June 5, 2000
Jonathan G. Katz
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Dear Mr. Katz:

This letter is in response to the request for comment on the SEC Concept Release, "International Accounting Standards," File No. S7-04-00 (the Concept Release). We commend the SEC for its ongoing efforts to uphold the quality of financial reporting domestically while encouraging the development of a high-quality global financial reporting framework, and we appreciate the opportunity to respond to the Concept Release.

The views expressed in this letter and its appendix are those of the Financial Accounting Standards Board (FASB). The FASB has also expressed its views on some nontechnical issues in another comment letter jointly issued by the FASB and the Trustees of the Financial Accounting Foundation (FAF).[1] Although both letters reach similar conclusions about the conditions for acceptance of IASC standards in the United States, because this letter contains technical subject matter, the FAF was not asked to comment on any of the FASB's views in this letter or its appendix. The two letters should be viewed together as the FASB's response to the Concept Release.

The FASB is committed to the objective of increasing international comparability while maintaining the highest quality accounting standards in the United States. Our position on that topic is set forth in a report, *International Accounting Standard Setting: A Vision for the Future*, issued jointly by the FAF and the FASB (the FAF-FASB Vision report). There is a strong and growing demand for high-quality, internationally comparable financial information that capital providers find useful for decision making in global public capital markets. Ideally, that demand would be satisfied by use of a single set of high-quality accounting standards for both domestic and cross-border financial reporting. The FASB continues to work with the International Accounting Standards Committee (IASC) and with other standard setters in an effort to converge national and international standards while improving the quality of financial reporting worldwide. Our comments reflect our commitment to the objective and goals in the FAF-FASB Vision report.

Introduction

The Concept Release seeks input to determine under what conditions the SEC should accept in U.S. markets financial statements of foreign private issuers (foreign issuers) that are prepared based on standards promulgated by the IASC. We acknowledge that the IASC has significantly improved many of its standards as a result of the core standards project and that an increasing number of countries and international organizations have expressed support for use of the IASC core standards for cross-border

filings. The potential benefits that can be reaped from those improvements must be assessed with consideration given to (1) the potential differences between financial information reported by cross-border filers that would use IASC standards and other cross-border and domestic filers that would use or reconcile to U.S. generally accepted accounting principles (GAAP), (2) the desire to support the restructured IASC, and (3) the current lack of an adequately developed global financial reporting infrastructure.

Potential Differences between IASC-based and U.S. GAAP-based Filers

We believe it is appropriate for the SEC to consider the extent to which IASC standards might contribute to improving the quality of *cross-border* financial information reported (that is, the information reported in financial statements of foreign private issuers) in U.S. markets. However, we note that if the SEC concludes that foreign issuers may use IASC standards without reconciliation of their financial statements to U.S. generally accepted accounting principles (GAAP), that would inevitably lead to questions about whether domestic issuers should likewise be permitted to use IASC standards. We do not believe it is appropriate at the present time to consider whether there is a role for IASC standards for *domestic* financial reporting in the United States. The Concept Release does not contemplate use of IASC standards for domestic financial statements and the SEC's conclusions would apply only to cross-border filers. However, because there are differences between IASC standards and U.S. GAAP, acceptance of IASC-based financial statements without reconciliation would inevitably introduce noncomparability between those financial statements and financial statements prepared by domestic or foreign issuers based on U.S. GAAP or financial statements prepared by foreign issuers that are reconciled to U.S. GAAP. Investors should not bear the additional costs that would result from that noncomparability.

