board (“FASB”) is an independent, private-sector organization. Its mission is to establish and improve standards of financial accounting and reporting for both public and private enterprises, including small businesses and not-for-profit organizations. Those standards are essential to the efficient functioning and operation of the U.S. capital markets because investors, creditors, and other consumers of financial reports rely heavily on sound, honest, and unbiased financial information to make rational resource allocation decisions.

The FASB’s process for establishing standards involves extensive due process that includes consultation with all key participants of the financial reporting system. As part of that due process, we listen carefully to the views expressed by investors and other capital providers, the companies that prepare financial statements, the firms that audit those financial statements, and governmental bodies. However, our funding source (as dictated by the Sarbanes-Oxley Act<sup>1</sup>) and governance mechanisms provide us the independence that is essential to ensuring the integrity of the standards we produce and the neutrality of the financial information that companies provide by applying those standards.

The FASB’s independence, the importance of which was reaffirmed by the Sarbanes-Oxley Act, is fundamental to our mission because our standards are the basis entities use

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<sup>1</sup> Public Company Accounting Reform and Protection (Sarbanes-Oxley) Act of 2002, Public Law Number 107-204, Sections 108-109.

to measure and communicate the economic substance of their activities to investors, creditors, and other users of external financial reports. Investors and creditors need an independent FASB to maintain the integrity and neutrality of the standards so that the resulting financial information enhances their ability to make sound capital allocation decisions.

Our work is technical in nature, designed to provide entities with the guidance they need to prepare financial reports for investors, creditors, and other users. The FASB believes that information in financial reports must be neutral, or unbiased. That is, financial reporting is meant to tell it like it is, not to allow distortions or the skewing of the information to favor particular industries, particular types of transactions, or particular political, social, or economic goals other than sound and honest reporting. While bending the standards to favor or retain a particular outcome may seem attractive to some in the short run, in the long run, a biased accounting standard is harmful to investors, creditors, the capital markets, and the U.S. economy.

***FASB's Mission and International Convergence***

The FASB's views on financial reporting and international convergence are shaped primarily by our perceptions of the costs and benefits of providing financial information to investors and the capital markets. We give priority to the needs of investors because, in our view, the primary reason for developing high-quality accounting and external financial reporting standards for public companies is to enhance the efficiency of the capital market by giving potential investors the information and the confidence to buy and sell securities. We also give careful consideration to the costs and benefits to companies that prepare the accounting information as well as the costs imposed on

auditors, regulators, and the rest of society, but in our view, these costs are important but secondary criteria for setting external financial reporting policy.

Recent years have been marked by a continuing and rapid globalization of capital markets, cross-border investing, and international capital-raising. In light of that, we agree with the Securities and Exchange Commission's ("SEC") view that "having a widely used single set of high quality globally accepted accounting standards accepted and in place could benefit both the global capital markets and investors."<sup>2</sup> The ultimate goal, however, is not simply identical accounting standards. We believe the ultimate goal should be a common, high-quality global financial reporting system (at least for publicly listed companies) that can be used for decision-making purposes across borders. Achieving that ideal system, however, will require improvements and convergence in various elements of the infrastructure that support the international capital markets, including:

- a. A single set of high-quality international standards developed and promulgated by an independent, well-funded, global standard-setting organization, with a global interpretive body to provide timely guidance as implementation issues arise;
- b. Common, high-quality disclosure requirements beyond the financial statements and footnotes (e.g., MD&A, market risk disclosures, executive compensation) promulgated by an international group such as the International Organization of Securities Commissions (IOSCO);

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<sup>2</sup> SEC *Concept Release on Allowing U.S. Issuers to Prepare Financial Statements in Accordance with International Financial Reporting Standards* (August 7, 2007) Section III.A

- c. Cooperative international regulatory, enforcement, and corporate governance regimes focused on the needs of investors and other key users of reported financial information;
- d. Common, high-quality auditing standards, including auditor independence requirements;
- e. Systems for training and educating capital market participants (investors, auditors, preparers, regulators, etc.).

Achieving this ideal financial reporting system would bring many benefits and opportunities. For example, it should significantly improve the overall usefulness and comparability of reported financial information and increase investor confidence worldwide. In addition, achieving the ideal system should reduce the complexity (and related costs) that investors and companies currently face because of the multiple financial reporting languages that are in use today. As a result, global capital markets should function more efficiently and effectively, contributing to overall economic growth.

The challenges involved in developing the ideal financial reporting system are many. Among them are existing differences in institutional, regulatory, business, and cultural environments; the inevitable resistance to change by some; differing priorities among jurisdictions; and the existing U.S. demand for detailed guidance and specialized industry standards. The benefits and opportunities the ideal system offers, however, should justify the cost and effort of confronting these many challenges.

***The Current State of Convergence of Accounting Standards***

The view that continuing and rapid globalization of capital markets drives a need for a converged and improved financial reporting system is not new. Work is under way to improve and converge various elements of the international financial reporting infrastructure, and we encourage and support the continuation of those efforts.

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

Many jurisdictions around the world have since decided to require or permit public companies to use International Financial Reporting Standards (“IFRS”) established by the IASB. Many others are planning to move in this direction. Some of those jurisdictions, however, have a post-issuance process for endorsing each IFRS that has resulted in changes to the standard issued by the IASB, resulting in “as-endorsed” or “as-adopted” versions of IFRS. Moreover, evidence reveals apparent differences in the implementation of IFRS in various jurisdictions that can and do result in national variants of IFRS.<sup>3</sup>

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<sup>3</sup> Financial Reporting Policy Committee of the Financial Accounting and Reporting Section of the American Accounting Association, “Response to SEC Proposing Release,” September 24, 2007, pp. 10–13.

In the U.S., the FASB and IASB committed in 2002 to the goal of developing a set of high-quality, compatible standards. The 2002 Norwalk Agreement<sup>4</sup> describes the broad plans for achieving that goal, such as coordinating the agendas of both Boards so that all major projects are undertaken jointly, and eliminating narrow differences in other projects through focused, short-term convergence projects. The 2006 Memorandum of Understanding<sup>5</sup> sets specific milestones to be achieved by 2008. The SEC<sup>6</sup> and others (including the Trustees of the Financial Accounting Foundation<sup>7</sup> and the Financial Accounting Standards Advisory Council<sup>8</sup>) have encouraged and supported this approach. The IASB and FASB have made steady progress toward convergence since 2002. Standards have been issued by both Boards that improve financial reporting by eliminating differences between IFRS and U.S. GAAP (in areas such as inventory, nonmonetary transactions, share-based payments, segment reporting, and the use of a fair value option to simplify the accounting for financial instruments). Both Boards will soon issue a common standard that improves, simplifies, and converges the accounting for business combinations and noncontrolling interests. Differences in existing standards for business combinations are some of the more common reconciling items between U.S. GAAP and IFRS. In upcoming months, both Boards will be seeking comments from their constituents on several major improvement initiatives, including their joint projects

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<sup>4</sup> FASB & IASB, *The Norwalk Agreement*, September, 2002. See Attachment A.

<sup>5</sup> FASB & IASB, *A Roadmap for Convergence between IFRSs and US GAAP—2006-2008 Memorandum of Understanding between the FASB and the IASB* February 27, 2006. See Attachment B.

<sup>6</sup> SEC News Release, "SEC Welcomes Plans of U.S., International Standard Setters for Convergence of Accounting Systems," February 27, 2006, <http://www.sec.gov/news/press/2006-27.htm>.

<sup>7</sup> The Financial Accounting Foundation is the independent, private-sector organization with responsibility for the oversight, administration, and finances of the FASB, the Governmental Accounting Standards Board, and their advisory councils. The FAF selects the members of the standard-setting Boards and Councils, and protects the independence of the Boards.

<sup>8</sup> The primary function of Financial Accounting Standards Advisory Council is to advise the FASB on issues related to projects on the FASB's agenda, possible new agenda items, project priorities, procedural matters that may require the attention of the FASB, and other matters as requested by the chairman of the FASB. FASAC members have varied business and professional backgrounds.

on financial statement presentation, liabilities and equity, revenue recognition, and an improved and converged conceptual framework.

Although the FASB and IASB have made significant progress since 2002 in improving and converging IFRS and U.S. GAAP, that work is incomplete.

- Two SEC studies of accounting issues, for example, conclude that both existing U.S. GAAP and IFRS need improvement in several key areas.<sup>9</sup>
- Many key differences between IFRS and US GAAP remain. Some arise from differences between existing standards. Others arise because of differences in the scope of existing U.S. GAAP and IFRS (for example, IFRS does not currently include comprehensive standards for insurance contracts).
- Studies of foreign filers using IFRS document that the 20-F reconciliations report significant differences in earnings and equity.<sup>10</sup> For example, one recent study of 130 foreign issuers' reconciliations from IFRS to U.S. GAAP reports that earnings reported under IFRS were 5% higher than earnings reported under U.S. GAAP for half of the companies; IFRS earnings exceeded U.S. GAAP earnings by 20% for a quarter of the companies; and seven companies' IFRS earnings were more than double their U.S. GAAP earnings.<sup>11</sup>

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<sup>9</sup> SEC "Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System," July 25, 2003, and SEC "Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 On Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers," June 15, 2005.

<sup>10</sup> Financial Reporting Policy Committee, p. 4.

<sup>11</sup> Results reported here are based on data from Jack Ciesielski, *The Analyst's Accounting Observer*, "It's Not a Small World, After All: The SEC Goes International" September 24, 2007, pp. 8 and 9

***The Future of Convergence of Accounting Standards***

While the Boards' current efforts are producing results, it will take many years to realize the goal of a single set of high-quality international standards using the approach spelled out in the Norwalk Agreement. As discussed below, in order to accelerate progress toward a single set of high-quality international standards for use in both domestic and cross-border markets, we believe now is the appropriate time to develop a plan for moving all U.S. public companies to an improved version of IFRS and to consider any actions needed to strengthen the IASB as the global accounting standard setter.

***Why an Improved Version of IFRS Is Likely to Be the Global Standard***

While U.S. GAAP has enjoyed wide acceptance in the past, current trends suggest that it will not become the single set of international standards. To date, over 100 jurisdictions, including Hong Kong, Australia, and the countries in the EU, either require or permit the use of IFRS or a local variant of IFRS.<sup>12</sup> Recently, other jurisdictions with large capital markets (e.g., Canada, Japan, and Korea) have announced plans to replace their national GAAP for public companies with IFRS. To be truly international, however, any single set of international standards would also need to be adopted and used by U.S. public companies. Therefore, achieving the goal of a single set of high-quality international standards logically requires U.S. accounting standards to transition to IFRS because it is highly unlikely that the other countries that recently embraced IFRS will be willing to convert to U.S. GAAP. Thus, we believe that planning for a transition by U.S. public companies to an improved version of IFRS is the logical way forward to achieving the

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<sup>12</sup> See <http://www.iasplus.com/country/useias.htm> (updated as of October 5, 2007).

goal of a single set of high-quality international standards that will deliver the quality and comparability in financial reporting that investors demand.

***Managing the Complex Process of Moving U.S. Public Companies to IFRS***

Moving all U.S. public companies to an improved version of IFRS will be a complex, multi-year endeavor. A smooth transition will not occur by accident. To manage a change of this magnitude, we believe that the first step should be the development of a blueprint for coordinating and completing the transition that is agreed to by all major stakeholders in the process (SEC, FASB, IASB, PCAOB, users, preparers, auditors, regulators, educators, and others). The goal of the blueprint should be to identify the most orderly, least disruptive, and least costly approach to transitioning to an improved version of IFRS. The blueprint should set a target date or dates for U.S. registrants to move to IFRS that allows adequate time for making the many changes, both within the U.S. and internationally, that are needed before requiring the use of IFRS by all U.S. public companies.

***Changes Needed Internationally***

The blueprint should identify changes to the reporting system internationally that are necessary to achieving the goal of a single set of high-quality international standards. Some of the more important of those changes follow:

- Evaluating and possibly changing the post-issuance endorsement processes currently in place in many jurisdictions to reduce or eliminate the “as-adopted” versions of IFRS. The existence of “as-adopted” versions is inconsistent with the goal of a single set of high-quality international standards.

- Further strengthening the IASB as an independent, global standard setter by establishing mechanisms to ensure the sufficiency and stability of its funding and staffing.
- Improving IFRS in key areas by developing standards where none currently exist (such as insurance contracts and extractive industries) and strengthening other existing standards to provide more relevant, less complex reporting (for example, the conceptual framework, financial instrument accounting, and leasing)
- Improving coordination of global regulatory review and enforcement.

*Changes Needed Within the U.S.*

As noted above, moving U.S. public companies to IFRS will be a complex, multi-year endeavor. The blueprint should also identify and establish timetables to accomplish the myriad of changes necessary to support this move, including changes to the financial reporting infrastructure in the U.S. that would be necessary to support the move to an improved version of IFRS. Some of the key infrastructure elements to consider include:

- How to effectively train and educate issuers, their auditors, investors, and other users of financial statements about the improved version of IFRS, including implications for the U.S. education system and the uniform Certified Public Accountant examination;
- How a transition to IFRS will affect audit firms and auditing standard setting;
- How to modify existing internal control systems that were designed around existing U.S. GAAP requirements;

- How a move to IFRS would affect current laws, regulatory agency policies, contractual arrangements, or state legal requirements that are currently based on U.S. GAAP financial reports;
- How current SEC disclosure requirements would mesh with the reporting requirements under IFRS;
- How to determine financial reporting standards for private companies and not-for-profit enterprises, which currently use U.S. GAAP; and
- How other elements of the U.S. system might need to change to enable the use of accounting standards that include less specific and less detailed guidance (thus requiring more judgment) and less specialized industry accounting requirements.

The many changes to the U.S. financial reporting infrastructure and the changes within U.S. companies necessary to support the move to IFRS will take a number of years to complete. During that time, the FASB and IASB would continue our cooperative efforts to develop common, high-quality standards in those key areas where neither existing U.S. GAAP nor IFRS provides sufficient information for investors. Those common standards, issued by both the FASB and IASB, should be adopted by companies in the U.S. and internationally when issued and effective. In other areas that are not the subject of those joint improvement projects, U.S. public companies would adopt the IFRS standards “as is” over a period of years.<sup>13</sup> The adoption of those IFRS standards by U.S. companies would complete the migration to an improved version of IFRS.

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<sup>13</sup> If it were clear that U.S. GAAP in a particular area was demonstrably better than the IFRS standard, consideration should be given to incorporating the U.S. GAAP standard into IFRS “as is”.

We believe there are many advantages to such an “improve and adopt” approach to transitioning U.S. public companies to an improved version of IFRS. Financial statement users both domestically and internationally will benefit from the continued, cooperative efforts by the FASB and IASB to improve, simplify, and converge financial reporting in those areas of existing U.S. GAAP and IFRS that are clearly deficient. U.S. capital market participants are accustomed to adopting new accounting standards from time to time. Under this approach, new standards or existing IFRS will be gradually adopted over a period of several years, smoothing the transition process and avoid the capacity constraints that might develop in an abrupt mandated switch to IFRS. Moreover, this approach permits the Boards to focus their resources on improving standards in areas important to investors, rather than on eliminating narrow differences among many standards.

***FASB Views on SEC Proposing and Concept Releases***

The process of moving to a single set of high-quality international standards—either by implementing the Norwalk Agreement or by developing and implementing a blueprint to move U.S. companies to IFRS—would take a number of years to complete. The length of that process raises valid questions about allowing U.S. companies a choice of using IFRS before the process is complete. Thus, the issues raised by the two recent SEC Releases related to the use of IFRS in the U.S. are important and timely, and we commend the SEC for stimulating a dialogue on those issues. The Proposing Release, if adopted, would allow foreign private issuers to file financial statements prepared in accordance with IFRS without preparing a reconciliation of their reported numbers to

U.S. GAAP. The Concept Release seeks input from interested parties on whether U.S. issuers should be allowed to prepare financial statements in accordance with IFRS.

*The Concept Release—Whether To Allow Individual U.S. Public Companies the Choice of Adopting IFRS*

Of the issues covered in the releases, we are most interested in the potential for U.S. issuers to use IFRS. A move to IFRS by U.S. issuers seems desirable and inevitable for reasons mentioned above. However, the Concept Release envisions allowing individual U.S. public companies a choice of adopting IFRS or continuing to use U.S. GAAP, thus raising the possibility of a two-GAAP system for public companies. We are generally opposed to allowing companies to elect different accounting methods for economically similar transactions, because of the cost and complexity that such choices create for investors and others trying to use financial information, and the cost and complexity involved in developing a U.S. financial reporting and educational infrastructure that supports two financial reporting languages. The SEC has historically voiced similar concerns about permitting such choices.<sup>14</sup> Furthermore, the underlying infrastructure elements needed to support the use of different accounting methods will not be in place, and as a result, investor confidence could be reduced.

For those reasons, we do not support permitting U.S. companies a choice between IFRS and U.S. GAAP for any extended period of time. We believe it would be preferable instead to move all U.S. public companies to an improved version of IFRS over a transition period of several years following the blueprint mentioned above. That said, within the context of a plan to move the U.S. to an IFRS-based system, consideration

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<sup>14</sup> SEC *Concept Release: International Accounting Standards*, Section IV.A.2 (February 18, 2000).

could be given to permitting some companies the choice of transitioning to IFRS more rapidly than the timeframes established in the blueprint.

*The Proposing Release—Whether to Remove the Existing U.S. GAAP Reconciliation Requirement*

A variety of differing views have been expressed on the SEC's proposal to remove the requirement for foreign issuers preparing financial statements using IFRS, as issued by the IASB, to reconcile their reported results to U.S. GAAP. Foreign preparers and regulators, not surprisingly, support the elimination. Some U.S. companies support removal because reconciliations are costly, and respondents are concerned that they may face retaliatory reconciliation requirements in some foreign capital markets. Some financial statement users contend the reconciliation arrives too late to affect their decisions, while others find it useful in their analysis of financial statements. Academics report evidence that the reconciling items between IFRS and U.S. GAAP are often material, and the differences could get larger once the reconciliation is removed. Of greater concern is evidence of low-quality application and enforcement of IFRS in countries with weak investor protection laws.<sup>15</sup>

We believe that whether or not to eliminate the reconciliation requirement in the near future is a difficult and sensitive matter that could have important implications for the continued development of a global reporting system. On the one hand, we acknowledge the views and concerns of those who believe it would be premature and would result in a loss of information that some investors and other users find important. On the other hand, this change only relates to a relatively small number of SEC registrants in relation

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<sup>15</sup> Financial Reporting Policy Committee, pp. 10–13.

to the overall size of our capital market, and continuing the reconciliation requirement could well be viewed by some parties outside this country as a clear signal that the U.S. is not truly interested in participating in the development of an international financial reporting system. In turn, that could negatively impact the willingness of these parties to support continued convergence between IFRS and U.S. GAAP. Conversely, we believe that once the reconciliation requirement is eliminated, some parties who have viewed the convergence effort between the IASB and the FASB as the price of getting the SEC to eliminate the reconciliation may see no further benefit in continued improvement and convergence of IFRS and U.S. GAAP. In that regard, recent comments made in the public press and in public forums give reason to believe that eliminating the reconciliation requirement will result in calls by some for a cessation of any improvement of IFRS, especially any improvements designed to achieve convergence with U.S. GAAP.<sup>16</sup> The decision whether, when, and how to remove the reconciliation requirement rests with the SEC. However, in doing so, we feel it would be very important to make it clear that getting to a single set of high-quality international standards remains the ultimate goal, and that further convergence and improvement of standards is necessary to achieve that goal. Thus, in our view, it would be advisable that the removal of the reconciliation requirement coincide with the commitment, by all relevant parties internationally and within the U.S., to implementing the blueprint for changing to an IFRS-based global reporting system. Furthermore, we strongly agree with the SEC proposal that the reconciliation requirement only be eliminated for those foreign private issuers that fully apply IFRS as issued by the IASB and not for those who use “as-

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<sup>16</sup> See, for example, Kate Burgess, “Rethink is urged over accounting proposals,” *Financial Times* (11 July 2007) p. 23; and “EU fears U.S. influence,” *Accountancy* (August 1, 2007).

adopted” versions of IFRS. To do otherwise would in our view be inconsistent with the goal of moving to a single set of high-quality international standards.

***Conclusion***

The Financial Accounting Standards Board remains firmly committed to achieving a single set of high-quality international standards, and we believe that now is the time for the SEC, FASB, IASB, PCAOB, users, preparers, auditors, regulators, educators, and others to develop a blueprint for moving U.S. public companies to an improved version of IFRS. Recognizing the emerging trends in the global economy, we stand fully prepared to work with the financial reporting community to implement an orderly and cost effective transition to IFRS.

**ATTACHMENT A**  
**2002 NORWALK AGREEMENT**

## Memorandum of Understanding

**“The Norwalk Agreement”**

At their joint meeting in Norwalk, Connecticut, USA on September 18, 2002, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) each acknowledged their commitment to the development of high-quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. At that meeting, both the FASB and 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.