Desire to Support the Restructured IASC

We appreciate the salience of the SEC's consideration of the IASC core standards. The SEC's conclusions about the conditions for acceptance of those standards may affect, for example:

1. The extent to which those standards are used worldwide

2. The extent to which an appropriate infrastructure will develop to support their use

3. The nature of the restructured IASC's agenda priorities

4. The future agenda priorities of other standard setters that are working with the IASC to converge national and international standards to achieve the highest quality international solutions.[2]

There seems to be an unfortunate perception on the part of some that the future of the IASC as an organization is in some way contingent upon the SEC's conclusions about the acceptability of the core standards in their current form for use without reconciliation by foreign issuers listing in the United

States. Regardless of the SEC's conclusions, we believe that more widespread use of IASC standards outside U.S. markets is desirable and that the IASC, once restructured, will play an increasingly important role in the evolving global financial reporting infrastructure. As we have publicly stated on many occasions, we support the restructuring of the IASC and believe it will help in leading efforts to converge national and international accounting standards. Further, there will continue to be a prominent role for the IASC outside of the United States as emerging market countries look to IASC standards as a basis for developing their own standards and as member states of the European Union increasingly consider IASC standards for use in European capital markets. The success of the restructured IASC will be vital to the continued development of a single set of high-quality international accounting standards and to the successful evolution of a high-quality global financial reporting infrastructure.

Lack of a Global Financial Reporting Infrastructure

In the FAF-FASB Vision report, we identified a number of elements that would be necessary to support an international accounting system in the future. Those elements are similar to many of the elements identified in the Concept Release as necessary to a global financial reporting infrastructure. We continue to believe that, in order for a set of high-quality international accounting standards to be used successfully worldwide and the maximum benefits of their use to be comprehensively realized, those standards must be supported by an adequate global financial reporting infrastructure. Ideally, acceptance of international standards would result from a process-oriented approach (like the SEC's approach to acceptance of FASB standards) with all of the elements of a global financial reporting infrastructure, as identified both in the Concept Release and in the FAF-FASB Vision report, in place.

We observe that many of the various elements of a global financial reporting infrastructure are still in the early stages of development or do not yet exist. As a result, a conclusion must be reached about the acceptability of IASC-based financial statements for U.S. markets in terms of the current U.S. financial reporting infrastructure. For example, the SEC will necessarily have to evaluate whether methods and means are available in various nations to ensure the appropriate application and enforcement of IASC standards because there is no international counterpart. Without a global enforcement mechanism and without the adequate development of other elements of a high-quality global financial reporting infrastructure, there is no ideal conclusion about the use of IASC standards by foreign issuers in U.S. markets.

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Although the future of the IASC is bright, conclusions about the acceptability of the IASC's core standards for use in U.S. markets must be reached in the present, amid a number of competing national and international perspectives and in an environment in which the elements of a global financial reporting framework are in various stages of development. The SEC's decision, while it may weigh heavily outside of the United States, must ultimately be in the best interests of U.S. investors participating in U.S. markets-consistent with the SEC's mandate of U.S. investor protection. Such a decision should be one that benefits U.S. investors by increasing their ability to compare investment

opportunities and to make informed investment decisions.

In lieu of an ideal solution, we believe that an optimal conclusion about the use of the IASC's core standards by foreign issuers in U.S. markets would be one that does not increase the costs to financial statement users of comparing investment alternatives to make effective investment decisions but that (1) maintains the comparability and quality of financial information provided by foreign issuers to U.S. investors, (2) intensifies pressure on national standard setters (including the FASB) and on the IASC to converge their standards to achieve the highest quality international solutions, and (3) helps to identify and prioritize those areas of accounting that should be the focus of convergence efforts. Further, an optimal solution should maintain reliance for the development of international accounting standards (and their interpretations and amendments) on an independent, private sector standard-setting structure and process.

Summary of FASB's Conclusions

We support the IASC's efforts and are, ourselves, committed to supporting the development of a single set of high-quality accounting standards to be used worldwide. However, it is difficult to conclude that elimination at this time of some or all of the current requirements for foreign issuers using IASC standards to reconcile to U.S. GAAP would provide a net benefit to U.S. investors. In particular, the results of that conclusion would conflict in some respects with the FASB's overall objective of increasing international comparability while maintaining the highest quality accounting standards in the United States. For example, if the SEC concluded that an individual IASC standard was of a quality equal or superior to its U.S. GAAP counterpart but that standard differed from its U.S. GAAP counterpart, eliminating the requirement for a foreign issuer using that standard to reconcile to U.S. GAAP would decrease the comparability of financial information provided to U.S. investors.