To achieve compatibility, the FASB and IASB (together, the “Boards”) agree, as a matter of high priority, to:

- a) undertake a short-term project aimed at removing a variety of individual differences between U.S. GAAP and International Financial Reporting Standards (IFRSs, which include International Accounting Standards, IASs);
- b) remove other differences between IFRSs and U.S. GAAP that will remain at January 1, 2005, through coordination of their future work programs; that is, through the mutual undertaking of discrete, substantial projects which both Boards would address concurrently;
- c) continue progress on the joint projects that they are currently undertaking; and,
- d) encourage their respective interpretative bodies to coordinate their activities.

The Boards agree to commit the necessary resources to complete such a major undertaking.

The Boards agree to quickly commence deliberating differences identified for resolution in the short-term project with the objective of achieving compatibility by identifying common, high-quality solutions. Both Boards also agree to use their best efforts to issue an exposure draft of proposed changes to U.S. GAAP or IFRSs that reflect common solutions to some, and perhaps all, of the differences identified for inclusion in the short-term project during 2003.

As part of the process, the IASB will actively consult with and seek the support of other national standard setters and will present proposals to standard setters with an official liaison relationship with the IASB, as soon as is practical.

The Boards note that the intended implementation of IASB’s IFRSs in several jurisdictions on or before January 1, 2005 require that attention be paid to the timing of the effective dates of new or amended reporting requirements. The Boards’ proposed strategies will be implemented with that timing in mind.

**ATTACHMENT B**

**2006 MEMORANDUM OF UNDERSTANDING**

**A Roadmap for Convergence between IFRSs and US GAAP—2006-2008****Memorandum of Understanding between the FASB and the IASB****27 February 2006**

After their joint meeting in September 2002, the US Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued their Norwalk Agreement in which they 'each acknowledged their commitment to the development of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. At that meeting, the FASB and the IASB pledged to use their best efforts (a) to make their existing financial reporting standards fully compatible as soon as is practicable and (b) to co-ordinate their future work programmes to ensure that once achieved, compatibility is maintained.'

At their meetings in April and October 2005, the FASB and the IASB reaffirmed their commitment to the convergence of US generally accepted accounting principles (US GAAP) and International Financial Reporting Standards (IFRSs). A common set of high quality global standards remains the long-term strategic priority of both the FASB and the IASB.

The FASB and the IASB recognise the relevance of the roadmap for the removal of the need for the reconciliation requirement for non-US companies that use IFRSs and are registered in the United States. It has been noted that the removal of this reconciliation requirement would depend on, among other things, the effective implementation of IFRSs in financial statements across companies and jurisdictions, and measurable progress in addressing priority issues on the IASB-FASB convergence programme. Therefore, the ability to meet the objective set out by the roadmap depends upon the efforts and actions of many parties—including companies, auditors, investors, standard-setters and regulators.

The FASB and the IASB recognise that their contribution to achieving the objective regarding reconciliation requirements is continued and measurable progress on the FASB-IASB convergence programme. Both boards have affirmed their commitment to making such progress. Recent discussions by the FASB and the IASB regarding their approach to the convergence programme indicated agreement on the following guidelines:

- Convergence of accounting standards can best be achieved through the development of high quality, common standards over time.
- 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.
- Serving the needs of investors means that the boards should seek to converge by replacing weaker standards with stronger standards.

Consistently with those guidelines, and after discussions with representatives of the European Commission and the SEC staff, the FASB and the IASB have agreed to work towards the following goals for the IASB-FASB convergence programme by 2008:

#### Short-term convergence

The goal by 2008 is to reach a conclusion about whether major differences in the following few focused areas should be eliminated through one or more short-term standard-setting projects and, if so, complete or substantially complete work in those areas.

Topics for **short-term convergence** include:

To be examined by the FASB	To be examined by the IASB
Fair value option*	Borrowing costs
Impairment (jointly with the IASB)	Impairment (jointly with the FASB)
Income tax (jointly with the IASB)	Income tax (jointly with the FASB)
Investment properties**	Government grants
Research and development	Joint ventures
Subsequent events	Segment reporting
<i>FASB Note:</i> *On the active agenda at 1 July 2005 ** To be considered by the FASB as part of the fair value option project	<i>IASB Note:</i> Topics are part of or to be added to the IASB's short-term convergence project, which is already on the agenda.

Limiting the number of short-term convergence projects enables the boards to focus on major areas for which the current accounting practices of US GAAP and IFRSs are regarded as candidates for improvement.

#### Other joint projects

The goal by 2008 is to have made significant progress on joint projects in areas identified by both boards where current accounting practices of US GAAP and IFRSs are regarded as candidates for improvement.

The FASB and the IASB also note that it is impractical, when factoring in the need for research, deliberation, consultation and due process, to complete many of the other **joint projects** by 2008. The two boards understand that during this time frame measurable progress on such projects, rather than their completion, would fulfil their contribution to meeting the objective set forth in the roadmap.

Furthermore, it is noted that the strategy regarding other joint projects and the goals described below should be consistent with one of the IASB's objectives of providing stability of its standards for users and preparers in the near term.

After consultations with representatives of the European Commission and the SEC staff and consistently with existing priorities and resources, the FASB and the IASB have expressed the progress they expect to achieve on their convergence project in the form of a list of 11 areas of focus. It is noted that these projects will occur in the context of the ongoing joint work of the FASB and the IASB on their respective Conceptual Frameworks. As part of their Conceptual Framework project, the FASB and the IASB will be addressing issues relating to the range of measurement attributes (including cost and fair value) to enable a public discussion on these topics to begin in 2006.

After considering the complexity of those topics and consultation requirements, the boards set the following goals for 2008 for convergence topics already on either their active agendas or the research programmes:

<b>Topics already on an Active Agenda</b>			
<b>Convergence topic</b>	<b>Current status on the FASB Agenda</b>	<b>Current status on the IASB Agenda</b>	<b>Progress expected to be achieved by 2008</b>
1. <b>Business combinations</b>	On agenda – deliberations in process	On agenda – deliberations in process	To have issued converged standards (projected for 2007), the contents and effective dates of which to be determined after taking full account of comments received in response to the Exposure Drafts.
2. <b>Consolidations</b>	On agenda – currently inactive	On agenda – no publication yet	To implement work aimed at the completed development of converged standards as a matter of high priority.
3. <b>Fair value measurement guidance</b>	Completed standard expected in the first half of 2006	On agenda – deliberations in process	To have issued converged guidance aimed at providing consistency in the application of existing fair value requirements. <sup>17</sup>
4. <b>Liabilities and equity distinctions</b>	On agenda – no publication yet	On agenda (will follow FASB's lead)	To have issued one or more due process documents relating to a proposed standard.
5. <b>Performance reporting</b>	On agenda – no publication yet	Exposure draft on a first phase	To have issued one or more due process documents on the full range of topics in this project.
6. <b>Post-retirement benefits (including pensions)</b>	On agenda – deliberations underway on the first phase of multi-phase project	Not yet on the agenda	To have issued one or more due process documents relating to a proposed standard.
7. <b>Revenue recognition</b>	On agenda – no publication yet	On agenda – no publication yet	To have issued one or more due process documents relating to a proposed comprehensive standard.

<sup>17</sup> The fair value guidance measurement project will not extend requirements for the use of fair value measurements, and any proposals regarding increasing the use of fair value accounting will be addressed in the context of the Conceptual Framework and other projects on the FASB's and IASB's respective agendas.

The objective of the goals set out above is to provide a time frame for convergence efforts in the context of both the objective of removing the need for IFRS reconciliation requirements by 2009 and the existing agendas of the FASB and the IASB. The FASB and the IASB will follow their normal due process when adding items to the agenda. Items designated as convergence topics among the existing research programmes of the boards include:

<b>Topics already being researched, but not yet on an Active Agenda</b>			
<b>Convergence topic</b>	<b>Current status on the FASB Agenda</b>	<b>Current status on the IASB Agenda</b>	<b>Progress expected to be achieved by 2008</b>
<b>1. Derecognition</b>	Currently in the pre-agenda research phase	On research agenda	To have issued a due process document relating to the results of staff research efforts.
<b>2. Financial instruments (replacement of existing standards)</b>	On research agenda and working group established	On research agenda and working group established	To have issued one or more due process documents relating to the accounting for financial instruments.
<b>3. Intangible assets</b>	Not yet on agenda	On research agenda (led by a national standard-setter)	To have considered the results of the IASB's research project and made a decision about the scope and timing of a potential agenda project.
<b>4. Leases</b>	Pre-agenda research underway	On research agenda (led by a national standard-setter)	To have considered and made a decision about the scope and timing of a potential agenda project.

In setting out the projects for both the short-term convergence topics and the major joint topics, the FASB and the IASB recognise that with respect to its foreign registrants the SEC staff will undertake an analysis of their 2005 IFRS financial statements across companies and jurisdictions. This analysis may reveal the need for additional standard-setting actions by one of the boards or both. Furthermore, the FASB and the IASB note that their work programmes are not limited to the items listed above, but remain committed to fulfilling their contribution to meeting the objectives set out by the roadmap.

The FASB and the IASB also recognise the need to undertake this work in a manner that is consistent with their established due process, including consultation with interested parties on their ongoing joint efforts before reaching conclusions.



**TESTIMONY  
OF**

**CONRAD W. HEWITT, CHIEF ACCOUNTANT  
JOHN W. WHITE, DIRECTOR  
DIVISION OF CORPORATION FINANCE  
U.S. SECURITIES AND EXCHANGE COMMISSION**

**CONCERNING  
GLOBALLY ACCEPTED ACCOUNTING STANDARDS**

**BEFORE THE  
SUBCOMMITTEE ON SECURITIES, INSURANCE, AND  
INVESTMENT  
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS**

**UNITED STATES SENATE**

**OCTOBER 24, 2007**

**U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549**

**Testimony Concerning Globally Accepted Accounting Standards**

*Conrad W. Hewitt, Chief Accountant  
John W. White, Director, Division of Corporation Finance  
U.S. Securities and Exchange Commission*

Before the Senate Subcommittee on Securities, Insurance, and Investment

October 24, 2007

Chairman Reed, Ranking Member Allard and Members of the Subcommittee:

Thank you for the opportunity to testify today on behalf of the Securities and Exchange Commission (Commission) concerning ongoing efforts to foster development and use of high quality globally accepted accounting standards. This testimony is presented jointly on behalf of the Office of the Chief Accountant, which advises the Commission on accounting and auditing matters, and of the Division of Corporation Finance, which is responsible for overseeing disclosures by domestic and foreign issuers of securities.

This testimony highlights the Commission's long history of supporting the goal of high quality globally accepted accounting standards. Global accounting standards help investors to understand investment opportunities more clearly and increase access to foreign investment opportunities. They reduce costs for issuers, who no longer have to incur the expense of preparing financial statements using differing sets of accounting standards. And lower costs facilitate cross-border capital formation as well as benefit shareholders, who ultimately bear the burden of the entire cost of the financial reporting system.

This summer, the Commission began a process to determine whether it is appropriate and timely to allow foreign and domestic registrants the alternative to submit for SEC filing purposes financial statements prepared in accordance with International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Board (IASB). Under the Commission's current filing requirements, foreign registrants have two alternatives for the preparation of financial statements, either (1) prepare them under U.S. GAAP or (2) prepare them under IFRS or a national GAAP and provide reconciling information to U.S. Generally Accepted Accounting Principles (U.S. GAAP). So, the Commission's proposal would allow foreign registrants to file IFRS financial statements without a required reconciliation to U.S. GAAP. The Commission has also asked questions about whether it would be appropriate to give domestic registrants the option of preparing their financial statements using IFRS in contrast to the current requirement that domestic registrants prepare their financial statements only under U.S. GAAP.

**A Long History of Promoting Robust Global Accounting Standards**

The Commission has long advocated reducing the disparity between the accounting and disclosure practices of the United States and other countries as a means to facilitate cross-border capital formation while ensuring adequate disclosure for the protection of investors and the promotion of fair, orderly and efficient markets.

- In 1981, the Commission encouraged the efforts of standard setters and other market participants to do the same.
- In 1988, 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.
- In 1996, in the National Capital Markets Efficiency Act, Congress directed the SEC to respond to the growing internationalization of securities markets by giving “vigorous support” to the development of “high-quality international accounting standards as soon as practicable.”
- In a 1997 report to Congress, the Commission encouraged the efforts of the International Accounting Standards Committee, the part-time volunteer 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. Those standards have now become part of IFRS, which we discuss further below.
- 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.
- In 2002, when Enron and the wave of accounting scandals called into question the intensely rule-based approach of U.S. GAAP, Congress, in section 108(d)(1) of the Sarbanes-Oxley Act, directed the SEC to undertake a study on the “adoption by the United States ... of a principles-based accounting system.” SOX expressly required that we examine the length of time that would be necessary to change from a rules-based to a principles-based financial reporting system. Also that year, the Commission supported the announcement by the Financial Accounting Standards Board (FASB) and the IASB 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.
- In 2005, as the European Union (EU) and others first adopted IFRS, the Commission adopted an accommodation to allow foreign first-time adopters of IFRS to file two years rather than three years of IFRS financial statements in their Commission filings.
- In February 2006, Chairman Cox endorsed a previously published “roadmap” containing the SEC staff’s evaluative work plan. This “roadmap” makes the case for high-quality, globally accepted accounting standards and suggests several considerations that the SEC staff would include in evaluating the appropriateness of permitting foreign private issuers to use IFRS for purposes of the U.S. capital markets without a U.S. GAAP reconciliation.
- In March 2007, the Commission hosted a roundtable regarding IFRS reporting by foreign private issuers.

- In July 2007, the SEC staff published a review of the 2005 filings of the foreign private issuers who currently submit IFRS financial statements that are reconciled to U.S. GAAP.

Throughout this process, the SEC has pursued these goals through a variety of international multilateral and bilateral fora, including the International Organization of Securities Commissions (IOSCO), a bilateral dialogue with the Committee of European Securities Regulators, and with fellow securities regulators from countries that have moved to or are moving to IFRS reporting. The SEC's staff has also participated, in some cases on behalf of IOSCO, as an Observer to the IASB's Advisory Council, its Interpretations Committee, and certain of its Working Groups.

### **International Financial Reporting Standards**

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. In 2001, these efforts were transformed from part-time voluntary efforts to full-time paid efforts with the establishment of the London-based International Accounting Standards Committee Foundation (IASC Foundation), which is a Delaware non-profit corporation whose core operation is the activities of its standard setting board, the IASB, which develops and maintains the body of IFRS.

The IASC Foundation is governed by a Board composed of twenty-two Trustees, six of whom constitutionally are from North America. Five of the North American Trustees currently serving are from the United States, with the other from Canada. Constitutionally, an additional six Trustees are from Europe; six are from Asia/Oceania; and four are "at large." The founding Chairman of the Board of Trustees was Paul Volcker. Having completed his term as Chairman, Mr. Volcker now chairs the Trustee Appointments Advisory Group, which is composed of nine individuals from international public sector banking, finance, and securities regulatory organizations who are consulted on new Trustee appointments. The incoming Chairman of the Board of Trustees is Gerrit Zalm, a former Netherlands Deputy Prime Minister and Minister of Finance. Because the IASC Foundation lacks the power to require contributions, it is currently funded through voluntary contributions, although it has an objective of establishing a permanent and independent funding structure. Some countries have or are instituting a local levy system to fund contributions.

The IASB is composed of fourteen members: twelve full-time and two part-time. The IASB members are appointed by the IASC Foundation Trustees. IASB member seats are not geographically driven; rather, members are chosen based upon an objective of assembling a group with the best available combination of technical skills and background experience of relevant international business and market conditions. Currently, three of the Board members are from the United States: two full-time and one part-time. In addition to the Board members, approximately thirty technical staff members from around the world are employed by the IASC Foundation to support the IASB's work.

Almost 100 countries now either require or permit the use of IFRS for the preparation of financial statements by their domestic listed companies. Under a regulation adopted in 2002, the EU required its listed companies to report using endorsed IFRS beginning in 2005. Japan's accounting standard setter and the IASB have agreed to work to accelerate convergence between Japanese accounting standards and IFRS, with certain interim target dates in 2008 and 2011. Other countries, such as China, Israel and India, have either begun to move toward use of IFRS (China and Israel) or have announced plans to do so (India). Closer to home, Canada has announced plans to move to IFRS reporting around 2011, while we understand Mexico is working to incorporate IFRS aligned content into Mexican accounting standards. The incentives and reasons for these national IFRS policy decisions, as well as the method and timing of the transition to IFRS reporting for companies in a particular country, are as varied as the profiles of the countries involved.

#### **The Financial Accounting Standards Board and the Convergence Process Between U.S. GAAP and IFRS**

The FASB is the independent, private-sector body whose pronouncements establishing and amending accounting principles the Commission has, since 1973, recognized as "authoritative" and "generally accepted" for purposes of the federal securities laws, absent any contrary determination by the Commission. Consistent with the FASB's objective to increase the quality of standards used in the United States and international comparability, the FASB is engaged in international accounting standard setter activities. This objective is consistent with the FASB's obligation to its domestic constituents, who benefit from comparability of information across national borders. In pursuit of this objective, the FASB as noted above entered into the Norwalk Agreement with the IASB in 2002, which marked a significant step towards formalizing their commitment to the convergence of U.S. GAAP and IFRS. In the Norwalk Agreement, the two bodies acknowledged their joint commitment 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.

In a further 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. The FASB and the IASB continue to work to align the content of U.S. GAAP and IFRS – an effort that has now been underway for five years. The better part of the two standard setters' current agendas (fourteen projects on the active agenda and four projects on the research agenda) are part of this effort. Areas of this work include addressing the manner in which information is displayed and presented in the financial statements as well as the accounting for revenue and leases.

#### **The Commission's Current Efforts Regarding Globally Accepted Accounting Standards**

The most recent and significant aspect of this current phase of the Commission's work involves the issuance of two releases regarding the potential use of IFRS in the U.S. capital markets. The first is the publication of a proposal in June to allow foreign private issuers to report using IFRS financial statements without a U.S. GAAP reconciliation. The comment period on the foreign private issuer proposal ended September 24, 2007. The second is the

issuance of a concept release in July to explore a more far-reaching prospect – the possibility of giving domestic issuers the alternative to report using IFRS. The comment period on the concept release is still open and closes on November 13, 2007.

These recent initiatives address the core policy issue of what role, if any, should the use of IFRS play in the U.S. public capital markets at this time along with U.S. GAAP. As with any policy decision, such a determination includes giving due consideration to the benefits and costs. In all of the Commission's work to date, a consistent premise is that investors are better served by having high quality financial information across issuers, regardless of domicile. This aids investors' ability to make informed capital allocation decisions among competing alternatives. Investors also benefit if costs of compliance for issuers in entering and staying in our capital markets are reduced, thereby encouraging additional investing opportunities from the global economy.

Of course, there are issues to consider in adjusting to a new set of accounting standards. With respect to the foreign private issuer proposal, for those not already familiar with IFRS this would include working with IFRS financial statements without a U.S. GAAP reconciliation. The impact of the loss of the reconciliation depends on the extent to which investors currently use it and the extent to which IFRS and U.S. GAAP continue to differ in some respects. The effect also depends on the number of issuers that would potentially avail themselves of this alternative. Currently, approximately 110 reporting foreign private issuers, out of a total of over 1,100 who file with the Commission, provide in their filings financial statements that are prepared pursuant to IFRS as published by the IASB, which is the subject of the foreign private issuer proposal. In addition, approximately 70 more reporting foreign private issuers prepare their financial statements in accordance with a jurisdictional adaptation of IFRS. If these issuers could also state that their financial statements are prepared in accordance with IFRS as published by the IASB, they would be in a similar position. Looking to the future, the Commission also has approximately 100 issuers from Israel and approximately 500 from Canada; both countries have announced moves to IFRS reporting.

#### **Public Response to the Foreign Private Issuer Proposal**

As noted above, the comment period on the foreign private issuer proposal closed on September 24, 2007, and the Commission received approximately 120 comment letters. The vast majority of commenters agreed that, overall, the use of high quality globally accepted accounting standards was an important and worthwhile goal in helping the global capital markets function effectively.

- Some commenters stated that IFRS were suitable to be used as an internationally accepted set of standards and that allowing IFRS without a U.S. GAAP reconciliation would be perceived as recognition of the adequacy of the convergence process to date and would not hinder the ongoing convergence process. However, other commenters stated that the time was not yet ripe for accepting financial statements prepared using IFRS without a U.S. GAAP reconciliation. Some of these commenters also expressed concern over the adequacy of the governance and funding for the IASC Foundation and/or that removing the reconciliation requirement would sap momentum from the overall convergence project.

- Many commenters stated that the reconciliation information is highly technical, not widely understood and is typically not available on a sufficiently timely basis to be useful. These commenters also generally expressed confidence in the quality of application of IFRS in practice. Others noted the usefulness of both the quantitative and qualitative aspects of the U.S. GAAP reconciliation.
- Many commenters urged the Commission to go further than just accepting without reconciliation financial statements prepared in accordance with IFRS as issued by the IASB. These commenters advocated a number of ideas, including: allowing financial statements prepared pursuant to jurisdictional adaptations of IFRS without a U.S. GAAP reconciliation; allowing financial statements prepared pursuant to jurisdictional adaptations of IFRS if reconciled to IFRS as published by the IASB; and allowing financial statements prepared pursuant to any home country GAAP if reconciled to IFRS as published by the IASB.

#### **Conclusion and Next Steps**

The Commission is currently analyzing the comments received thus far on the releases and for the proposal to remove the reconciliation process we have begun the process of evaluating the important issues raised. Given the increasing globalization of capital markets, it is imperative that the Commission be vigilant in keeping our regulatory standards up-to-date for the protection of investors, for the maintenance of efficient and orderly markets, and for the promotion of capital formation. Our ongoing work in the area of accounting and financial reporting is an important part of the Commission's wide-ranging efforts in this regard.

Thank you for the opportunity to appear today, and we would be pleased to respond to any questions.

**Testimony Concerning International Accounting Standards**  
Jack T. Ciesielski, President, R.G. Associates, Inc.

Before the Subcommittee on Securities, Insurance, and Investment  
of the U.S. Senate Committee on Banking, Housing, and Urban Affairs

October 24, 2007

Chairman Reed, Ranking Member Allard and Members of the Subcommittee:

Thank you for the opportunity to testify today. My remarks are based on my experiences as a former buy-side analyst and current investor and accounting analyst who works closely with buy-side and sell-side institutions through a research service called The Analyst's Accounting Observer. I also represent investor views as a member of the Emerging Issues Task Force. I would like to address four main areas of concern regarding international accounting standards and their convergence with U.S. accounting standards.

**1. Opportunities and challenges as the U.S. and international countries move towards convergence of IFRS with U.S. GAAP**

As convergence of International Financial Reporting Standards (IFRS) with U.S. Generally Accepted Accounting Principles (GAAP) moves forward, the opportunities are apparent. As long as the converged reporting system is consistent and understandable to U.S. investors, there will be more companies speaking the same language. That will open up more investment choices to U.S. investors - choices which may have been previously available only to investors with far greater resources and specialized knowledge of foreign country financial reporting.

At the same time, those opportunities won't present themselves without genuine convergence between the international accounting standards and U.S. GAAP standards. That's the most serious challenge at this time. Convergence between the two systems is worth striving for, but it's not clear that the two systems of reporting have been satisfactorily converged at this time.

In my opinion, the SEC's proposal to eliminate the reconciliation is premature. In its proposal, the Commission relies heavily on the fact that there is a process in place for converging the standards of the International Accounting Standards Board and the Financial Accounting Standards Board. It's true that the two standard setters have agreed to work on convergence of their standards since the Norwalk Agreement was reached

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in 2002. In fact, the two standard setters have worked jointly on all major projects since that time. The presence of a mechanism to achieve convergence is not the same thing as actually achieving convergence, however. Eliminating the reconciliation before genuine convergence is achieved simply because there's a process in place to reach the goal is like choosing to smoke a pack of cigarettes a day because there's a process in place to find a cure for lung cancer. You might be right, but the timing might not save your life. It's not a choice a rational person would make.

Deciding on whether or not convergence is satisfactory at present is an exercise that can be done far more objectively than the Commission has done in its proposal. Instead of relying on a prospective process, quantitative information is available for assessing the similarity of the results under the two systems. The differences between existing IFRS and U.S. GAAP standards can be isolated from the reconciliations found in U.S. filings, and the degree of materiality caused by those differences can be assessed by applying the SEC's own criteria for materiality as expressed in Staff Accounting Bulletin No. 99. After reviewing the state of the information produced by the two systems, a decision can be made as to whether or not the differences between the two systems would affect the investment decisions of reasonable investors. If the differences are of such a magnitude that they would affect investors' decisions, then dropping the reconciliation requirement should be postponed until the Commission is satisfied that convergence on the standards causing the differences has been reached.

If the Commission has done this kind of objective, quantitative assessment, it has not mentioned it in its proposal.

**2. Potential issues with the proposal to accept, in the filings of foreign private issuers, financial statements prepared using IFRS without reconciliation to U.S. GAAP**

The most far-reaching issue is obvious: if the two systems of financial reporting are not sufficiently alike, investors may not be confident that there are genuine similarities in the financial results of foreign private issuers and domestic registrants. Without the reconciliation to highlight differences, investors will not be able to easily -

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if at all - quantify or reasonably estimate such differences. There could be a loss of confidence in the reporting of foreign private issuers, which might be reflected as a discount in the prices of their securities.

There are other issues. It is not clear that there is consistent auditing and enforcement of IFRS at this stage. The SEC's own study of the application of IFRS in their first year of application showed inconsistent application of the standards.<sup>1</sup> While there is effective oversight of the U.S. auditing profession and its involvement with the financial reporting under U.S. GAAP through the Public Company Accounting Oversight Board, there is nothing quite comparable regarding the application of IFRS.

Another issue raised by the elimination of the reconciliation: the future of convergence efforts. As long as the reconciliation is present in filings, it presents a real-world scorecard on how well convergence efforts are progressing. Eliminate the reconciliation, and there's less accountability on the part of the IASB and the FASB for their efforts to develop a single set of high quality accounting standards. In fact, if the reconciliation is eliminated, one might question why the International Accounting Standards Board would have to care about convergence: the elimination puts their standards on the same level as those of the FASB, in the eyes of the Commission. If the reconciliation goes away entirely, so might the cooperative spirit that has marked convergence efforts to date.

If the IASB standards are going to be given the same level of authority by the SEC as FASB standards, one would hope that they are developed with the same level of objectivity and independence. While I respect the work of the IASB, their funding mechanism is not as independent as the FASB's. The FASB has been funded by public fees since 2003 under the Sarbanes-Oxley Act. It is free of the potential influences that might occur in seeking contributions from constituents to fund its operations. The IASB's operations are funded by donor contributions; its trustees are currently searching for a funding program for 2008.<sup>2</sup> At this time, the new funding program has not been announced.

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<sup>1</sup>See SEC Staff Observations in the Review of IFRS Financial Statements 2 (July 2, 2007), available at [http://www.sec.gov/divisions/corpfin/ifrs\\_staffobservations.htm](http://www.sec.gov/divisions/corpfin/ifrs_staffobservations.htm) (indicating inconsistent application of International Financial Reporting Standards in a number of areas including statement of cash flows, common control mergers, recapitalizations, reorganizations, acquisitions, and minority interests).

<sup>2</sup> International Accounting Standards Board, Future Funding, available at <http://www.iasb.org/About+Us/About+the+Foundation/Future+Funding.htm>.

**3. The impact of these proposed efforts on stakeholders, including regulators, investors, auditors, and companies**

If the reconciliation is eliminated, there will certainly be more choices for U.S. investors: this is a move that should spur more listings from overseas on U.S. exchanges. Furthermore, it might tempt even more firms to adopt IFRS in their reporting, so they might be able to more freely trade their securities in our markets. At the same time, if investors are not comfortable with the equivalence of the IFRS reporting to U.S. reporting, they may have to incur costs to satisfy themselves. While investor choices may increase, they may have to work much harder to compensate for gaps in IFRS that currently exist. For instance, as the Commission acknowledges in the proposal, there are no standards in IFRS for the extractive industries or for insurance accounting.

To the degree that convergence is not yet reached, investors will have to invest in directly building their knowledge of IFRS. That won't be easy for them: IFRS is scarcely taught in the American education system, and investors likely learn about IFRS through on-the-job experience. Ironically, that on-the-job experience might very well include the reconciliation that the SEC seeks to eliminate.

The SEC might have problems of its own if it eliminates the reconciliation. The Commission's staff is still more versed in U.S. GAAP than in IFRS, and is still gaining familiarity<sup>3</sup> with the proper application of IFRS through its review of filings. Eliminating reconciliation could trigger a wave of IFRS-reported filings. The Commission's mission of investor protection could be jeopardized if it's forced to deal with more IFRS filings than it can handle while still trying to gain IFRS application skills. Accounting talent has been extremely scarce in recent years and there is no apparent surplus of accountants in the U.S. with IFRS expertise. It is unlikely that the Commission could quickly obtain the staff it would need to handle a major rise in IFRS-reporting volumes.

As for auditors, the Big Four might be able to adapt better than the SEC in the event that elimination of the reconciliation increases the amount of IFRS-based filings from other countries. If there are companies overseas that

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<sup>3</sup> 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, page 29.

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now reporting on an IFRS basis but not filing in the U.S. because they wish to avoid the reconciliation, and they decide now to register securities here, there's no difference in their workload or the workload of their auditors. If there are companies overseas now deciding to move to IFRS for the first time so they can register securities here, they may need to involve their auditors more. If auditing firms need to acquire more talent to cope with a rush of work, it will likely take place overseas, and not directly affect the pool of IFRS accounting talent in the United States. If the large auditing firms find themselves dueling with the SEC for IFRS talent in any market, they will usually be able to best the Commission on compensation.

Concerns have been raised about the concentration of power among the Big Four auditing firms in the past few years. If the reconciliation is eliminated, any increase in IFRS-related activity will only strengthen the competitive position of those firms.

Domestic companies may find themselves competing with firms that don't have the same depth of financial reporting or level of disclosure - not because IFRS reporting is inherently inferior, but simply because they're still being newly applied by many companies and there isn't the same kind of regulatory enforcement of IFRS as compared to the United States application of GAAP. That may cause firms to consider moving offshore to take advantage of perceived benefits of IFRS application, unless the SEC grants them the opportunity to choose between U.S. accounting standards or IFRS in their filings with the Commission.

#### **4. Differences that exist in the financial reporting results produced by U.S. GAAP compared to IFRS**

As the Commission notes in its proposal, there are still two major differences in the International Financial Reporting Standards and U.S. GAAP standards: there are no comprehensive IFRS standards for insurance contracts and for activities in the extractive industries. So there are at least two gaps in common results that will occur.

Many other material differences remain between the two sets of standards which are exposed by the reconciliation. Our research team has examined the IFRS to GAAP reconciliations contained in the 2006 filings of 130 foreign registrants. Some of our findings:

- Out of the 130 companies, only 2 had earnings that were the same under both reporting regimes.

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- For 84 of the firms, the IFRS earnings were higher than the GAAP earnings; and for 44 of the firms, the GAAP earnings were higher than the IFRS earnings.

- For the firms with IFRS earnings greater GAAP earnings, the median earnings increase was 12.9%; for firms with GAAP earnings greater than IFRS earnings, the difference was 9.1%.

Those measures make for a wide band for converged earnings - a rather "material" band, by the criteria the Commission considers such matters in Staff Accounting Bulletin No. 99: "The omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item."<sup>4</sup>

It seems likely that the judgment of a reasonable person could be affected by a 22% range of meaning for the word "earnings."

The reconciliation exposes what could be called "legacy differences" between the standards. These reconciling items arise from transactions that firms completed long before convergence was achieved on a particular set of accounting standards. The effects of these differences in accounting standards would linger after the reconciliation's elimination and investors would not be able to discern the continuing effects. For example, the recording of business combinations affects a firm's balance sheet and earnings long after the consummation of a deal. There are numerous instances of firms that accounted for such combinations under IFRS as a "uniting of interests," which would not have met the criteria for a similar treatment (pooling) under U.S. GAAP. These firms have had to account for their combinations as acquisitions in the reconciliation, the way they would have had to report them if they were reporting in United States GAAP at the time of the acquisition. Though it's no longer a difference in the two sets of standards, the effects of those *past* differences lingers in *current* reporting. Eliminate the reconciliation, and investors will not be able to discern how the different accounting standards governing transactions in the past continue to affect present performance reporting.

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<sup>4</sup>See Staff Accounting Bulletin No. 99 - Materiality, at <http://www.sec.gov/interns/account/sab99.htm>

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These do not appear to be isolated instances. Of the 130 reconciliations examined, "legacy differences" relating to goodwill and business combination accounting appeared in 48 of them - about 37%. Investors will not be served well if the performance of some companies appears to be enhanced or harmed by the continuing effects of differences in accounting principles existing before convergence efforts began in earnest only five years ago.

If the Commission intends to eliminate the reconciliation, I suggest that the Commission review the areas where such legacy differences exist and require continued disclosures of their effects. This would not be the same as having a current reconciliation; rather, it would be a disclosure of the effects of past accounting decisions and policies on current results. It would help investors understand why the financial performance of IFRS-reporting companies may still be very different from that of firms reporting under U.S. GAAP, even though convergence has been assumed to exist.

For the 130 firms' reconciliations examined by us, the table on the following page presents the differences between IFRS earnings and U.S. GAAP earnings as shown in the reconciliations, sorted from greatest positive difference (IFRS greater than U.S. GAAP) to the greatest negative difference (IFRS less than U.S. GAAP).

## From The 2006 Reconciliations: Earnings Differences For 130 Filers

(All figures in millions of native currencies)	IFRS	GAAP	% Diff.		IFRS	GAAP	% Diff.
OCE NV	72.9	7.9	826.4%	Corporate Express	123.0	137.0	5.1%
Head NV	4.4	0.6	666.5%	Smith & Nephew	745.0	709.0	5.1%
Cityview Corporation Limited	(5.3)	(0.8)	570.5%	Westpac Banking Corp.	3,071.0	2,936.0	4.6%
Bayer AG	1,695.0	269.0	530.1%	British Sky Broadcasting Group	499.0	479.0	4.2%
Rhodia	66.0	15.0	340.0%	BASF AG	3,215.2	3,094.3	3.9%
Global Crossing	13.5	5.8	131.7%	National Australia Bank Ltd	4,392.0	4,232.0	3.8%
Fiat SPA	1,519.0	716.0	111.3%	Telefonica SA	657.9	634.1	3.6%
Abbey National PLC	313.0	173.0	80.9%	Veolia Environment	758.7	732.1	3.6%
Telecom Italia	3,003.0	1,862.0	61.3%	Invesco (London)	460.1	474.5	3.3%
Reed Elsevier PLC	625.0	399.0	56.6%	Total SA	11,768.0	11,400.0	3.2%
Lloyds TSB Group	2,803.0	1,815.0	54.4%	Petrochina Co.	19,143.0	18,719.0	2.3%
Lihir Gold	53.8	35.3	48.4%	Novo Nordisk	6,452.0	6,310.0	2.3%
Oredicorp	247.3	175.0	41.3%	Groupe Danone	1,353.0	1,326.0	2.0%
WPP Group	462.6	347.0	39.1%	TNT NV	670.0	657.0	2.0%
Asiarzeneca	6,043.0	4,392.0	37.0%	Koolinkijke KPN	1,563.0	1,559.0	0.9%
Aegon NV	2,789.0	2,046.0	36.3%	Australia and NZ Banking	3,688.0	3,657.0	0.8%
Suez	3,606.3	2,883.0	34.4%	Nokia	4,306.0	4,275.0	0.7%
Novartis	7,019.0	5,264.0	33.3%	Ericsson LM Telephone	26,251.0	26,080.0	0.7%
Sodexo Alliance SA	333.0	250.0	33.2%	Swisscom	1,589.0	1,589.0	0.6%
Pearson PLC	446.0	341.0	30.6%	Pfeiffer Vacuum Technology	29.6	29.4	0.6%
Coles Group	1,153.6	892.3	30.4%	Publicis Group	443.0	441.0	0.5%
Endesa	3,798.0	2,916.0	30.2%	Guangshen Railway Co	98.9	98.5	0.4%
Portugal Telecom	954.1	734.7	29.8%	National Telephone - VZ	1,130,375.0	1,129,351.0	0.1%
Metal Storm	(14.2)	(11.1)	26.3%	Randgold Resources	47.6	47.6	0.0%
CGG Veritas	157.1	123.9	26.8%	Atlas South Sea Pearl	3.2	3.2	0.0%
Syngenta	634.0	504.0	25.8%	Banco Bilbao Vizcaya Argentaria	4,971.0	4,971.7	-0.0%
Baniflex Group	124.9	99.8	25.2%	Governor & Company - Ireland	1,651.0	1,655.0	-0.2%
Prudential	674.0	705.0	24.0%	Reuters Group PLC	305.0	306.0	-0.3%
Glaxo Smith Kline	5,498.0	4,465.0	23.1%	Tenaris	1,945.3	1,957.3	-0.6%
China Telecom Corporation	27,142.0	22,046.0	23.1%	Sinopec Shanghai Petrochemical	844.4	850.0	-0.7%
Vodafone Group	(10,427.0)	(6,514.0)	22.5%	Sanofi-Aventis	4,008.0	4,034.0	-0.7%
LaFarge	1,589.0	1,299.0	22.3%	Yanzhou Coal Mining	2,373.0	2,405.8	-1.4%
National Grid PLC	1,394.0	1,146.0	21.6%	AS Steamship	234.5	238.1	-1.5%
Rio Tinto PLC	7,867.0	6,649.0	18.3%	Deutsche Telekom	3,165.0	3,219.0	-1.7%
Electrolux AB	3,847.0	3,264.0	17.9%	China Petroleum & Chemical	53,912.0	54,662.0	-1.7%
Aktiebolaget Electrolux	3,847.0	3,264.0	17.9%	HSBC Holdings PLC	15,789.0	16,358.0	-3.3%
ING Group	8,933.0	8,827.0	17.7%	Euro Disney SCA	(68.6)	(92.0)	-4.6%
AXA	5,085.0	4,330.0	17.4%	Ternium	795.4	841.0	-5.4%
CRH plc	1,224.2	1,000.7	15.4%	China Eastern Airlines	(3,452.8)	(3,661.0)	-5.7%
Akzo Nobel	1,153.0	1,000.0	15.3%	Royal Ahold	915.0	973.0	-6.0%
Unilever	5,015.0	4,385.0	14.4%	Delhaize Group	361.9	374.9	-6.7%
Aktiebolaget Volvo	16,318.0	14,309.0	14.0%	Grupo TMM SAB	69.9	75.6	-7.5%
Royal Bank of Scotland	6,202.0	5,440.0	14.0%	Eni SPA	6,217.0	10,005.0	-7.9%
Aixtron AG	5.9	5.2	13.1%	Stora Enso	585.0	637.5	-8.2%
Cadbury Schweppes	1,165.0	1,034.0	12.7%	Alumina	511.1	559.8	-8.7%
Repsol	3,348.0	2,972.0	12.7%	Telekom Austria AG	561.8	620.8	-9.5%
Mittal Steel Company	6,086.0	5,406.0	12.6%	France Telecom	6,292.0	6,970.0	-9.7%
Banco Santander	8,245.8	7,414.6	11.2%	Inmarsat Group	128.0	142.0	-9.9%
Hanson PLC	401.5	363.4	10.5%	Technip	200.1	224.2	-10.7%
Allied Irish Banks	2,185.0	1,986.0	10.0%	BG Group	1,824.0	2,102.0	-13.2%
Imperial Tobacco	851.0	776.0	9.4%	Intercontinental Hotels Group	405.0	468.0	-16.7%
Air France	891.0	817.0	9.1%	Arcadis	44.9	54.1	-16.9%
Allianz	7,021.0	6,517.0	7.7%	Turkcell Iletisim	832.9	1,015.6	-18.0%
Huaneng Power	6,889.1	6,394.7	7.7%	Enel SPA	4,007.0	4,907.0	-18.3%
Mitsui	409.0	380.0	7.6%	UPM Kymmene Corp.	638.0	424.0	-20.3%
National Westminster Bank	2,586.0	2,423.0	6.7%	Millicom Intl.	168.9	230.7	-26.8%
UBS AG	12,257.9	11,486.0	6.7%	SGL Carbon Aktienges.	53.6	77.2	-30.6%
Royal Dutch Shell	26,311.0	24,797.0	6.1%	Cruceil NV	(87.6)	(138.4)	-36.7%
Barclays Bank	4,571.0	4,318.0	5.9%	China Southern Airlines	126.0	216.0	-41.7%
ABN Amro	4,715.0	4,461.0	5.7%	Alcatel Lucent	(176.0)	(590.0)	-70.2%
BP	22,315.0	21,116.0	5.7%	Protherics PLC	(3.4)	(20.3)	-83.3%
Magyar Telekom	75,453.0	71,481.0	5.6%	Sappi Ltd	(4.0)	(116.0)	-98.6%
Telkom	1,214.0	1,151.0	5.5%	Thomson	55.0	(189.0)	-127.6%
Wolseley PLC	537.0	510.0	5.3%	Trinity Biotech	3.3	(1.9)	-268.3%
Signet Group PLC	141.5	134.4	5.3%	Caltech	(0.6)	0.3	-336.0%

In the study of the 130 companies, there were 20 firms whose IFRS reporting could be termed “IFRS as published by the IASB” - the same basis as the SEC is requiring companies to use in order to waive the reconciliation. These 20 firms are presented in the table below and on the next page, sorted by the number of times a particular adjustment appeared in the twenty reconciliations. There is a wide range of difference between the earnings on an IFRS basis and a U.S. GAAP basis - between 33% and -337%.