We also note that it would not be possible to completely eliminate all reconciliation requirements for foreign issuers that use IASC standards. Even if the entire set of core standards was accepted without reconciliation, some reconciliation to U.S. GAAP still would be necessary in those cases in which an IASC standard did not address a particular type of transaction, for example, a specialized industry transaction.

The Concept Release poses four alternatives to the level of acceptance of IASC standards, three of which would require elimination of some or all of the current requirements for foreign issuers using IASC standards to reconcile their financial statements to U.S. GAAP. As noted above, unless elimination of reconciliation requirements maintains or improves both the comparability and the quality of financial reports used in the United States, each those three alternatives poses difficulties. In principle, we are concerned about eliminating some or all of the current reconciliation requirements for the following reasons:

1. *Convergence.* As stated in the FAF-FASB Vision report, we are committed to (1) ensuring that international accounting standards are of the highest quality and (2) accelerating convergence of national

and international standards to achieve the highest quality international solutions. The IASC shares a similar commitment. Current reconciliation requirements provide a focal point for the efforts of the IASC and the FASB and a mechanism for measuring progress toward meeting the goals of high quality and convergence. Removing the requirement that foreign issuers using IASC standards provide a reconciliation to U.S. GAAP could impede those efforts in the following ways:

- *Absence of a reconciliation requirement can eliminate an important source for identifying and prioritizing areas on which to focus convergence efforts*. Both the IASC and the FASB support the objective of developing a single set of high-quality global accounting standards. In the United States, reconciling items tend to arise from differences between the results that are reported based on the standards used by foreign issuers to prepare their financial statements and the results that would have been reported if the financial statements had been prepared based on U.S. GAAP. A requirement to reconcile helps to identify the primary areas of noncomparability on which national and international standard setters need to focus their convergence efforts in order to achieve the highest quality international solutions.

- *Absence of a reconciliation requirement can reduce incentives for the FASB and the IASC to converge their standards.* One of the greatest perceived benefits of using a single set of accounting standards worldwide is the concurrent increase in the quality and the comparability of financial reporting. When two sets of standards are not comparable and there is no requirement to reconcile, the motivation to converge those standards to achieve a single high-quality international solution is likely to be reduced. Further, without a reconciliation requirement, important information about the quality of one solution relative to another may be lost or obscured. Reconciliation provides a benchmark not only for identifying areas on which to focus convergence efforts, but also for identifying areas in which there are variances in the application or interpretation of standards, that is, areas in which the quality of standards potentially could be improved. In conjunction with the intensifying demand for a single set of high-quality global accounting standards, the reconciliation requirement provides a strong incentive for both the IASC and the FASB continually to evaluate the quality of their respective standards in their efforts to eliminate differences.

- *Absence of a reconciliation requirement can make it more difficult to measure the progress of convergence efforts.* A reconciliation requirement is a source that can be used in monitoring and evaluating the success of convergence efforts. To the extent that convergence efforts are successful, there will be a natural decline in the amount and type of reconciling items that prevail when IASC standards are reconciled to U.S. GAAP. If convergence efforts are not successful, reconciling items may continue or new reconciling items may emerge.

2. *Comparability*. Regardless of the relative quality of the two sets of standards, there are differences between IASC standards and U.S. GAAP and there are variations in the way IASC standards are applied around the world. Current reconciliation requirements are intended to help create comparability among foreign issuers using different accounting standards and comparability between foreign issuers that do not use U.S. GAAP as a basis for their financial reports and domestic issuers that use U.S. GAAP. We

believe that a continued reconciliation requirement will assist in creating comparability and will reduce costs that would arise if reconciliation were abandoned because:

- *Absence of a reconciliation requirement can increase costs to U.S. investors even if IASC standards and U.S. GAAP are judged to be of equivalent quality.* International comparability is cited by many as a primary benefit to be gained by using a set of international accounting standards. Ideally, the unreconciled financial statements of a foreign issuer prepared based on IASC standards would be of equivalent quality with those of other foreign issuers using IASC standards and with the financial statements of foreign and domestic issuers reconciling to or using U.S. GAAP. However, even if the two sets of accounting standards were of equal quality, there would be differences between them that would create costs in comparing those financial statements.