**“Pure IFRS” Filers: Earnings Reconciliation To GAAP (Part 1)**

(All figures in millions of native currencies)	Count	Novartis	UBS AG	Syngenta	Sappt	Telkom	Swiss-com	Huaneng Power	China Southern Airlines	China Petr. & Chem.	China Eastern Airlines	
Net tax effect of GAAP adjustments	12	--	(166.0)	46.0	(19.0)	(14.0)	--	(66.4)	(16.0)	(421.0)	(26.3)	
Deferred taxes methodology	10	125.0	--	27.0	(12.0)	(47.0)	--	--	(10.0)	--	--	
Other	9	(68.0)	(130.0)	3.0	(25.0)	(12.0)	--	(26.2)	--	--	(27.0)	
PP&E/Long-term assets	8	58.0	--	--	4.0	--	--	--	--	1,420.0	210.4	
Pensions/OPEBs	8	(188.0)	(165.0)	(48.0)	(44.0)	(7.0)	(16.0)	--	--	--	--	
Minority interests on adjustments	7	(27.0)	--	--	--	(28.0)	--	--	--	--	(93.0)	
Capitalization of interest	6	--	--	--	--	--	20.0	3.6	(35.0)	(40.0)	--	
Purchase price accounting	5	(58.0)	(31.0)	(50.0)	--	--	--	315.3	74.0	--	--	
Asset impairment	5	--	--	2.0	(43.0)	1.0	--	(30.1)	--	--	38.0	
Goodwill and business combinations	4	64.0	3.0	--	18.0	--	--	152.1	--	--	--	
IFRS Minority Interests	4	--	--	--	--	--	--	(17.9)	--	--	199.3	
Securities and investments	4	(114.0)	(107.0)	--	--	--	--	--	--	--	--	
Inventory	4	103.0	--	(13.0)	(1.0)	(1.0)	--	--	--	--	--	
Derivatives	4	--	372.0	--	7.0	14.0	--	--	--	--	--	
Leases	4	--	--	--	1.0	--	32.0	--	93.0	--	(126.5)	
Compensation costs: share based	3	(5.0)	(475.0)	--	(2.0)	--	--	--	--	--	--	
Derivatives on own shares	3	--	6.0	(60.0)	--	17.0	--	--	--	--	--	
Equity method investments	3	--	--	--	--	--	--	--	(14.0)	--	--	
Foreign exchange gains/losses	2	--	--	--	--	--	--	--	--	49.0	--	
Restructuring provisions	2	--	--	(8.0)	4.0	--	--	--	--	--	--	
Revenue recognition	2	--	--	(13.0)	--	--	16.0	--	--	--	--	
Fair value of securities	1	--	(682.0)	--	--	--	--	--	--	--	--	
Translation of financial statements	1	--	--	--	--	--	--	--	--	--	--	
Start-up costs	1	--	--	--	--	--	(40.0)	--	--	--	--	
Real estate investments	1	--	(4.0)	--	--	--	--	--	--	--	--	
Consolidation/deconsolidation of VIEs	1	--	(2.0)	--	--	--	--	--	--	--	--	
Other intangible assets	1	(441.0)	--	--	--	--	--	--	--	--	--	
GAAP Disc. Ops	1	114.0	--	--	--	--	--	--	--	--	--	
Dist. restructuring	1	--	--	--	--	--	--	--	--	--	--	
Assets held for disposal	1	--	--	--	--	--	--	--	--	--	(434.6)	
Oilstrip contracts	1	--	--	--	--	--	(5.0)	--	--	--	--	
Environmental provisions	1	--	--	(27.0)	--	--	--	--	--	--	--	
Mining rights	1	--	--	--	--	--	--	--	--	--	--	
In-process R&D	1	(1,308.0)	--	--	--	--	--	--	--	--	--	
Asset retirement obligations	1	--	--	--	--	--	(2.0)	--	--	--	--	
Share buyback - treasury shares	1	--	--	--	--	--	(17.0)	--	--	--	--	
Convertible debt	1	--	--	--	--	--	--	--	--	--	--	
Total reconciling items		(1,755.0)	(771.0)	(130.0)	(112.0)	(63.0)	(10.0)	(494.4)	90.0	950.0	(208.2)	
IFRS Earnings		7,019.0	12,257.0	634.0	(4.0)	1,214.0	1,589.0	6,888.1	128.0	53,912.0	(3,452.8)	
US GAAP Earnings		5,264.0	11,486.0	504.0	(118.0)	1,151.0	1,589.0	6,394.7	216.0	54,862.0	(3,661.0)	
Difference in earnings			33%	7%	26%	-97%	5%	1%	8%	-42%	-2%	-6%
	Avg.											
Positive adjustments	2.5	5	5	4	5	4	3	3	2	3	3	
Negative adjustments	3.8	8	7	7	6	5	5	4	4	3	3	
Total adjustments	6.2	13	12	11	11	9	8	7	6	6	6	

**“Pure IFRS” Filers: Earnings Reconciliation To GAAP (Part 2)**

(All figures in millions of native currencies)	Turkcell Iletisim	Grupo TMM	Petro- china	Nat'l Telephone Venezuela	Yanzhou Coal Mining	Sinopec Shanghai Petrochem.	Credi- corp	China Telecom Corp.	Calcitech	Guangshen Railway
Net tax effect of GAAP adjustments	--	--	(174.0)	--	--	(1.0)	(5.1)	1,737.0	--	--
Other	--	--	--	--	(97.8)	--	--	--	--	(0.4)
Deferred taxes methodology	(93.8)	(0.4)	--	(994.0)	(64.3)	--	--	(17.0)	--	--
PP&E/Long-term assets	--	--	528.0	--	187.9	15.9	--	(6,816.0)	--	--
Pensions/OPEBs	--	(3.6)	--	8,589.0	--	--	--	--	--	--
Minority interests on adjustments	--	(0.0)	(1,129.0)	(2,955.0)	--	--	(12.0)	--	--	--
Capitalization of interest	--	--	--	(6,883.0)	--	(9.3)	--	--	--	--
Purchase price accounting	--	--	--	--	--	--	--	--	--	--
Asset impairment	--	--	--	--	--	--	--	--	--	--
Goodwill and business combinations	--	--	--	--	--	--	--	--	--	--
IFRS Minority interests	42.6	--	--	--	--	--	--	--	--	(0.0)
Securities and investments	(4.0)	--	--	--	--	--	(55.2)	--	--	--
Inventory	--	--	--	--	--	--	--	--	--	--
Derivatives	--	--	--	--	--	--	--	--	0.9	--
Leases	--	--	--	--	--	--	--	--	--	--
Compensation costs: share based	--	--	--	--	--	--	--	--	--	--
Derivatives on own shares	--	--	--	--	--	--	--	--	--	--
Equity method investments	(1.6)	--	350.0	--	--	--	--	--	--	--
Foreign exchange gains/losses	--	1.2	--	--	--	--	--	--	--	--
Restructuring provisions	--	--	--	--	--	--	--	--	--	--
Revenue recognition	--	--	--	--	--	--	--	--	--	--
Fair value of securities	--	--	--	--	--	--	--	--	--	--
Translation of financial statements	249.2	--	--	--	--	--	--	--	--	--
Start-up costs	--	--	--	--	--	--	--	--	--	--
Real estate investments	--	--	--	--	--	--	--	--	--	--
Consolidation/deconsolidation of VIEs	--	--	--	--	--	--	--	--	--	--
Other intangible assets	--	--	--	--	--	--	--	--	--	--
GAAP Disc. Ops	--	--	--	--	--	--	--	--	--	--
Debt restructuring	--	8.4	--	--	--	--	--	--	--	--
Assets held for disposal	--	--	--	--	--	--	--	--	--	--
Onerous contracts	--	--	--	--	--	--	--	--	--	--
Environmental provisions	--	--	--	--	--	--	--	--	--	--
Mining rights	--	--	--	--	7.0	--	--	--	--	--
In-process R&D	--	--	--	--	--	--	--	--	--	--
Asset retirement obligations	--	--	--	--	--	--	--	--	--	--
Share buyback: treasury shares	--	--	--	--	--	--	--	--	--	--
Convertible debt	--	--	--	--	--	--	--	--	--	(0.1)
Total reconciling items	182.7	5.6	(424.0)	(1,024.0)	32.8	5.8	(72.2)	(5,096.0)	0.9	(0.4)
IFRS Earnings	832.9	69.8	19,143.0	1,130,375.0	2,373.0	844.4	247.3	27,142.0	(0.6)	98.9
US GAAP Earnings	1,015.6	75.4	18,719.0	1,129,351.0	2,405.8	850.0	175.0	22,046.0	0.3	98.5
Difference in earnings	-18%	-7%	2%	0%	-1%	-1%	41%	23%	-337%	0%
Positive adjustments	2	2	2	1	2	1	0	1	1	0
Negative adjustments	3	3	2	3	2	2	3	2	1	2
Total adjustments	5	5	4	4	4	3	3	3	2	2

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**Conclusion**

The Commission has long championed clarity in financial reporting by international firms and foreign registrants and it is to be commended for its efforts to stimulate convergence of accounting standards by eliminating the reconciliation requirement for firms reporting using IASB standards. The idea is sound, but premature: instead of eliminating the reconciliation, the Commission should use the information in them to isolate the differences produced by the two standard setters and to develop a sound timetable with the IASB and the FASB for achieving truly converged standards. Any premature elimination of the reconciliation will force investors to pay a price in terms of greater effort to understand the differences between companies in their basis of reporting.

In addition to using the reconciliation information to develop a reasoned path to convergence, the Commission should also consider the necessary disclosure regime for the “evergreen” legacy differences that will never be fully converged. This is information that investors would find useful, but would never be able to estimate or compile for themselves in any effective fashion.

Thank you for the opportunity to appear today. I would be happy to take your questions.

**Testimony of Charles E. Landes  
Vice President, Professional Standards and Services  
American Institute of Certified Public Accountants (AICPA)**

**Before the  
Committee on Banking, Housing, and Urban Affairs  
of the U.S. Senate  
Subcommittee on Securities, Insurance, and Investment  
October 24, 2007**

Thank you, Chairman Reed, Ranking Member Allard, and Members of the Subcommittee. It's a pleasure to be here. My name is Charles Landes, and I am testifying today on behalf of the American Institute of Certified Public Accountants, or AICPA, as Vice-President—Professional Standards and Services.

The AICPA, with approximately 340,000 members, is the national professional organization for certified public accountants. Our mission is to provide members with the resources, information, and leadership that enable them to provide valuable services in the highest professional manner to benefit the public as well as employers and clients.

The global convergence of accounting and financial reporting standards presents opportunities, challenges, and issues for the profession, financial markets, and regulators.

**International Convergence of Accounting Standards**

I want to state as directly as possible that the AICPA supports the goal of a single set of high-quality, comprehensive accounting standards to be used by public companies in the preparation of transparent and comparable financial reports

throughout the world. The debate or question should no longer be whether we move to convergence of high quality accounting standards, but how soon we can accomplish convergence.

The AICPA was a charter member of the International Accounting Standards Committee (IASC), formed in 1973, the predecessor of the International Accounting Standards Board (IASB), and has used its best efforts to advance international convergence of accounting standards in the more than three decades since then.

The Financial Accounting Standards Board (FASB) and IASB have made tremendous strides in harmonizing accounting standards through working cooperatively. The United States Securities and Exchange Commission (SEC), under the direction of Chairman Christopher Cox and Chief Accountant Conrad Hewitt, has demonstrated U.S. leadership in expediting this harmonization.

Accounting is often referred to as the language of business. And because this global marketplace affects both large and small U.S. public companies, there is a need for a common business language—a common set of accounting standards.

In today's global economy, that one common accounting language will benefit all participants in the capital markets. It will benefit investors because it will facilitate the comparison of financial results of reporting entities domiciled in different countries. It will benefit public companies that have subsidiaries in multiple jurisdictions because it will allow them to use one accounting language company-wide. It will allow them to present their financial statements in the same language as their competitors. And it will benefit our members in public practice because it would allow them to simplify their training of auditors of public

companies by allowing them to focus on one core set of accounting standards, rather than multiple accounting standards.

But the AICPA also recognizes that, in today's global economy, a major concern is financial information that is reliable, relevant, and organized in a manner that is valuable to users. Therefore, international standards, whether they are in the area of accounting or auditing, must be of high quality to enhance the value of this information. The FASB, which sets U.S. financial reporting standards, and the SEC, because of their long experience as leaders in the accountancy profession, are in a unique position to influence the development of international standards in a way that will serve investor interests in the United States and around the world.

Is there still hard work to be done towards convergence? Yes. Will there be bumps in the road as we take this journey? Absolutely. But it is a journey that must be taken.

***Securities and Exchange Commission's Proposing Release, Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP***

As stated in the Center for Audit Quality<sup>1</sup> (CAQ) letter dated September 24, the AICPA supports the elimination of the U.S. GAAP reconciliation for foreign private issuers using International Financial Reporting Standards or IFRS.

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<sup>1</sup> The Center for Audit Quality, an autonomous body affiliated with the AICPA, was created to serve investors, public company auditors, and the markets. The Center's mission is to foster confidence in the audit process and to aid investors and the capital markets by advancing constructive suggestions for change rooted in the profession's core values of integrity, objectivity, honesty, and trust.

This is an important step in the process towards the acceptance of a single set of high-quality globally accepted accounting standards. A copy of the letter setting forth the views of the CAQ in more detail is attached as exhibit A.

***Current SEC Concept Release, Concept Release on Allowing U.S. Issuers to Prepare Financial Statements in Accordance With International Financial Reporting Standards.***

The AICPA supports giving U.S. issuers an option to prepare financial statements in accordance with IFRS as published by the IASB for purposes of complying with the rules and regulations of the SEC.<sup>2</sup>

Giving U.S. issuers such an IFRS option will be yet another important step towards achieving the larger goal of a single set of high quality, comprehensive accounting standards to be used by public companies in the preparation of transparent and comparable financial reports throughout the world.

**Status of Convergence and Differences**

Despite the ongoing convergence work of the FASB and the IASB, differences remain between U.S. generally accepted accounting principles (GAAP) and IFRS. Among those differences are:

- IFRS are less detailed than U.S. GAAP.
- IFRS contain relatively little industry-specific guidance, for example insurance and oil and gas.

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<sup>2</sup> Our views, as expressed herein, relate to the use of International Financial Reporting Standards (IFRS) by issuers (public companies) only. The AICPA believes that a separate, dedicated effort would be required to consider the appropriateness of an IFRS option for U.S. private companies and not-for-profit organizations (both of which have in common with U.S. public companies that they apply U.S. generally accepted accounting principles as promulgated by the Financial Accounting Standards Board).

- IFRS still do not address the accounting for several significant issues that apply across industries.

But by the same token, I don't think anyone would assert that U.S. GAAP is perfect. Despite these differences, IFRS has proven to be a reputable set of standards for preparing financial information. IFRS, like FASB pronouncements, are issued through a robust process that is transparent to the public. That process reflects the collective input of accounting experts from around the world who contribute to the standards-development process. Many of these individuals are technicians and practitioners who have also served on national standards-setting bodies.

Due to the initial costs that converting from U.S. GAAP to IFRS would entail, we believe a relatively small number of U.S. issuers will choose such an option immediately. Should a large number of U.S. public companies choose the option immediately, system-wide readiness could be an issue. Accordingly, in a comment letter yet to be filed, the AICPA will recommend that the SEC solicit information on the number of issuers that will likely choose an IFRS option immediately or in the near term to help the SEC form its views on the timing of giving such an option.

#### **The SEC's Role**

The AICPA fully supports the SEC in its role of protecting U.S. investors. We encourage the SEC to continue to provide input during the IASB standards-setting process. The AICPA also encourages the SEC to work with other regulators around the world to agree on an appropriate framework for the acceptance of IFRS, and to work with those regulators to encourage robust enforcement of IFRS.

Should the SEC allow U.S. issuers to use IFRS, the AICPA believes the sharing of information among security regulators will be vital to the timely identification and resolution of financial reporting matters under IFRS.

The challenge will be balancing the needs of investors and the needs of the security regulators with one set of global accounting standards. In the end, any activity to remove organizational barriers and avoid geographical differences ultimately will aid in achieving one set of international accounting standards.

### **Holistic Undertaking**

Although this hearing is to deal with the acceptance of IFRS financial statements in the SEC filings of Foreign Private Issuers and the granting of an IFRS option to U.S. public companies filing with the SEC, the AICPA believes that the SEC should view international convergence holistically. That is, if IFRS are to serve as a basis for U.S. issuers' financial reporting, there will also need to be changes in the auditing, regulatory, and legal environments.

Just as the SEC is exploring the use of international accounting standards for U.S. public companies, it, along with the Public Company Accounting Oversight Board (PCAOB), should also explore the convergence of PCAOB auditing standards and International Standards on Auditing or ISAs.

While the PCAOB will need to determine for itself the best way to set standards, the AICPA's Auditing Standards Board (ASB)<sup>3</sup> has been successful in adopting an International Standards on Auditing (ISA)-based approach. ISA-based means, in addition to harmonizing our agenda with the International Auditing and Assurance Standards Board (IAASB), that the ASB starts with the ISA as the base standard

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<sup>3</sup> The AICPA's Auditing Standards Board promulgates generally accepted auditing standards that are used in the audits of non-issuers. PCAOB auditing standards are used in the audits of issuers.

and works from there. By moving to this approach, the AICPA has been able to increase its influence and participation with the IAASB. Although the PCAOB has been participating in IAASB matters, more can be done.

As a result, the AICPA encourages the SEC and PCAOB to pursue a strategy that will achieve convergence of auditing standards for audits of public companies.

Because IFRS currently are less detailed than U.S. GAAP, a decision by the SEC to permit an IFRS option should carry with it an expectation by regulators and investors that the use of reasoned professional judgment will sometimes yield different outcomes in similar circumstances.

In the absence of IFRS guidance, guidance should come from an appropriate IASB interpretive body. Security regulators, under the auspices of the International Organization of Securities Commissions (IOSCO), could participate in the IASB and International Financial Reporting Interpretations Committee (IFRIC).

Working from less prescriptive standards may result in more second-guessing by regulators and users and thereby result in unwarranted increased legal liability for preparers and auditors of financial statements. As a result, the SEC should work with Congress and other governmental agencies to explore this potential increased risk and work to mitigate it when preparers and auditors have applied reasoned professional judgment.

Finally, because IFRS would represent a change in the U.S. financial reporting system, the SEC should have in place a well-developed plan to solicit user feedback on how well the option is meeting financial statement users' information needs. The concept equates to the sound business practice of checking with customers after a new product has been introduced into the marketplace.

**Standards-Setting Process**

If the SEC gives U.S. issuers an IFRS option, does that mean convergence has been achieved? No. The convergence work of the FASB and IASB must continue and would be just as important if an IFRS option is given to U.S. issuers as it is today.

At the international level, continued progress towards high-quality international accounting standards requires an improved funding mechanism for the IASB that will allow the IASB to remain independent and objective. The International Accounting Standards Committee (IASC) Foundation<sup>4</sup> trustees are currently developing a mechanism for public funding of the IASB's work. The AICPA encourages the SEC to engage the IASC Foundation trustees in that effort. Furthermore, continued progress towards high quality international accounting standards will best be achieved if the IASB takes full advantage of the resources available in the United States, and specifically at the FASB.

**AICPA Responsibilities**

The AICPA acknowledges that it also will need to fulfill a number of responsibilities to make convergence to a single set of global accounting standards for public companies a success. This includes continuing to educate our members about IFRS; to work with accounting educators, textbook authors, and educational institutions to prepare future professionals; and to begin incorporating IFRS into the Uniform CPA Examination. Rest assured that the AICPA will meet its responsibilities.

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<sup>4</sup> The IASC Foundation is an independent body that oversees the International Accounting Standards Board (IASB). The IASC Foundation's constitution is available at <http://www.iasb.org/About+Us/About+the+Foundation/Constitution.htm>.



Cynthia M. Fornelli, Executive Director

September 24, 2007

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Ms. Nancy M. Morris  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Dear Ms. Morris:

**RE: File Number S7-13-07 Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP**

The Center for Audit Quality (CAQ) is an autonomous public policy organization serving investors, public company auditors and the capital markets and is affiliated with the American Institute of CPAs. The CAQ's mission is to foster confidence in the audit process and to aid investors and the markets by advancing constructive suggestions for change rooted in the profession's core values of integrity, objectivity, honesty and trust. Based in Washington, D.C., the CAQ consists of approximately 800 member firms that audit or are interested in auditing public companies. We welcome the opportunity to share our views on the Securities and Exchange Commission's (the SEC or the Commission) proposing release, *Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP* (the SEC Proposal or the Release).



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#### OVERALL APPROACH AND USE OF IFRS

Under the SEC Proposal a foreign private issuer would not need to reconcile to U.S. GAAP provided that:

- It prepares financial statements that comply fully with the English language version of International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Board (IASB)<sup>1</sup>,
- It makes a statement of unreserved compliance with IFRS, and
- Its auditor opines on compliance with IFRS.

Overall, the Center supports the elimination of the U.S. GAAP reconciliation for foreign private issuers using IFRS, which we believe is an important step in the process toward development of a single-set of high-quality globally-accepted accounting standards. In addition, we do not believe that the elimination of the U.S. GAAP reconciliation should be predicated on the adequacy or continuation of the convergence process, nor on the development of further guidance in areas not currently addressed by IFRS. We do believe, however, that the Commission should develop a plan to solicit and evaluate user feedback after a year or two once U.S. investors gain more experience using IFRS financial statements without reconciliation.

While we support the overall approach taken by the Commission in the Release, we note that there may be certain implications of limiting its scope to IFRS. As proposed, the acceptance of IFRS financial statements without reconciliation might have limited applicability in the future. The governments of many countries, including the United States, have the sovereign power to establish accounting standards for use within their respective jurisdiction. When considering competing national priorities, a government (or its designated regulatory authority) might make modifications to such standards as they believe necessary in the circumstances. For example, there are jurisdictions such as the European Union that require endorsement or approval of IFRS before such standards can be used. As a result, there might be situations where a foreign private issuer is required to follow the jurisdictional version of IFRS in preparing its financial statements, and, therefore, is unable to make an explicit and unreserved statement of compliance with IFRS because certain standards have not been endorsed (or are still in the process of being endorsed).

In light of these practical realities, we believe that foreign private issuers that use local GAAP (including jurisdictional IFRS) should have an ability to reconcile to IFRS in lieu of reconciling

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<sup>1</sup> For purposes of this letter, references to IFRS are in the context of the English language version of IFRS, as published by the IASB, unless otherwise noted.



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to U.S. GAAP. Under this alternative, all foreign private issuers would have the following options in preparing financial statements filed with the SEC:

1. U.S. GAAP;
2. IFRS;
3. Any comprehensive basis of GAAP, reconciled to U.S. GAAP; or
4. Any comprehensive basis of GAAP, reconciled to IFRS.

This approach would give IFRS equal prominence with U.S. GAAP. We note that the IASB, as part of its annual improvement project, is considering amending IAS 1, *Presentation of Financial Statements*, to require financial statements that can not assert compliance with IFRS to describe each difference between the basis of accounting used to prepare the financial statements and IFRS and how reported financial position and performance would have differed under IFRS. However, in cases where jurisdictional IFRS is used, we believe that an issuer, when reconciling to IFRS, should provide both a narrative description of the differences and a quantitative reconciliation of specific financial statement line items (i.e., in a manner that would be substantially similar to the current requirements of Items 17 or 18 of Form 20-F, as applicable).

We believe that this proposal has the following advantages:

- It creates a common benchmark, IFRS, for all companies located outside the U.S. that are raising capital in the U.S. markets.
- For many companies, their local GAAP is more closely aligned with IFRS, not U.S. GAAP. As a result, there is the potential to reduce their costs of complying with U.S. reporting requirements if the SEC were to permit reconciliation to IFRS in lieu of reconciliation to U.S. GAAP.
- The acceptance of IFRS as a benchmark standard should, over time, discourage countries from adopting jurisdictional variants that differ greatly from IFRS. Given this expectation, the reconciliation between a jurisdictional variant of IFRS and IFRS should be more easily understandable to investors than a reconciliation to U.S. GAAP.
- Most importantly, it achieves the objectives desired in the Release while recognizing the pragmatic reality that sovereign governments might modify, selectively endorse or delay endorsing accounting standards in certain circumstances.

In lieu of reconciling to U.S. GAAP, an alternative would be to require each foreign private issuer to prepare, and file with the SEC, financial statements using IFRS. In many cases however, such IFRS financial statements filed with the SEC would be different than the financial



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statements, filed in the home country and distributed to shareholders, that are prepared using local GAAP or jurisdictional IFRS. In our view, this would be an undesirable situation. Not only would this force foreign private issuers to prepare, and obtain audits of, two sets of financial statements, it would be potentially confusing to investors. Accordingly, we strongly believe that Form 20-F should continue to require only the English version of the same financial statements that the foreign private issuer uses in its communications to shareholders.

#### Technical amendments and references to U.S. GAAP

The Commission, in its rules, forms and releases, and the SEC staff in its Staff Accounting Bulletins, frequently make reference to specific U.S. GAAP accounting standards (e.g., SFAS 57 on related parties) in setting forth various non-financial statement disclosure requirements. This can become problematic as accounting standards are constantly changing and such references can become outdated. In addition, with the contemplated acceptance of IFRS without reconciliation, the references, definitions, and scope of the related disclosure instructions might be different for an issuer using IFRS rather than U.S. GAAP.

Instead of making reference to the applicable IFRS, the SEC Proposal incorporates IFRS into the instructions of Form 20-F through a broad-based approach by instructing the preparer to "follow the appropriate provisions of IFRS that contain the principles embodied in the referenced U.S. GAAP items." We do not support such an ambiguous approach and believe that it could lead to inefficient and inconsistent interpretations in practice.

We acknowledge that in many cases the corresponding IFRS notion of the principles embodied in the referenced U.S. GAAP can be readily identified, as IFRS includes a definition or guidance similar to the U.S. GAAP principle. However, there are numerous instances where the principle or rule embodied in the referenced U.S. GAAP pronouncement is not readily apparent, or not even included, in IFRS. In addition, there are definitions referenced in U.S. GAAP that are different in IFRS. For example, while the fundamental objectives of disclosures about related parties are similar under IFRS and U.S. GAAP, their definitions of a related party are not the same.

In a reporting framework that allows for the use of IFRS without reconciliation, we believe it is important for the Commission to specifically identify areas where U.S. GAAP pronouncements are referenced and address the implications, if any, of using IFRS. We believe that this issue would become more important as the SEC considers allowing U.S. companies the option of using either U.S. GAAP or IFRS, as discussed in the Commission's *Concept Release On Allowing U.S. Issuers To Prepare Financial Statements In Accordance With International Financial Reporting Standards* (Release No. 33-8831).

Therefore, we recommend that in future drafting of rules, forms, releases and other materials, both the Commission and the SEC staff avoid making references to specific accounting standards



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when the respective requirement is intended to apply to all registrants regardless of the basis of accounting used in their primary financial statements. Instead, we recommend that the SEC's non-financial statement disclosure requirements describe the concept and objective of the required disclosure, and differentiate the operational instructions as necessary based on whether the registrant uses U.S. GAAP or IFRS. For example, instead of making reference to related parties as defined by SFAS 57, make reference to related parties as defined by the GAAP used in the primary financial statements.

As a way of addressing this issue in existing SEC forms, rules and regulations, the SEC might wish to categorize each reference to a U.S. GAAP pronouncement as follows:

- *Category 1 – Instances where similar guidance exists in both U.S. GAAP and IFRS.* These cases appear straightforward and should not present any difficulties for issuers using IFRS. However, in the interest of clarity the Commission may wish to include the corresponding reference to IFRS. Alternatively, we recommend that the Commission amend the instructions to describe the underlying concept in generic terms without making reference to a specific U.S. GAAP or IFRS pronouncement.
- *Category 2 – Instances where no guidance exists in IFRS.* In these cases, the SEC would need to consider whether the non-financial statement disclosure requirement is even applicable for issuers using or reconciling to IFRS. If the Commission concludes that the disclosure remains relevant, then it may want to retain the U.S. GAAP reference as a basis for the disclosure and specifically indicate that the disclosure also is required for an issuer using IFRS. Alternatively, we recommend that the Commission amend the instructions to describe the underlying concept in generic terms without making reference to a specific U.S. GAAP pronouncement.
- *Category 3 – Instances where the guidance in U.S. GAAP and IFRS is different.* In these cases, the SEC would need to consider the implication of having different definitions under IFRS versus U.S. GAAP. Depending on the nature and significance of the difference, the Commission should reconsider the applicability of the disclosure to an issuer using or reconciling to IFRS. If still applicable, the Commission should amend the instructions to describe the underlying concept in generic terms without making reference to a specific U.S. GAAP or IFRS pronouncement. If not applicable, the Commission should amend the instructions to clarify that the disclosure only applies to an issuer using or reconciling to U.S. GAAP.

The Appendix to this letter provides specific examples of items in each of the above categories.



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#### Interim period financial statements

The SEC Proposal would require that interim period financial statements comply with the requirements of Article 10 of Regulation S-X even if they comply with IFRS. We do not see any incremental benefit to requiring additional interim disclosures under Article 10. We believe that IAS 34 *Interim Reporting* represents a comprehensive interim reporting standard that does not differ materially from Article 10 and APB Opinion No. 28, *Interim Financial Reporting*, as amended.

If the Commission accepts interim financial statements prepared in accordance with IFRS then it would need to amend Instruction 2 to Item 8.A.5 of Form 20-F, which states that the required interim financial statements may be in condensed form using the major line items from the audited financial statements, determined based on Rule 10-01(a)(1)-(7).

#### **TRANSITION AND TIMING**

We believe foreign private issuers using IFRS should not have to reconcile to U.S. GAAP once the proposed amendments are adopted. For example, if the SEC adopts the proposed amendments and they become effective on January 15, 2008, then any IFRS financial statements included in a filing with the Commission made on or after January 15, 2008, should not require a reconciliation to U.S. GAAP.

#### First-time adopters of IFRS

The Release extends the accommodation for first time adopters of IFRS for an additional five years. However, we would propose extending the accommodation for an indefinite period. This accommodation should be available to any company transitioning to IFRS for the first time. To remove this accommodation after a period of time might create inequality for those that decide to move to IFRS after the period, which might hinder the progression towards a single-set of high-quality globally-accepted accounting standards. Extending the accommodation indefinitely would serve as an incentive for other issuers to adopt IFRS in filings with the SEC.

#### **FILING DUE DATES**

At this time, the Center does not support making any changes to the current filing due dates of the periodic reporting forms used by foreign private issuers. Instead, we believe that this is a larger issue that is beyond the scope of the SEC Proposal. Accordingly, if the Commission believes there should be an acceleration in any due dates applicable to foreign private issuers, we recommend that the SEC further consider this question in a separate release.



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#### **SAFE HARBOR AND FORWARD-LOOKING INFORMATION**

The SEC Proposal asks whether the Commission should address the implications of forward-looking disclosure contained in a footnote to the IFRS financial statements as required by IFRS 7 *Financial Instruments: Disclosures* (IFRS 7). IFRS 7 requires disclosure in the notes to the annual financial statements of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk. Regarding market risk, IFRS 7 requires financial statement disclosure of, among other things, either a sensitivity analysis for each type of market risk exposure, or a value-at-risk measure that reflects interdependencies between various types of market risks. There is no corresponding disclosure requirement in U.S. GAAP, although under Item 11 of Form 20-F, foreign private issuers must disclose similar information outside the financial statements, where it is subject to the statutory safe harbor for forward-looking statements, to the extent it constitutes “forward-looking statements,” and also is subject to safe harbor protection under Commission rules.

Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 provide safe harbor protection for forward-looking statements, subject to certain conditions and limitations. However, these statutory safe harbor provisions do not extend to forward-looking statements “included in a financial statement prepared in accordance with generally accepted accounting principles.”

As a matter of equitable treatment, we do not believe foreign private issuers that use or reconcile to IFRS should incur a higher exposure in private securities litigation just because IFRS requires more forward-looking disclosures than U.S. GAAP. Accordingly, we encourage the SEC to utilize its rule-making authority to extend the statutory safe harbor protections to the forward looking information required in the notes to financial statements under IFRS 7.

#### **ADDITIONAL DETAILED RESPONSES**

See the Appendix for more detailed responses to specific aspects of the SEC Proposal and the Exhibit for a summary of non-financial statement disclosures and references to U.S. GAAP.

\* \* \* \* \*



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We appreciate the opportunity to comment on the SEC Proposal and would welcome the opportunity to meet with you to clarify any of our comments.

Sincerely,

A handwritten signature in black ink that reads "Cynthia M. Fornelli".

Cynthia M. Fornelli  
Executive Director  
Center for Audit Quality

cc: SEC  
Chairman Christopher Cox  
Commissioner Paul S. Atkins  
Commissioner Annette L. Nazareth  
Commissioner Kathleen L. Casey  
Conrad Hewitt, Chief Accountant  
John W. White, Director of the Division of Corporation Finance

PCAOB  
Mark W. Olson, Chairman  
Kayla J. Gillan, Member  
Daniel L. Goelzer, Member  
Willis D. Gradison, Member  
Charles D. Niemeier, Member  
Thomas Ray, Chief Auditor and Director of Professional Standards

**APPENDIX**

This Appendix provides more detailed responses to specific aspects of the Release and summarizes various technical amendments and references to U.S. GAAP that we believe should be considered.

**Eligibility Requirements (Q11-Q17)**

The SEC Proposal asks whether the Commission should place any limitations on the eligibility of a foreign private issuer that uses IFRS to file financial statements without reconciliation to U.S. GAAP. The Center supports the elimination of the U.S. GAAP reconciliation for all foreign private issuers that use or reconcile to IFRS and does not support placing any limitations on the eligibility requirements.

**U.S. GAAP Reconciliation (Q18-Q25)*****Amendments to Items 17 and 18***

If, as we recommend, the Commission chooses to allow foreign private issuers that use local GAAP (including jurisdictional IFRS) to reconcile to IFRS in lieu of reconciling to U.S. GAAP, then we recommend that the Commission also make conforming revisions to Items 17 and 18 to reflect the issuer's choice of reconciliation.

Furthermore, we have several observations in response to the SEC Proposal's request as to whether any other changes to Items 17 or 18 of Form 20-F, or elsewhere, are needed to implement fully the proposed elimination of the reconciliation requirement for issuers using IFRS. We believe the SEC should address the following:

- Instruction 3 to Item 8.A.2 of Form 20-F provides that in initial registration statements, the earliest of the three years of financial statements may be omitted if the financial statements are prepared in accordance with U.S. GAAP and those financial statements haven't been included in a previous filing with the SEC. If the SEC accepts financial statements prepared in accordance with IFRS without reconciliation, we believe this accommodation should be extended to an initial registration statement in which the foreign private issuer presents financial statements prepared under IFRS but had been not previously publicly distributed any IFRS financial statements for the earliest of the three years.
- Footnote 80 of the Release indicates that the SEC does not read Item 17(b) as imposing U.S. GAAP requirements on financial statements prepared using IFRS. Some have read Item 17(b) to mean that financial statements shall disclose information content substantially similar to U.S. GAAP and Regulation S-X. Notwithstanding the discussion in Footnote 80, we believe that Item 17(b) could be interpreted otherwise, and therefore, in the interest of clarity should be amended to address the fact that the primary financial statements can be prepared using IFRS without U.S. GAAP and Regulation S-X disclosures.

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- Instruction 2 to Item 17 requires disclosure of earnings per share in accordance with U.S. GAAP, if materially different than the earnings per share otherwise presented. If the SEC accepts financial statements prepared in accordance with IFRS without reconciliation to U.S. GAAP, then we believe that this instruction should be amended to accept earnings per share as calculated pursuant to IFRS.
- The proposed change to Instruction 2.b. of General Instruction G(h) is not clear. The Release changes the word “need” to “should” within the sentence that discusses the reconciliation to U.S. GAAP. Some may view this change as confusing. Therefore, we suggest as an alternative that the second sentence of Instruction 2.b. be deleted, as it is clear that if the issuer is not required to present the U.S. GAAP reconciliation, then it follows the operating and financial review and prospects information would not include references to U.S. GAAP.
- The proposed change to Item 17(c)(2)(v) and (vi) is unclear. Therefore, we suggest as an alternative that the following language be added to the first sentence of Item 17(c)(2)(v) and (vi): “U.S. generally accepted accounting principles *or on the basis of the English language version of IFRS as published by the IASB....*”

***IAS 21 accommodation***

The Commission notes in the Release that not many foreign private issuers use the IAS 21 accommodation related to hyperinflationary economies. While this may be the case, we nonetheless believe that the accommodation is still useful for those foreign private issuers that rely on it and, therefore, suggest that it not be eliminated. In addition, its limited use is partially a function of the fact that currently there are very few economies that are highly inflationary. As this could change in the future, the accommodation could become applicable to more companies.

**Accounting and Disclosure Issues (Q26-Q34)*****Other non-financial statements disclosures***

The table below provides illustrative examples of items in each of the categories described in the attached letter. While we have not attempted to identify all items where U.S. GAAP pronouncements have been referenced in the SEC rules and regulations, we have noted additional examples of references to U.S. GAAP in the Exhibit to this letter.

## APPENDIX

Category	Form 20-F or Applicable Regulation	Text of Form 20-F or Applicable Regulation	Observation on applicable IFRS notion
1	Instruction 1C to Item 11(a) of Form 20-F	Functional currency means functional currency as defined by generally accepted accounting principles (see FASB Statement of Financial Accounting Standards No. 52, "Foreign Currency Translation", ("FAS 52") paragraph 20 (December 1981)).	See IAS 21 <i>The Effects of Changes in Foreign Exchange Rates</i> (December 2006), paragraphs 9-14.
2	Item 5(E)(2)(d) of Form 20-F	Any obligation, including a contingent obligation, arising out of a variable interest (as referenced in FASB <b>Interpretation No. 46, Consolidation of Variable Interest Entities</b> (January 2003), as may be modified or supplemented) in an unconsolidated entity that is held by, and material to, the company, where such entity provides financing, liquidity, market risk or credit risk support to, or engages in leasing, hedging or research and development services with, the company.	IFRS (SIC 12 <i>Consolidation – Special Purpose Entities</i> ) does not contain the term "variable interest."
3	Rule 1-02(u) of Regulation S-X	The term "related parties" is used as that term is defined in the Glossary to Statement of Financial Accounting Standards No. 57, <i>Related Party Disclosures</i> ("FAS 57").	The definition of related parties in IFRS (see IAS 24 <i>Related Party Disclosures</i> ) is different than the definition in FAS 57.

## APPENDIX

***FAS 69***

IFRS does not currently provide comprehensive guidance with respect to Oil & Gas producing activities, other than guidance provided in IFRS 6 *Exploration for and Evaluation of Mineral Resources*. We believe that supplemental information on reserves as required by FAS 69 is necessary to understanding the financial statements of an oil and gas company and to allow comparability among such companies.

Most large foreign oil and gas companies follow Item 18 and therefore provide FAS 69 disclosures. We believe a continuation of these disclosures would be in the best interests of investors. Accordingly, we believe that, for the time being, foreign private issuers that prepare financial statements in accordance with or reconciled to IFRS should be required to comply with the disclosure requirements of FAS 69.

We suggest that the Commission continue to monitor IFRS developments in this area.

***Materiality***

With regard to materiality and misstatements, we note that practice has been such that foreign private issuers generally have looked to the guidance in Staff Accounting Bulletin Topic 1.M (SAB 99). We expect that would continue for foreign private issuers using IFRS and do not believe that the elimination of the U.S. GAAP reconciliation would have an impact on how materiality is applied in filings with the SEC.

**Regulation S-X (Q35-Q37)*****Application of the Proposed Amendments to Rules 3-05, 3-09, and 3-16***

If the Commission does not allow foreign private issuers the ability to reconcile to IFRS, then we believe the SEC should at least consider allowing acquirers, investees, and guarantors providing financial statements prepared using local GAAP the ability to reconcile those financial statements to IFRS for purposes of Rules 3-05, 3-09, and 3-10. For example, it would not seem logical to require a significant equity investee to reconcile its financial statements to U.S. GAAP when the issuer does not provide any U.S. GAAP information.

The SEC staff has published guidance indicating that significance tests should be determined based on U.S. GAAP financial information. The Release, however, provides that significance tests should be determined based on the primary financial statements. However, that assumes that either IFRS or U.S. GAAP is used in the preparation of the primary financial statements. If the Commission allows a foreign private issuer to use local GAAP (including jurisdictional IFRS) and then reconcile to U.S. GAAP or IFRS, then the SEC should clarify that significance testing should be based on either U.S. GAAP or IFRS, depending on the GAAP to which the financial statements of the issuer are reconciled.

***Rule 3-05 Requirements for the Acquisition of a Foreign Business***

Historically, the significance tests under Rule 1-02 (w) of Regulation S-X have been performed using U.S. GAAP amounts. Under the proposed amendments, if a U.S. company acquires a foreign business whose financial statements are prepared in accordance with IFRS, the financial statements filed under Rule 3-05 of Regulation S-X would not be required to include a reconciliation to U.S. GAAP. However, notwithstanding this accommodation, it still would be necessary to reconcile the historical financial statements of the acquired business to U.S. GAAP solely to perform the significance test. As proposed, a foreign private issuer using IFRS would face a similar requirement to determine the significance of its acquisition of a business that does not prepare financial statements using IFRS.

We believe Rule 1-02(w) of Regulation S-X should be modified to allow, as an alternative, the significance test of an acquired business with a different basis of accounting to be performed using pro forma amounts (i.e., based on the pro forma adjustment of the acquired company's historical financial information to reflect the registrant's purchase accounting under either U.S. GAAP or IFRS, as applicable). Under this concept, the issuer would prepare a pro forma income statement for the most recent annual period and balance sheet under Article 11 of Regulation S-X reflecting the business combination. The differences between the historical amounts of the issuer and the pro forma amounts for assets and pretax income would be used for the significance tests. For example, if the historical pretax income of the issuer was 750 and its pro forma pretax income assuming the acquisition was 1,000, the difference of 250 would be compared to the 750 and the acquisition would be significant at the 33% level under the income test.

While it would be necessary to determine information related to the acquired business on the basis of either U.S. GAAP or IFRS to prepare the pro forma information, that information would be based on fair value estimated in the pro forma purchase price allocation, which would frequently be more efficient to determine than reconciling the historical information of the acquired business solely to determine significance.

**Application of the Proposed Amendments to other Forms, Rules and Schedules (Q38-Q41)*****Conforming Amendments to Securities Act Forms F-4 and S-4 and Rule 701***

Unlike Form 20-F that contains detailed instructions regarding the information required to be presented therein, the disclosure requirements of the other F Forms and Form S-4 are derived by reference to the various SEC rules and regulations, including Regulations S-K, S-X and Form 20-F. Accordingly, if the SEC were to accept IFRS financial statements without reconciliation to U.S. GAAP, then we believe that the various rules and regulations that govern the preparation of such forms would require modification.

In the Release, the SEC has proposed certain conforming changes to Rule 701 and Forms F-4 and S-4. In addition, the SEC has proposed conforming changes to Form 20-F and

## APPENDIX

Rule 3-01 and Rule 4-01 of Regulation S-X. These conforming changes appear to address the information requirements of Forms F-1 and F-3 to the extent such information is required by reference to Form 20-F and Rule 3-01 and Rule 4-01 of Regulation S-X. However, certain of the information requirements of these and the other forms are determined by reference to Regulation S-K as outlined below:

- Item 301 (selected financial data)

Instruction 6 to Item 301 requires a foreign private issuer that presents selected financial data on the basis of accounting principles used in its primary financial statements to also present the data on the basis of any reconciliation to U.S. GAAP and Regulation S-X made pursuant to Rule 4-01. If the SEC accepts financial statements prepared in accordance with or reconciled to IFRS, then we believe that this instruction would need to be modified.

In Form S-4, an issuer is required to present in comparative columnar form, historical and pro forma per share data of the registrant and historical and pro forma data of the company being acquired, including book value per share as of the date financial data is presented pursuant to Item 301 of Regulation S-K. For issuers using or reconciling to IFRS, this requirement should be on an IFRS basis. Further, we note that under IFRS minority interest is classified as part of equity. Therefore, the SEC may want to clarify whether or not the required computation of “book value per share” includes minority interest.

- Item 303 (OFR)

Instruction 12 to Item 303(a) states that a foreign private issuer should refer to its reconciliation to U.S. GAAP, and discuss any aspects of the differences between its comprehensive body of accounting principles and U.S. GAAP that are not otherwise discussed in the reconciliation, but necessary for an understanding of its financial statements as a whole. If the SEC accepts financial statements prepared in accordance with or reconciled to IFRS, then we believe that this instruction would need to be modified.

- Item 503 (risk factors and ratio of earnings to fixed charges)

Instruction 2(c) to Item 503(d) requires a foreign private issuer to show the ratio based on the figures resulting from the reconciliation to U.S. GAAP, if the ratio is materially different. If the SEC accepts financial statements prepared in accordance with or reconciled to IFRS, then we believe that this instruction would need to be modified.

For issuers using or reconciling to IFRS, the ratio should be presented on an IFRS basis. However, we note that IFRS permits use of the proportionate consolidation method. Therefore, the Commission should address whether amounts relating to proportionately consolidated entities, which would not be controlled by the issuer, should be excluded in the determination of the ratio.

***Canadian Issuers***

We note that Canada is contemplating the adoption of IFRS (possibly by 2011). If and when Canada adopts IFRS, then we support an amendment to Part F/S of Form 1-A to permit the use by Canadian issuers of financial statements prepared in accordance with IFRS without a reconciliation to U.S. GAAP. We believe that continuing a requirement for a Canadian company to prepare U.S. GAAP financial statements to qualify for a Regulation A financing, regardless of whether or not an audit is required, would be cost prohibitive for most Canadian issuers unless the Canadian issuer is already using U.S. GAAP. We do not believe that the fact that financial statements prepared under current Part F/S of Form 1-A are not required to be audited would support retaining a U.S. GAAP reconciliation requirement under Form 1-A.

**Quality Control Issues – Appendix K (Q42)**

It is our understanding that the Appendix K procedures were developed so that SEC filings of foreign private issuers including reports of non-U.S. firms would have procedures performed by a person knowledgeable about U.S. GAAP, U.S. GAAS and SEC independence matters. The filing reviewer would discuss with the engagement team the evaluation of significant differences between the requirements in the U.S. with respect to GAAP, GAAS, SEC reporting requirements, and auditor independence and the requirements applied in the home country. We also note that Appendix K predates current requirements that firms auditing foreign private issuers be registered with the PCAOB and subject to its inspection process.

At the time this guidance was developed, non U.S. auditors were allowed to report that the audit was conducted using non U.S. auditing standards that were *substantially similar* to U.S. generally accepted auditing standards (U.S. GAAS). As the audits did not need to be conducted in accordance with U.S. GAAS, the guidance was developed so a person knowledgeable about U.S. GAAS would discuss with the engagement team the evaluation of whether the auditing procedures performed were substantially similar to U.S. GAAS.

Subsequent to the development of the Appendix K procedures, the Commission adopted *International Disclosure Standards* - Securities Act Release No. 7745. This guidance required that the audit be performed using U.S. GAAS - now the standards of the PCAOB - and the report include a specific statement to that effect. As the audit must be performed using the standards of the PCAOB, it is no longer necessary for the Appendix K procedures to require the involvement of the filing reviewer relative to differences in auditing standards.

Likewise, there have been changes with respect to the procedures for gathering and reporting information on scope of services since the adoption of the Appendix K procedures. For example, as a result of amendments made in 2003 to the independence rules contained in Securities Act Release No. 8183, work performed by the auditor is required to be pre-approved by the audit committee. Accordingly, we do not believe it

**APPENDIX**

is necessary for the Appendix K procedures to require the involvement of a filing reviewer relative to differences in U.S. independence requirements.

Accordingly, we believe the Appendix K procedures should be modified to eliminate the requirement for the filing reviewer to discuss audit and independence issues; rather, the procedures should be limited to U.S. GAAP issues. Therefore, if the financial statements are not prepared in accordance with U.S. GAAP or do not include a reconciliation to U.S. GAAP, we do not believe the remaining Appendix K procedures should be applicable. In addition, we do not propose to alter the other aspects of Appendix K relating to inspection procedures and disagreements.

EXHIBIT

Summary of Non-Financial Statement Disclosures and References to U.S. GAAP

SEC RULE OR REGULATION	U.S. GAAP	SPECIFIC REFERENCE
Regulation S-X	APB 30	Rule 10-01(b)(5) – Other instructions as to content
Regulation S-X	FAS 7	Rule 10-01(a)(7) – Condensed statements Industry Guide 7
Regulation S-X	FAS 19	Rule 4-10(b) – Financial accounting and reporting for oil and gas producing activities pursuant to the federal securities laws and the Energy Policy and Conservation Act of 1975 - Successful Efforts Method
Regulation S-X	FAS 57	Rule 1-02 (u) – Definitions of terms used in Regulation S-X – Related parties
Regulation S-X	FAS 80	Instruction 3 to Paragraph 4-08(n)
Regulation S-X	FAS 109	Rule 4-08(h)(3) – General Notes to Financial statements – Income tax expense
Regulation S-X	FAS 119	Instruction 1 to Paragraph 4-08(n) Instruction 2 to Paragraph 4-08(n)
Regulation S-X	FAS 123R	Rule 4-01(a)(3)(i) – Form, order, and terminology Rule 4-01(a)(3)(ii) – Form, order, and terminology
Regulation S-K	APB 15	Item 601 (11) Statement re computation of per share earnings
Regulation S-K	FAS 5	Instruction 3(B) to Paragraph 305(a) Instruction 4(B) to Paragraph 305(a) General Instruction 5(F) to Paragraphs 305(a) and 305(b)
Regulation S-K	FAS 13	303 (a)(5)(ii)(B) - Full fiscal years – Tabular disclosure of contractual arrangements

EXHIBIT

Summary of Non-Financial Statement Disclosures and References to U.S. GAAP

SEC RULE OR REGULATION	U.S. GAAP	SPECIFIC REFERENCE
		303 (a)(5)(ii)(C) - Full fiscal years – Tabular disclosure of contractual arrangements
Regulation S-K	FAS 47	303 (a)(5)(ii)(A) - Full fiscal years – Tabular disclosure of contractual arrangements
Regulation S-K	FAS 52	Instruction 1(C) to Paragraph 305(a) Instruction 2(B)(vi) to Paragraph 305(a) Instruction 2(E) to Paragraph 305(a) Instruction 3(E) to Paragraph 305(a) Instruction 4(D) to Paragraph 305(a)
Regulation S-K	FAS 69	302(b) – Information about oil and gas producing activities  Industry Guide 2
Regulation S-K	FAS 71	Instruction 1(C) to paragraph 503(d)
Regulation S-K	FAS 80	General Instruction 7 to Paragraphs 305(a) and 305(b)
Regulation S-K	FAS 89	Instruction 9 to Paragraph 303(a)
Regulation S-K	FAS 107	General Instruction 3(B) to Paragraphs 305(a) and 305(b)  General Instruction 3(C)(ii) to Paragraphs 305(a) and 305(b)
Regulation S-K	FAS 119	General Instruction 3(A) to Paragraphs 305(a) and 305(b)  General Instruction 7 to Paragraphs 305(a) and 305(b)
Regulation S-K	FAS 123	Instruction 1 to Paragraph (d)

EXHIBIT

Summary of Non-Financial Statement Disclosures and References to U.S. GAAP

SEC RULE OR REGULATION	U.S. GAAP	SPECIFIC REFERENCE
Regulation S-K <sup>2</sup>	FAS 123R	402(a)(6)(iii) – Definitions 402(a)(6)(iv) – Definitions Instructions to Item 402(c)(2)(iii) and (iv)-2(v) Instructions to Item 402(c)(2)(iii) and (iv)-2(vi) 402(c)(2)(ix)(C) – Summary compensation table 402(d)(2)(viii) – Grants of plan-based awards table 402(e)(1)(iii) – Narrative disclosure to summary compensation table and grants of plan-based awards table 402 (k)(2)(iii) – Compensation of directors 402 (k)(2)(iv) – Compensation of directors Instruction to Item 402(k)(2)(iii) and (iv) Instruction to Item 402(k)(2)(iii) and (iv)-(vii)(C)
Regulation S-K	FAS 131	Instruction 2 to Item 101
Regulation S-K	FAS 133	303 (a)(4)(ii)(C) - Full fiscal years – Off-balance sheet arrangements
Regulation S-K	FIN 39	General Instruction 5(C) to Paragraphs 305(a) and 305(b)
Regulation S-K	FIN 45	Item 303(a)(4)(ii)(A) – Full fiscal years – Off-balance sheet arrangements
Regulation S-K	FIN 46	Item 303(a)(4)(ii)(D) – Full fiscal years – Off-balance sheet arrangements

<sup>2</sup> Currently foreign private issuers are not required to provide such disclosures. However, if the SEC allows U.S issuers the option to use IFRS then such references would be applicable.

EXHIBIT

Summary of Non-Financial Statement Disclosures and References to U.S. GAAP

SEC RULE OR REGULATION	U.S. GAAP	SPECIFIC REFERENCE
Regulation S-K	SOP 94-6	Instruction 3(C) to Paragraph 305(a) Instruction 4(C) to Paragraph 305(a) General Instruction 5(E) to Paragraphs 305(a) and 305(b)
Form 20-F	FAS 5	Instruction 3(B) to Item 11(a) Instruction 4(B) to Item 11(a) General Instruction 5(F) to Items 11(a) and 11(b)
Form 20-F	FAS 52	Instruction 1(C) to Item 11(a) Instruction 2(B)(vi) to Item 11(a) Instruction 2(E) to Item 11(a) Instruction 3(E) to Item 11(a) Instruction 4(D) to Item 11(a)
Form 20-F	FAS 80	General Instruction 7 to Items 11(a) and 11(b)
Form 20-F	FAS 107	General Instruction 3(B) to Items 11(a) and 11(b) General Instruction 3(C)(ii) to Items 11(a) and 11(b)
Form 20-F	FAS 119	General Instruction 3(A) to Items 11(a) and 11(b) General Instruction 7 to Items 11(a) and 11(b)
Form 20-F	FAS 131	Instruction 3 to Item 17
Form 20-F	FIN 39	General Instruction 5(C) to Items 11(a) and 11(b)
Form 20-F	FIN 45	Item 5(E)(2)(a) – Off-Balance Sheet Arrangements

EXHIBIT

Summary of Non-Financial Statement Disclosures and References to U.S. GAAP

<b>SEC RULE OR REGULATION</b>	<b>U.S. GAAP</b>	<b>SPECIFIC REFERENCE</b>
Form 20-F	FIN 46	Item 5(E)(2)(d) – Off-Balance Sheet Arrangements
Form 20-F	SOP 94-6	Instruction 3(C) to Item 11(a) Instruction 4(C) to Item 11(a) General Instruction 5(E) to Items 11(a) and 11(b)

**TESTIMONY OF  
TERI LOMBARDI YOHN, PhD, CPA  
ASSOCIATE PROFESSOR  
KELLEY SCHOOL OF BUSINESS, INDIANA UNIVERSITY**

**SUBMITTED TO THE SUBCOMMITTEE ON SECURITIES, INSURANCE, AND  
INVESTMENT**

**U.S. SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE**

**“INTERNATIONAL ACCOUNTING STANDARDS: OPPORTUNITIES,  
CHALLENGES AND GLOBAL CONVERGENCE ISSUES”**

**October 24, 2007**

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Mr. Chairman, Members of the Subcommittee, good afternoon. I am Teri Yohn, Associate Professor of Accounting at Indiana University's Kelley School of Business. I appreciate the opportunity to appear before you today.

I have been asked to provide testimony on issues related to the international convergence of accounting standards and to the potential acceptance of the financial statements of foreign private issuers using international financial reporting standards (IFRS) without reconciliation of net income and shareholders' equity to U.S. generally accepted accounting principles (GAAP). Let me begin by saying that my views are primarily the result of an analysis of academic research on international accounting issues included in a comment letter submitted in response to the SEC's proposal to eliminate the required IFRS – U.S. GAAP reconciliation. The comment letter was prepared with Christine Botosan, Professor at University of Utah, and members of the

American Accounting Association's (AAA) Financial Accounting and Reporting Section's (FARS) Financial Reporting Policy Committee (FRPC), whose goal is to evaluate proposed accounting standards and reporting regulations and provide timely, substantive, and constructive written feedback that is grounded in relevant academic research.

As requested, my testimony will cover the following topics:

- the opportunities and challenges as the U.S. and international countries move toward convergence of IFRS with U.S. GAAP;
- the potential issues with the proposal to accept, in the filings of private issuers, financial statements prepared using IFRS without reconciliation to U.S. GAAP;
- the impact of these proposed efforts on stakeholders, including regulators, investors, auditors, and companies; and
- the differences that exist in the financial reporting results produced by U.S. GAAP compared to IFRS.

Because these four topics are interrelated, I will not address them separately. I will, instead, address the broad issues of the opportunities and challenges of international convergence of accounting standards and the potential issues related to the proposal to eliminate the 20-F reconciliation, including the potential impact of the reconciliation elimination on U.S. investors. I will conclude with a discussion of the competitiveness of the U.S. securities markets and the costs and benefits of foreign firms listing on the U.S. markets. Within these discussions, I will address the impact of the issues on stakeholders and the differences that exist between financial reporting results under IFRS versus U.S. GAAP.

In summary, my testimony that follows will provide evidence that, while the convergence of IFRS with U.S. GAAP is a worthwhile and beneficial goal, the elimination of the required IFRS - U.S. GAAP reconciliation is premature (at this point in time) and will cause U.S. investors to possess a significantly diminished set of relevant information for investment-related decision making.

**Opportunities and Challenges of Convergence of IFRS and U.S. GAAP**

It is my view that convergence of accounting standards is a laudable goal to which U.S. standard setters and regulators should strive. In general terms, the purpose of Regulation S-X is to provide U.S. investors with inter-temporally consistent information that is comparable across registrants, and internationally converged accounting standards will increase the comparability of financial information. The increased comparability will therefore, in the long run, allow investors to make improved investment decisions and/or reduce the cost of decision making. I note that some academics (Sunder 2002; Huddart, Hughes, and Brunnermeier 1999) argue that convergence may not be the optimal solution for financial reporting and argue for competition among accounting standards across countries or markets. These academics argue that companies should be able to choose the accounting standard to adopt and that investors will gravitate to companies with preferred standards. In my opinion, this does not seem to be a realistic solution in that it reduces, rather than increases, comparability of financial information across companies and it assumes that investors are able to effectively evaluate the differential quality of standards. Even given this alternative scenario for financial reporting, I would argue that convergence of accounting standards is in the best interest of investors, companies and other stakeholders.

Convergence of standards is occurring through the joint standard-setting activities of the IASB and FASB, and academic evidence (Leuz 2003; Bartov, Goldberg and Kim 2005; and Daske 2006) suggests that IFRS appears to possess information attributes of a high quality set of standards. The research finds no significant difference in information asymmetries associated with or the value relevance of IFRS and U.S. GAAP for non-U.S. companies in non-U.S. markets. Therefore, it seems that most would agree that international convergence of accounting

standards would be beneficial to the financial markets, that great strides have been taken in recent years in achieving convergence between U.S. GAAP and IFRS, and that both IFRS and U.S. GAAP reflect high quality standards.

An important issue that remains is whether it is possible to achieve “real” convergence in financial reporting across countries. Even while standard setters and regulators strive to attain international convergence of the codified set of rules and requirements, there is reason to question the feasibility of uniform financial reporting across international borders. Institutional differences between countries might well create differences in financial reporting practices even within an otherwise uniform set of standards. In addition, there is the concern that forced uniformity in accounting standards might mislead investors into thinking that financial reporting is uniform when it is not.

Research (Ball, Kothari and Robin 2001; Bushman and Piotroski 2006; Leuz, Nanda and Wysocki 2003; Ball, Robin and Wu 2003; and Henry, Lin and Yang 2007) has documented systematic differences in financial reporting outcomes (i.e., in terms of the timeliness and conservatism of reported earnings and earnings management) across countries based on legal origin (i.e., common versus code law), judicial system, enforcement system, risk of expropriation, equity market development, ownership structure, and investor protection. This area of research suggests that even if a uniform set of standards were adopted across countries, international differences in institutions could result in systematic cross-country differences in implementation of those standards.

Given the differences in economic and political forces across countries, enforcement of standards is also unlikely to be uniform. Like the FASB in the U.S., the IASB is an independent standard setter that does not have enforcement responsibilities. The U.S. has the reputation for

providing the strictest enforcement of the securities markets; however, evidence on SEC enforcement of foreign firms cross-listed on U.S. markets suggests that enforcement remains an important issue even in U.S. markets. Research (Siegel 2005) has concluded that the SEC rarely acts effectively to enforce the law against cross-listed foreign firms. The academic studies also point out that there are legal and institutional obstacles to private litigators enforcing laws against cross-listed firms in the U.S. Therefore, while non-U.S. firms might have access to U.S. markets, they are not subject to the same scrutiny and oversight as U.S. firms. Consistent with this, research (Lang, Raedy and Wilson 2006) has documented that the reconciled earnings of non-U.S. firms listed on U.S. markets have characteristics that are more consistent with earnings management than earnings of U.S. firms. In addition, these results are more pronounced for firms from countries that are generally considered to have weaker local investor protection. This suggests that SEC oversight has not appeared to provide enough of a deterrent for non-U.S. firms and that the reconciled U.S. GAAP earnings are not comparable to U.S. GAAP earnings. These findings raise concern that even with U.S. GAAP reconciliations, there are underlying differences across financial reporting practices.

Academic evidence (Street and Gray 2002; Street and Bryant 2000; Glaum and Street 2003) also suggests that there is significant non-compliance with IFRS disclosure and measurement requirements and that the level of compliance is lower for IFRS than for U.S. GAAP firms. The research concludes that IFRS is less rigorously applied than U.S. GAAP and that cross-listing in the U.S. and being audited by a large firm can mitigate some of the non-compliance. These issues are important to consider because if there is no reliable enforcement mechanism and if implementation of standards varies widely in practice, then potential informational benefits of any high-quality set of reporting standards will be diminished. Taken

together, the research discussed in the section also points to the likelihood that the SEC would become less effective if it was forced to monitor the financial reporting of foreign-private issuers that did not reconcile to U.S. GAAP.

#### **The Proposal to Eliminate the IFRS - U.S. GAAP Reconciliation**

Even given these challenges to achieving international convergence of financial reporting, it might be that the financial reporting outcomes of IFRS and U.S. GAAP are sufficiently similar to warrant elimination of the reconciliation. Logically, any proposal to eliminate the 20-F reconciliation requirement must be based on the premise that U.S. GAAP and IFRS are informationally equivalent sets of accounting principles or that investors can reconstruct consistent and comparable U.S.-GAAP-based summary accounting measures from IFRS financial statements. Note that neither of these conditions is dependent on the quality of IFRS. IFRS may very well be a high quality set of accounting standards based on the properties of reported information and prices in other countries, but also fail to provide information that U.S. investors find most relevant for investing decisions.

While the IASB and FASB have been attempting to reduce the differences between IFRS and U.S. GAAP, academic studies (Henry, Lin and Yang 2007) have documented that material reconciling items remain. An analysis (Henry, Lin and Yang 2007; Haverty 2006) of IFRS to U.S. GAAP 20-F reconciliations in 2004 and 2005 shows significant differences in net income and equity between IFRS and U.S. GAAP. In addition, the research documents that IFRS reported net income is higher on average than U.S. reported income, suggesting the existence of a systematic bias in the reconciling items.

The research (Henry, Lin and Yang 2007) also documents that the IFRS-U.S. GAAP reconciliation is value relevant and used by U.S. investors. That is, the income and equity reconciling items included in the reconciliation have been found to be incrementally informative for explaining stock prices, and the change in the income-reconciling amount has been found to be incrementally value relevant over the change in IFRS net income in explaining annual stock returns. In addition, a significant positive relation between the magnitude of the income-reconciling amount and abnormal trading volume has been documented (Chen and Sami 2007). These results suggest that U.S. investors use the IFRS-U.S. GAAP reconciliation and that elimination of the reconciliation could leave investors with less relevant information for making investing decisions.

In addition to suggesting that investors use the IFRS-U.S. GAAP reconciliation in making investment decisions, research (Bradshaw, Bushee and Miller 2004; Plumlee and Plumlee 2007) also suggests that U.S. investors prefer U.S. GAAP over IFRS or other foreign GAAPs. U.S. institutional investors appear to prefer to invest in non-U.S. firms whose accounting methods conform more closely to U.S. GAAP and, as evidenced by trading volume, U.S. investors appear to react more to earnings reported under U.S. GAAP than under IFRS or other foreign GAAP. The preference for U.S. GAAP and the greater trading activity related to U.S. GAAP might occur because U.S. GAAP familiarity reduces U.S. investors' information processing costs or because U.S. investors consider U.S. GAAP standards to be of higher quality. In either case, the results suggest that U.S. investors prefer U.S. GAAP over IFRS in making investment decisions. Together, these results suggest that while convergence is occurring, there are currently significant differences between IFRS and U.S. GAAP and that U.S. investors use

the information in the 20-F reconciliation in making investment decisions. Therefore, U.S. investors do not appear to view IFRS and U.S. GAAP as substitutes.

Of course, the elimination of the reconciliation would not be problematic if investors could obtain the information necessary to determine the differences between IFRS and U.S. GAAP from information in the financial reports and if U.S. investors had the expertise to understand the differences between the two sets of standards. Without the reconciliation, it would be very difficult if not impossible for an accounting expert to reconstruct U.S. GAAP income and equity from IFRS-based financial statements and footnotes. In addition, at this point in time, U.S. investors do not have the necessary expertise in IFRS to understand the differences in financial reporting under IFRS versus U.S. GAAP. Universities are attempting to increase coverage of IFRS in their curricula; however, they are far from fully integrating international standards into the courses and accounting programs and are still attempting to determine the best way to do so. Thus, given the substantial differences that exist between IFRS and U.S. GAAP, U.S. investors must have an understanding of the two sets of standards. They do not.

In addition, if the reconciliation is eliminated for a subset of firms that participate in U.S. capital markets, it might lead U.S.-based companies to request permission to use IFRS instead of U.S. GAAP. At this point in time, it does not appear that U.S. stakeholders, including companies, auditors, analysts and investors, have sufficient expertise in IFRS to allow this to happen. For example, recent conversations with top executives from the largest auditing firms reveals that one of their biggest concerns is the lack of current expertise in IFRS within their domestic professional staff. This suggests that even our most expert stakeholders in the U.S. capital markets (i.e., auditors) recognize the continuing convergence of worldwide accounting

standards but that that they do not yet possess sufficient IFRS-related expertise within domestic offices.

The existence of significant reconciling items, the value relevance and use of the reconciliations by U.S. investors, the preference for U.S. GAAP over IFRS by U.S. investors, the lack of expertise in IFRS by auditors and analysts, and the work that still needs to be done to incorporate IFRS into accounting education suggest that elimination of the 20-F reconciliation for IFRS-reporting foreign private issuers is premature. It would perhaps be prudent to revisit the issue of the reconciling items and the use of the reconciliation by U.S. investors on a regular basis. In my opinion, it would be appropriate to consider eliminating the reconciliation when the reconciling items are immaterial and when U.S. investors appear to view IFRS and U.S. GAAP to be informationally equivalent. Without informationally equivalent standards or the reconciliation, it is essential that investors be proficient in IFRS and that the necessary information is available to create U.S. GAAP comparable income and equity measures. Neither of these criteria hold at this point in time.

#### **The Competitiveness of U.S. Markets**

I note that the above discussion focused on the benefits of the reconciliation to U.S. investors. It did not address the costs of the reconciliation to the companies cross-listed on the U.S. markets. A concern exists that the U.S. markets are losing their competitiveness because of the onerous reporting requirements and that eliminating the reconciliation could help to reduce these costs. Central to this concern is the issue of whether the costs are so significant as to effectively offset or exceed the benefits received from registration in the U.S. securities markets.

Research has addressed the issue of the net benefits of foreign firms listing on U.S. markets and the issue of whether the U.S. has lost its competitiveness with respect to the securities markets. The research (Reese and Weisbach 2002; Lins, Strickland, and Zenner 2005) suggests that listing on U.S. markets improves access to capital, especially for emerging market firms. Research (Doidge 2004; Doidge, Karolyi and Stulz 2004) also suggests that listing on U.S. markets provides greater investor protection and results in a premium for firms that list in the U.S. Specifically, cross-listed firms appear to be valued higher than foreign firms that do not list in the U.S. and the magnitude of the premium appears to be negatively associated with the level of home-country investor protection. The academic evidence (Lang, Raedy and Yetman 2003) also suggests that listing in the U.S. provides improved financial reporting quality to shareholders and that cross-listed firms are less aggressive in terms of earnings management, convey bad news in a more timely fashion, and have earnings that are more strongly associated with share price. In addition, research (Baker, Nofsinger and Weaver 2002; Lang, Lins and Miller 2003) finds that when non-U.S. firms cross-list in the U.S., their information environment improves. Firms that cross-list on U.S. exchanges have greater analyst coverage and forecast accuracy compared to firms that are not cross-listed. Accordingly, the research concludes that cross-listing improves the firm's information environment, which yields a higher stock valuation.

These studies all suggest that there are important benefits to listing in the U.S.; however, some have expressed concerns as to whether the U.S. has lost its competitiveness because of the significant costs of complying with SEC requirements and that the benefits of listing in the U.S. are offset by the costs. Research (Doidge, Karolyi, and Stulz 2007) has investigated the accepted wisdom that the decrease in flow of new listings in New York and the increase in flow of new listings in London is evidence that New York has become less popular due to the passage of the

Sarbanes-Oxley Act of 2002 (SOX). While the three major New York exchanges have not experienced changes in market share in recent years, London's share has increased. The research suggests that growth in the London exchange relative to the U.S. exchanges is explained by the changing mix of firms seeking cross-listing. The research documents no significant change in the characteristics of firms listing on U.S. markets since the adoption of SOX, and that the firms that cross-list on London exchange tend to be small and unlikely candidates to cross-list on U.S. markets. In addition, cross-listing on a U.S. exchange appears to result in a valuation premium, which has not declined over time, while cross-listing in London results in no premium. Based on these results, the authors conclude that SOX has not eroded the benefits of listing on a U.S. exchange and the benefits cannot be replicated through a London listing.

In summary, extant research suggests that cross-listing in the U.S. market improves access to capital, increases investor protection, and improves the firm's information environment. The implications for firm value are both direct and indirect. Firm value is enhanced directly because improved shareholder protection lowers the expected wealth transfers and is enhanced indirectly because improved access to capital allows managers to undertake more positive net present value projects. The evidence suggests that these benefits are greatest for firms domiciled in emerging markets and/or in countries with weak shareholder protection. Finally, the extant evidence suggests that SOX has not eroded the benefits of listing on a U.S. exchange, and that the benefits offered by such a listing are unique to the U.S.

**Conclusion**

While convergence is a laudable goal to which U.S. standard setters and regulators should strive, at this time the academic literature does not support the SEC's proposal to eliminate the U.S. GAAP – IFRS reconciliation requirement for foreign private issuers. While research on IFRS versus U.S. GAAP for non-U.S. companies in non-U.S. investment markets finds no significant difference in the value relevance or levels of information asymmetries between the two sets of standards in foreign markets, the research on the IFRS - U.S. GAAP reconciliation suggests that material differences between IFRS and U.S. GAAP exist and that information contained in the reconciliations are reflected in investment decisions made by U.S. investors. Until greater convergence is achieved, eliminating the reconciliation runs the risk of diminishing the relevant information set available to U.S. investors. However, the FASB and IASB continue to work jointly to achieve greater convergence. As a consequence, the importance of the reconciliation should diminish through the ongoing joint standard-setting efforts. Over time, standard setters and regulators should periodically revisit the question of the materiality of the reconciling items and the usefulness of the reconciliation to U.S. investors. When the difference between the two sets of standards becomes immaterial and when the reconciliation is no longer useful to U.S. investors, the SEC should reconsider eliminating the reconciliation requirement. However, we are not currently at that point. Thus, in the meantime, it will be important for the U.S. to focus on educating stakeholders, including auditors, investors, analysts and companies, on IFRS.

Deferring the elimination of the IFRS – U.S. GAAP reconciliation will also allow regulators to address some of the major challenges of convergence. Specifically, differences in the implementation of uniform standards across countries and issues with respect to compliance

to the standards by foreign firms are important concerns that deserve attention. Whether the reconciliation requirement reduces the implementation differences and compliance issues remains an open question. However, before eliminating the reconciliation, the SEC should attempt to understand the role of the reconciliation in mitigating these issues.

While the costs of the reconciliation and of listing on the U.S. exchanges has been a concern, research suggests that foreign firms that list on U.S. exchanges benefit from greater access to capital and a richer information environment. In addition, U.S. requirements, including Sarbanes-Oxley-related reporting, do not appear to make the U.S. market less attractive to foreign firms.

Based on this evidence, I conclude that the elimination of the IFRS - U.S. GAAP reconciliation requirement is premature. Until the U.S. is willing either to adopt IFRS, or to require U.S. firms to reconcile to IFRS, elimination of the reconciliations will reduce comparability while significant differences in financial reporting remain.

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Statement  
Of  
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Before the Subcommittee on Securities, Insurance and Investment  
Committee on Banking, Housing, and Urban Affairs  
United States Senate

On  
International Accounting Standards: Opportunities, Challenges,  
and Global Convergence Issues.”

**October 24, 2007**

Thank you Chairman Reed and Ranking Member Allard for holding this hearing on an issue important to investors in America's capital markets. Before I start with my personal perspective on international accounting standards, it might be worthwhile to provide some background on my experience. I serve as a trustee of a mutual fund and \$40 billion public pension fund, both of which invest in foreign as well as domestic public companies. I serve on the board of directors of a small cap domestic public company. In the past, I have also served as chief accountant of the U.S. Securities and Exchange Commission (SEC) where I was deeply involved with the process leading to the creation of the International Accounting Standards Board (IASB) and its trustees as we know them today. I was also an audit partner in one of the major international auditing firms and the managing director of research at a financial and proxy advisory firm. In addition, I have also been a professor of accounting at a major U.S. public university and an investor representative on the Public Companies Accounting Oversight Board Standards Advisory Group and the Financial Accounting Standards Board's (FASB) Investor Technical Advisory Committee.

High quality financial reporting has been called the life blood of our capital markets by former SEC Chairman Levitt. I couldn't agree more. It is this information that provides investors with the ability to make informed judgments as to where they should allocate their capital, thus resulting in allocations which yield higher returns, with lower risks, thereby attracting a supply of capital. When the quality of this information is lowered, markets pay a price as we have seen throughout this decade both here in the U.S. and abroad.

Based on my experience, I believe maintaining high quality financial reporting is important to the competitiveness of US markets. As a former chief financial officer and business executive, I also know the importance of striving to provide investors with a product that is better than those of competitors, not just one that matches their performance. The U.S. markets will not maintain their current prominence if they simply become the equal of other markets, employing the same strategies and approach to business. Certainly the fallout from the subprime fiasco and Structured Investment Vehicles's around the globe is a classic example of this and how a lower quality in transparency can affect competitiveness.

#### **What Is True Convergence**

I would like to clarify what convergence is, not what some intend to avoid. Convergence is:

- A **SINGLE** set of high quality financial reporting and disclosure standards that result in companies reporting the true economics of the transactions they enter into.

- Standards that result in consistent reporting methods from period to period and comparable reporting by companies who enter into comparable transactions.
- A complete set of standards covering all significant industries that exist such as mining and oil and gas, and financial services including insurance.
- Transactions being reported in the financial statements and not left off the balance sheet and out of the income statement as investors have seen time and time again in recent years with special purpose entities, structured investment vehicles and off balance sheet financing of securitizations and other assets.
- Effective audits that ensure CLAIMED compliance has been achieved.
- Authorities with the expertise and experience to globally enforce these accounting standards and audits, wherever they are used in reporting to investors.

Unfortunately, few of these conditions exist globally today as I will discuss further below. No regulators and governments have fully committed themselves to this effort, to fund it and provide sufficient resources. And no timetable has been set among all countries internationally to fully achieve the changes needed to ensure complete and timely convergence. Instead efforts are at best, being done in a piecemeal, haphazard fashion.

As such, removing safeguards and protections for investors before these conditions are achieved bring with it significant risks for investors and capital market participants. It so will increase the likelihood of future scandals with an increase in the cost of capital for all companies, and a reduction in available capital in the markets. Unfortunately, the actions some propose taking are all too similar to what has led directly to the current subprime mess.

Let me also say convergence is not one of selection of the FASB standards over the IASB standards or vice versa. In fact at this time, due in part to the newness of the IASB standards, there is little if any meaningful fact based research that indicates one is that much better than the other albeit the FASB has a much more robust and complete set of standards. For example, the standards of both with respect to off balance sheet transactions have left global investors in the dark, and without sufficient transparency. For that, both bodies get a "D" at best, if not a failing grade. And while some FASB standards such as guidance on accounting for derivatives is complex and difficult to implement, likewise some IASB standards such as accounting for property, plant and equipment and research and development expenses are more complex and difficult than their comparable FASB standards. And unfortunately, both boards and their trustees, as Arthur Levitt recently noted in an op ed, lack adequate voting members and representation from the investor community, and both have allowed way to many

optional accounting treatments making it difficult and costly for investors to analyze and compare companies and their performance.

So this raises the question of why does the SEC feel compelled to remove the reconciliation at this point in time? Is it to make the U.S. capital markets more competitive? I seriously doubt it as today just over 100 foreign companies listing in the U.S. from among over 1,100 such companies who file with the SEC, and over 12,000 publicly listed companies, use International Financial Reporting Standards (IFRS) as published by the IASB. In addition, approximately 70 more reporting foreign companies prepare their financial statements in accordance with a jurisdictional adaptation of IFRS which is a way of saying their countries have picked and chosen among the IFRS they like and don't like. A concept far, far away from convergence and endorsement of the IASB and its work.

Likewise, Goldman Sachs has appropriately noted it is not our U.S. regulatory scheme that has the most significant impact on the competitiveness of our capital markets.<sup>1</sup> Rather it is economic factors such as the growth in our GDP that currently lags emerging economies such as China and India where their growth, and growth in business, is three to five times what it is here. And as a study from Ernst & Young has pointed out, it is most common that foreign companies list in their home markets, which quite frankly, is not a new or novel idea here in the U.S.<sup>2</sup>

Convergence is an objective many people are in agreement on. But as is often the case, the devil is in the details as to how one gets to a common financial reporting language. However, one must stay focused on the objective of development of accounting and disclosure standards that result in a company most accurately portraying the economics of its balance sheet, income statement and liquidity from cash being generated.

In striving to achieve that objective and convergence, a few key points are worth noting. These include:

1. Convergence on high quality accounting standards will best be achieved through the private sector standard setting process, not by one influenced by outside special interests, overbearing regulators and a lack of direct investor involvement.
2. There needs to be assurance that the necessary supporting infrastructure is in place, as set forth by the SEC in its 2000 Concept Release on International Accounting.
3. There are concerns regarding the independence of the IASB and lack of any meaningful representation of investors as members of its board or among its trustees.

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<sup>1</sup> Global Economics Weekly, Is Wall Street Doomed? Goldman Sachs. February 14, 2007

<sup>2</sup> Global Capital Market Trends. Ernst & Young. January 2007.

4. Comparability and consistency in reporting by companies has been a hallmark of high quality financial reporting by investors and the FASB's conceptual framework for several decades. Negatively impacting that will have consequences for the investing public around the globe.
5. In the U.S., there is a lack of resources, skills and training to make an orderly transition to IFRS any time soon. To require a change in the near term would disadvantage small auditing firms and result in significant costs for smaller companies.

#### **Need To Continue Convergence on High Quality Standards**

The SEC in its 2007 proposing release states:

"...audit firms have not been required to opine on IFRS as published by the IASB but have limited their opinions to jurisdictional variations of IFRS, consistent with a company's basis of presentation. In light of this wide-scale use of IFRS being less than two years old, the degree of experience, familiarity and understanding among companies, audit firms, investors, analysts, brokers, regulators, and others is continuing to develop....However, developing high-quality standards and issuing high-quality interpretations of IFRS may take some time."<sup>3</sup>

The SEC portrayal is a fairly accurate one and there is indeed much work that remains to be completed before high quality standards are achieved internationally. Accordingly, while elimination of the reconciliation at an appropriate time is to be applauded, that time has not yet come. Instead it begs the question as to the reason for the current change in direction and rush. Why now when the SEC has indicated there is much work that remains to be done?

Rather than have the SEC eliminate the reconciliation, a significantly better approach yielding a better product for investors is to continue to have the IASB and FASB, along with other international standard setters, continue to pool resources to develop a comprehensive set of international standards. As they achieve convergence on standards, they will also eliminate items reported in the reconciliation to investors over a reasonable period of time. In turn, the reconciliation will disappear without unintended consequences occurring.

Standards & Poors has recently stated "We believe elimination of the reconciliation would occur as a natural byproduct of the International Accounting Standards Board (IASB) and the U.S. Financial Accounting Standards Board (FASB...) on-going convergence process. As efforts to converge U.S. Generally Accepted Accounting

<sup>3</sup> Securities and Exchange Commission 17 CFR Parts 210, 230, 239 and 249 [Release Nos. 33-8818; 34-55998; International Series Release No. 1302 File No. S7-13-07] Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards Without Reconciliation to U.S. GAAP, Pages 31 and 32.

Principles (U.S. GAAP) and IFRS continue, differences between the models would be rationalized within the context of a comprehensive joint framework.”<sup>4</sup>

Accordingly, the FASB and IASB have demonstrated they will eliminate the reconciliation as higher quality standards are completed, and there is not a compelling need at this time for the government regulator to unduly interfere with this process. Periodically as the FASB, IASB and other international standard setters move forward with their convergence process, they should periodically publish updates on their progress including providing investors with an inventory of differences among their standards. This would greatly aid in training and educating investors, auditors, company accountants and students. The International Organization of Securities Commissions, the SEC and other international regulators should continue to encourage and oversee these efforts.

I believe strongly if the SEC reconciliation is eliminated, it will also eliminate the incentive for standard setters to work together. Indeed, each of the standard setters is likely to go their own way and I suspect within 10 years, if not sooner, the FASB will cease to exist, leaving the U.S. without a viable private standard setter responsive to the needs of U.S. investors. Ultimately this will contribute to a slow down or reversals in global efforts to improve the quality of financial information investors receive. It also results in a lack of competitive market incentives brought on by competing standard setters, which, as we have seen with the demise in number of auditing firms, is a negative event, not a positive one.

#### **Assurance The Necessary Infrastructure Is In Place**

In the Concept Release on International Accounting Standards issued by the SEC in 2000, it states:

“Accordingly, while the accounting standards used must be high quality, they also must be supported by an infrastructure that ensures that the standards are rigorously interpreted and applied, and that issues and problematic practices are identified and resolved in a timely fashion. Elements of this infrastructure include:

- effective, independent and high quality accounting and auditing standard setters;
- high quality auditing standards;
- audit firms with effective quality controls worldwide;
- profession-wide quality assurance; and
- active regulatory oversight.”<sup>5</sup>

<sup>4</sup> Standard and Poor’s comment letter to SEC dated September 24, 2007. Pages 1 and 2.

<sup>5</sup> Securities and Exchange Commission, 17 CFR PARTS 230 and 240, [RELEASE NOS. 33-7801, 34-42430; International Series No. 1215] File No. S7-04-00. International Accounting Standards. 2000.

As both an auditor of major international foreign companies, as a regulator, and as the director of research of financial analysts, I have learned standards that are not enforced are the equivalent of no standards at all. It is vitally important to provide U.S. investors adequate protections through proactive enforcement of the accounting standards, achieved by both effective audits by independent auditors and rigorous regulatory oversight. Yet today no single regulator or law enforcement agency has responsibility for enforcement of standards issued by the IASB.

Unfortunately, in their recent proposing release, the SEC provides little evidence the necessary infrastructure exists to ensure compliance with international standards. For example, actual regulatory actions being taken in many countries where foreign companies are domiciled are almost nonexistent. In some countries, including those with well known public markets, the ability of the securities regulators to take enforcement actions is severely limited. This has resulted in U.S. regulators finding themselves having to enforce such basic fundamental standards for foreign participants in the U.S. capital markets as those that ensure the independence of an audit. I believe this affects investor confidence in those markets. And not all international audits are adequate today as was demonstrated when in the past year; the Japanese regulator was forced to effectively shut down the affiliate of a major international auditing firm that was accused of engaging in fraud in its audits.

The international auditing standards also continue to be set by the auditing profession itself, with little direct voting involvement by investors. Such a process, while improved from what it has been in the past, continues to lack adequate independence and investor input.

Therefore, prior to elimination of the SEC reconciliation, I would urge the SEC provide Congress and investors, if it has it, data which demonstrates effective auditing and regulatory schemes actually operate in countries for which the reconciliation would no longer be required. The SEC proposing release falls way short of the target in this regard.

#### **Concerns Regarding the Independence Of The IASB and Representation Of Investors On Its Board**

In the past, the independence of the FASB has been strongly protected to ensure it is able to develop unbiased standards designed to provide transparency for investors. More recently, Congress enhanced the independence of the FASB by providing independent funding. This contributed to the FASB being able to recently adopt a new and badly needed standard on accounting for stock options, despite attempts by some to unduly influence its processes and outcomes.

When the FASB issues a new standard in the United States, it effectively becomes "law" without further review by the SEC or U.S. Congress. Only in very few instances, has the SEC or Congress overturned a new accounting pronouncement in the U.S. and it is almost universally acknowledged that intervention in those cases proved to be fatally

flawed. This process has also contributed to the independence and lack of bias in the standards issued by the FASB.

Unfortunately, the IASB lacks this level of independence. It must go hat in hand to companies impacted by its standards, and their auditors, to obtain funding for its operations, which are relatively small in size given its responsibilities and obligations. The IASB's meager preliminary budget for 2008 is for just 45 full time staff equivalents at a staffing cost of \$11.7 million pounds. It is difficult to understand how this organization can even remotely keep up with the financial reporting needs of the world's capital market. Indeed, its manpower is less than half the staffing of the U.S. national office of just one of the Big 4 auditing firms.

One should also be mindful that corporations and auditing firms currently provide 60 to 70 percent of the annual budget for the IASB. These organizations overwhelming control the seats of the members of the IASB and its trustees. As such, the IASB risks a negative outcome were it to anger those who provide funding with rules they oppose.

Equally importantly, new pronouncements of the IASB do not become law in Europe until after the European Parliament votes on and approves them. This process begins when the European Financial Advisory Group (EFRAG) and Accounting Reporting Committee (ARC) reviews the standards and make recommendations for changes or their adoption to the EU. This process has major flaws as special interests in recent years have unduly influenced the IASB's international standard setting process resulting in the EU not fully adopting all IASB standards and their interpretations. In turn, European companies are not required to comply with IASB standards in which EU jurisdictional differences have been approved by the EU. In the most recent meeting of the ARC just this month, some recommended once again that a new IASB standard be modified before it is accepted.

If the SEC (and Congress explicitly or implicitly) determines it is appropriate to eliminate the reconciliation, then they should also determine whether or not it is appropriate to accept the IASB standards in this country without reconciliation when jurisdictional differences are reported and used in preparation of the financial statements. I believe any company reporting using jurisdictional differences should have to continue with the full reconciliation.

**Comparability And Consistency In Financial Reporting – Significant Differences in International and U.S. Accounting Standards Exist.**

There remain significant differences in financial reporting by users of International Accounting Standards and those using U.S GAAP. For example, a recent research report by The Analyst's Accounting Observer based on a review of Forms 20-Fs filed with the SEC found significant variations in income reported by preparers using IFRS versus U.S. GAAP. A copy of this report is attached. Similarly, Maverick Capital, a \$23 billion investment fund cited numerous differences in the two GAAPS in a comment letter to the SEC which is attached hereto and which provides excellent, practical examples.

Some of these differences are the result of both more complex, detailed and more costly accounting standards issued by the IASB, than those issued by the FASB. Examples include IFRS related to accounting for property, plant and equipment and intangible assets.

Being able to compare the financial results of companies with one another is critically important to investors in making a determination as to where they should allocate their capital. It is a hallmark of an efficient capital market. Without comparability, and consistent reporting by companies period to period, it makes such comparisons difficult at best and extremely time consuming and costly. That is why the reconciliation has been very useful for investors.

The CFA Institute, the largest worldwide organization of financial analysts has stated to the SEC that:

“The current SEC reconciliation requirement is an important tool that allows them to compare companies in different countries on an apples-to-apples basis. To the extent accounting standards have not yet converged (or new differences develop) investment professionals rely on the reconciliation as an efficient and cost effective way of bringing to their attention, the material differences in accounting.”<sup>6</sup>

The credit rating agency Standards & Poor’s has also recently stated; “...the reconciliation, although perhaps not a vital input to our analysis, nonetheless serves a useful function in highlighting differences in accounting conventions, thereby supporting our analytical process and aiding us in making comparisons among global peers. This is particularly relevant because IFRS is still in its early days in terms of its application and interpretation.”<sup>7</sup> It is interesting that at a time when credit rating agencies have been criticized for their analysis and ratings, Congress and the SEC would take steps to reduce the information they have available when making their rating determinations.

SEC staff has also found the reconciliation useful when assessing whether foreign registrants have complied fully with international accounting standards. For example the reconciliation process has highlighted instances of noncompliance with IFRS that in turn were disclosed or proposed to be disclosed in the reconciliation of IFRS to U.S. GAAP. This information has provided useful information to SEC staff in reviews of such filings.

#### **Lack Of Resources, Skills And Training**

For the vast majority of U.S. companies, financial management is sufficiently challenged running their business, complying with existing accounting standards and ensuring they have adequate risk and accounting internal controls. I know of very few companies that have sufficient resources to comply with IFRS in their filings with the SEC and disclosures to investors.

<sup>6</sup> CFA Institute comment letter to SEC, October 2, 2007.

<sup>7</sup> Ibid. Page 2.

Small public companies are even more challenged and the costs to convert to IFRS at this time or in the near future would be astronomical. I know of no cost study by the SEC or others that has adequately studied and captured these costs to U.S. companies and the American economy. These costs would include the need to hire additional competent people trained in IFRS, train existing people, make necessary modifications to their systems for the significant differences in accounting conventions and fund major changes required in accounting education. As mentioned earlier, some of these changes, such as how technology companies might account for research and development expenditures could involve significant costs and added complexities.

Smaller auditing firms are challenged to comply with US auditing standards as noted in a recent report of the PCAOB. Very few of these currently have the resources, including staffs, which are knowledgeable of IFRS. At a time when the Treasury Committee on the Auditing Profession is looking for ways to make the auditing profession more competitive, moving to IFRS in this country is likely to have just the opposite effect on many small CPA firms in the U.S.

U.S. universities also do not have the resources or funding required to train new students in international accounting and auditing standards. I have recently surveyed leading professors of accounting and auditing in the U.S asking if there are adequate accounting texts for teaching IFRS in the universities as well as teaching international auditing standards. The response was universal they were not aware of such texts. In addition, they noted they were not teaching such courses at their universities. With very few accounting professors currently having a working knowledge of IFRS, and a large portion of them retiring in the next few years, it leaves a nonexistent ability of the education system to provide new graduates to industry or the auditing firms during this decade.

### **Concluding Remarks**

Let me wrap up by noting there are many challenges, and yet opportunities as well on the road to convergence. It is a road that has been well engineered and laid out in the past with proper course. Now is not the time to take off over country roads in a new direction, if investors are to be well served and the competitiveness of American markets maintained. I believe that will bring with it a bumpy road with an unclear outcome.

Thank you and I would be happy to take any questions you might have.

**RESPONSE TO WRITTEN QUESTIONS OF SENATOR REED  
FROM CONRAD W. HEWITT AND JOHN W. WHITE**

**Q.1.** Specifically, Section 108(a) of the Sarbanes Oxley Act directed the SEC to establish a program for recognizing accounting principles as “generally accepted,” by among other things considering the qualifications of the accounting standards-setter. The Act set forth several required qualifications, including that the standards-setter have independent funding in the same manner that the PCAOB and FASB have and that the standards-setter “considers, in adopting accounting principles, . . . the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors.”

In his testimony before the Subcommittee, Mr. Herz echoed some of the concerns underlying Section 108, when he testified that the blue print for international convergence “should also address strengthening the IASB as an independent, global standard setter by establishing mechanisms to ensure the sufficiency and stability of its funding and staffing.”

- Has the Commission or its staff considered how to apply Section 108 in the context of the IASB? That is, what is your process for evaluating whether the IASB satisfies the criteria set forth by Congress?
- Second, Congress determined in passing Section 108 that the accounting principles used for compliance with our federal securities laws should be established by an independent standards-setter with an independent source of funding. In your statement today you testified that the IASB does not have such a funding source at this time. Wouldn't the elimination of the reconciliation effectively mean, though, that the SEC is in essence recognizing the IASB as an independent standards-setter for purposes of filings by foreign private issuers? If so, is such recognition justified when the IASB does not have an independent funding source?

**A.1.** We believe that Section 108 of the Sarbanes-Oxley Act is not applicable to the Commission's decision to allow foreign private issuers to file their financial statements under IFRS as promulgated by the IASB, without reconciliation to the U.S. GAAP.

Since the passage of the Securities Act in 1933 and the Securities Exchange Act in 1934, Congress has given the Commission broad statutory authority to set the requirements for financial information in filings by issuers. That authority includes the power to determine the methods to be followed in the preparation of financial statements, as well as the contents of the financial statements themselves. (See 1933 Act Section 19(a); 1934 Act Section 13(b).)

Sections 108 and 109 of the Sarbanes-Oxley Act complement this long-standing statutory scheme. Section 108(c) explicitly recognizes the Commission's existing authority in this area, and provides that “[n]othing in this Act . . . impair[s] or limit[s] the authority of the Commission to establish accounting principles or standards for purposes of enforcement of the securities laws.” Further, Congress included a general savings clause at Section 3(c)(2) of the Sarbanes-Oxley Act, that expressly preserves the Commission's authority to

set accounting standards in terms nearly identical to Section 108(c).

What Sections 108 and 109 do accomplish is to provide an appropriate funding (and governance) mechanism for any accounting standard setter that the Commission chooses to recognize for the purposes of establishing “generally accepted” accounting principles. By its terms, Section 108 is permissive and does not require the Commission to recognize any particular standard-setting body: “[i]n carrying out its authority under [1933 Act Section 19(a)] and under [1934 Act Section 13(b)] the Commission may recognize, as ‘generally accepted’ for purposes of the securities laws, any accounting principles established by a standard setting body” meeting certain conditions (emphasis added).

In allowing foreign private issuers to file financial statements prepared in accordance with IFRS without reconciliation to U.S. GAAP, the Commission has not thereby recognized the IASB as a standard-setting body. This is so, because the Commission has not recognized IFRS as “generally accepted” accounting principles. Nor need it recognize IFRS in this way. The Securities Act and the Securities Exchange Act do not require the use in Commission filings only of financial statements meeting the requirements of U.S. generally accepted accounting principles (U.S. GAAP).

Historically, in cases in which the Commission has permitted financial statement of foreign private issuers to be filed based on foreign accounting systems, it has also required a reconciliation to U.S. GAAP. Reconciliation to U.S. GAAP does not, however, turn financial statements prepared on the basis of another set of accounting principles into U.S. GAAP financial statements. It rather provides quantitative disclosures (in footnote form) of some—but by no means all—of the differences between the foreign private issuer’s financial results under its primary set of accounting principles and the results had its financial statements been prepared on the basis of U.S. GAAP. Nothing in the Sarbanes-Oxley Act itself (or the Act’s legislative history) suggests that Congress believed the Commission should cease allowing foreign private issuers to file financial statements prepared on the basis of a set of accounting principles other than U.S. GAAP. Had Congress meant that in 2002, filings made since then using not only IFRS but also other non-U.S. accounting standards would not have satisfied these requirements. The Commission does not believe Congress intended this result.

**Q.2.** Some prominent academic research suggests that the additional uncertainty that will likely result from the increased use of IFRS by companies listed on the US exchanges will result in greater US stock market volatility. Have you performed or reviewed any relevant research on how the elimination of the reconciliation requirement and the greater use of IFRS in the US markets might impact market volatility?

**A.2.** The Commission’s staff reviewed the academic research cited in the comment letter of the American Accounting Association (AAA) and that cited in Professor Yohn’s testimony before the Subcommittee. We believe this research shows the way in which financial reporting affects capital markets, including volatility, is a func-

tion of the attestation, legal and regulatory environment, as well as the accounting standards used. In considering the adoption of amendments, the Commission carefully considered many factors, including the input received from the commenters, including that of the AAA, as part of the notice and comment process.

**Q.3.** How many current employees at the SEC would you characterize as experts in IFRS? How many IFRS experts does the SEC plan to hire in the next three years to assist in the enforcement of IFRS standards by foreign companies listing in the U.S. markets?

**A.3.** In 2006, the SEC conducted comprehensive IFRS training for all Commission staff responsible for reviewing, consulting on, and enforcing corporate disclosure filings. We will regularly augment this training through our continuing education program.

Organizationally, the Commission staff is not divided as to accountants that are responsible for IFRS and those that are responsible for U.S. GAAP. Rather, in both the Office of Chief Accountant and the Division of Corporation Finance, accountants are responsible for their knowledge of IFRS just as they are for U.S. GAAP. More specifically, in the Office of the Chief Accountant the staff members who consult on financial reporting policy and application matters are generally organized by subject matter (*e.g.*, pensions, leases and so forth), hence they focus on those subject matters with respect to both IFRS and U.S. GAAP. In the Division of Corporation Finance the staff members who review the registrant filings are generally organized by industry sector (*e.g.*, manufacturing, financial services and so forth), hence they focus on the application of both IFRS and U.S. GAAP within that industry. Further, there are other staff members within both the Office of the Chief Accountant and the Division of Corporation Finance who have experience with and are engaged in IFRS matters in connection with their more general responsibilities. We plan to perform future hiring to fill these roles as part of the normal course of carrying out our work.

The SEC staff has several years' experience with IFRS as some foreign private issuers have filed their home country financial statements under IFRS for many years. Further, in 2006, the staff reviewed the annual reports of more than 100 foreign private issuers containing financial statements prepared for the first time on the basis of IFRS. These reviews covered a wide range of industries. The staff has continued to review the filings of foreign private issuers that use IFRS and reviews the primary financial statements, regardless of the set of accounting standards used or the inclusion of a U.S. GAAP reconciliation, in foreign private issuer filings with the Commission. The more widespread use of IFRS has reduced the number of home country accounting standards used in SEC filings which has reduced the number of sets of accounting standards with which the SEC staff must be familiar.

**Q.4.** Would elimination of the reconciliation requirement affect the cross-listing premium that non-U.S. companies listed on U.S. exchanges currently enjoy? What steps could help to maintain the cross-listing premium and thus retain the competitiveness of U.S. markets? Would reliance on non-U.S. companies' home country in-

terpretation and enforcement of IFRS affect the cross-listing premium that non-U.S. companies listed on U.S. exchanges currently enjoy?

**A.4.** Any cross-listing premium may be attributed to a number of factors, including U.S. disclosure and corporate governance requirements, and enforcement mechanisms that contribute to the robustness of the U.S. capital markets. We do not believe that eliminating the reconciliation requirement diminishes the attractiveness of the U.S. market—one manifestation of which would be any cross-listing premium.

In addition, our policy work related to removing the reconciliation requirement considered factors consistent with the Commission's statutory mission of facilitating capital formation, maintaining fair and orderly capital markets, and protecting investors. To those ends, accepting financial statements from foreign private issuers prepared in accordance with IFRS was one of the actions that could provide an opportunity to reduce the number of home country accounting standards used in SEC filings while, at the same time, fostering the use of a set of globally accepted accounting standards and realizing the attendant benefits this would bring.

Finally, it is important to recognize that the SEC is not bound by decisions of regulators in other countries because their national mandates cannot supersede our statutory responsibility to enforce the U.S. securities laws. Consultation with other regulators does, however, contribute to our ability to effectively enforce the application of IFRS. The SEC has consultation protocols in place with other regulators to exchange information and to learn from their thinking and experience on IFRS matters.

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**RESPONSE TO WRITTEN QUESTIONS OF SENATOR REED  
FROM CHARLES E. LANDES**

**Q.1.** Would elimination of the reconciliation requirement affect the cross-listing premium that non-U.S. companies listed on U.S. exchanges currently enjoy? What steps could help to maintain the cross-listing premium and thus retain the competitiveness of U.S. markets? Would reliance on non-U.S. companies' home country interpretation and enforcement of IFRS affect the cross-listing premium that non-U.S. companies listed on U.S. exchanges currently enjoy?

**A.1.** We have no views or opinions as to how, if at all, the elimination would affect the cross-listing premium.

**Q.2.** Do you believe that the current quality of the implementation, auditing, and enforcement of IFRS standards by companies using those standards in the US markets is equivalent to the current quality of the implementation, auditing, and enforcement of U.S. GAAP in the U.S. markets? Why or why not?

**A.2.** We believe that IFRS is of a high quality, as demonstrated by the fact that many major capital marketplaces throughout the world either follow or have committed to follow IFRS. As for the implementation, audit and enforcement of IFRS standards, we believe that the quality is equivalent for those foreign firms auditing foreign private issuers filing with the SEC since those foreign firms

auditing foreign private issuers are required to be registered with the PCAOB and subject to its inspection process.

**Q.3.** The SEC's proposal in its concept release allows U.S. companies to choose between IFRS and U.S. GAAP. What will the impact be of creating a two tiered system for investors and businesses?

**A.3.** We support the goal of a single set of high quality, comprehensive accounting standards to be used by public companies because (1) we believe one common accounting language would benefit investors, as well as issuers and the capital markets, and (2) it would facilitate the comparison of reporting entities domiciled in different countries.

Our support for an IFRS option for U.S. issuers is postulated on a manageable number of U.S. issuers choosing the option in the foreseeable future. Should a large number of companies desire to choose the option immediately, system-wide readiness may become an issue. Accordingly, we recommended that the SEC solicit information on the number of issuers that are likely to choose an IFRS option immediately to help the SEC form its views on timing of giving such an option. We believe that during an optional period U.S. businesses would choose to adopt IFRS if they believe doing so would reduce their cost of capital, considering both the internal costs of preparing financial statements and the reaction of the financial markets to IFRS.

Allowing such market forces to play a significant role in the decision-making process allows for implementation difficulties and costs to be borne initially by those companies that expect to benefit. Initial participation by a motivated voluntary filing population will permit the issues that arise and are resolved to benefit those that follow on later. Market forces already have provided the impetus for many constituents to develop familiarity and expertise with IFRS. Some U.S. companies have subsidiaries in locations where IFRS is required. And auditors have increasingly been asked to provide more services around IFRS reporting.

To be clear, our views, as expressed herein, relate to the use of IFRS by U.S. issuers (public companies) only. The AICPA believes that a separate, dedicated effort would be required to consider the appropriateness of the IFRS option for U.S. private companies and not-for-profit organizations, which also currently apply U.S. GAAP as promulgated by the FASB.

**Q.4.** Many accounting experts believe that the reconciliation requirement has resulted in the introduction of important quality control processes at the "Big Four" accounting firms in which foreign private issuer financial statements are typically subject to review by firm experts in U.S. GAAP and IFRS, respectively, before those statements are issued to the public. Some experts are concerned that those processes will be abandoned if the reconciliation requirement is eliminated. Given that many companies have only recently begun to apply IFRS, should we be concerned that the elimination of the reconciliation requirement may weaken the quality control processes at the "Big Four" accounting firms?

**A.4.** No. The policy and procedures referred to (commonly known as Appendix K procedures) were developed so that SEC filings of foreign private issuers including reports of non-U.S. firms would

have procedures performed by a person knowledgeable about U.S. GAAP, U.S. GAAS, and SEC independence matters. The filing reviewer would discuss with the engagement team the evaluation of significant differences between the requirements in the U.S. with respect to GAAP, GAAS, SEC reporting requirements, and auditor independence and the requirements applied in the home country. Please note that Appendix K predates current requirements that foreign firms auditing foreign private issuers be registered with the PCAOB and subject to its inspection process and other developments.

At the time this guidance was developed, non-U.S. auditors were allowed to report that the audit was conducted using non-U.S. auditing standards that were substantially similar to U.S. generally accepted auditing standards (U.S. GAAS). As the audits did not need to be conducted in accordance with U.S. GAAS, the guidance was developed so a person knowledgeable about U.S. GAAS would discuss with the engagement team the evaluation of whether the auditing procedures performed were substantially similar to U.S. GAAS.

Subsequent to the development of the Appendix K procedures, the Commission adopted International Disclosure Standards—Securities Act Release No. 7745. This guidance required that the audit be performed using U.S. GAAS—now the standards of the PCAOB—and that the report include a specific statement to that effect.

Likewise, there have been changes with respect to the procedures for gathering and reporting information on scope of services since the adoption of the Appendix K procedures. For example, as a result of amendments made in 2003 to the independence rules contained in Securities Act Release No. 8183, work performed by the auditor is required to be preapproved by the audit committee.