- *Absence of a reconciliation requirement shifts the costs of producing comparable financial information from the preparers of that information to the users of that information and creates uncertainty.* Without reconciliation, the burden of producing comparable information will fall on a group of users (that is, U.S. investors, creditors, and others) that will have to expend resources in order to make the data comparable. Additionally, differences between reported financial results for essentially similar transactions and events creates uncertainty about the relevance, reliability, and representational faithfulness of those results. Reconciliation to U.S. GAAP helps to create comparability between foreign and domestic issuers, which minimizes the costs to investors of comparing investment alternatives and making informed investment decisions and reduces uncertainty.

  3. *The SEC's enforcement role.* The early stage of development of a high-quality global financial reporting infrastructure (in particular the lack of a global enforcement mechanism for IASC standards) places a great deal of pressure on the SEC's enforcement role of ensuring comparability and transparency of financial information reported in the United States by foreign issuers using IASC standards. The pressure on the SEC to relax its enforcement role would increase if instead of requiring reconciliation, the SEC allowed variations in the way IASC standards are presently interpreted and applied outside the United States to influence its enforcement decisions. In contrast, failure to accede to these variations may ultimately place the SEC in the awkward position of establishing a "U.S.-only" version of IASC standards.

Each of those concerns arises in the context of a conclusion to modify the current reconciliation requirements for foreign issuers that use IASC standards-whether that conclusion extends to one or more standards (or aspects thereof) assessed on an individual basis or to the entire set of core standards assessed as a whole. Those concerns are explained in more detail in the joint FAF-FASB letter. Ultimately, each of those concerns can lead to increased costs to financial statement users-U.S. investors-attempting to compare investment opportunities available in U.S. markets.

At the present time, we believe that there is only one conclusion that we can support as an optimal

solution to the issues raised in the Concept Release-the SEC should continue to require that foreign issuers that use IASC standards also provide full reconciliation to U.S. GAAP. The following sections of this letter describe some of the factors that led us to conclude that reconciliation to U.S. GAAP continues to be necessary for IASC-based financial reporting. Additional support for our conclusions can be found in our responses to the specific questions in the Concept Release, which are included as an appendix to this letter.

Our views are based on the issues we identified as being of primary importance in our role as an accounting standard setter committed to improving the quality and comparability of financial reporting in the United States through an independent and open due process. We recognize that other commentators on the Concept Release are likely to consider different issues and have different objectives for arriving at their own conclusions. We appreciate that the SEC will consider and weigh the various views and may find compelling reasons to modify the current reconciliation requirements despite our conclusions. We have, therefore, provided in a later section of this letter some thoughts on significant considerations that might be useful in contemplating a conclusion to modify the requirement for foreign issuers using IASC standards to reconcile to U.S. GAAP.

Why Reconciliation Continues to be Necessary

We conclude that the optimal solution to the issues raised in the Concept Release would be for the SEC to continue to require that foreign issuers that use IASC standards also provide full reconciliation to U.S. GAAP. We support that conclusion for the following reasons:

1. It is consistent with our objective of increasing international comparability while maintaining the highest quality standards in the United States.

2. It facilitates the convergence of national and international accounting standards to achieve the highest quality international solutions.

3. It helps to maintain the independence of international accounting standard setting.

We considered a number of factors in arriving at our conclusions, including (1) existing evidence about the quality and comparability of reported financial information prepared using the core standards, (2) the potential costs to users of eliminating reconciliation to U.S. GAAP when IASC standards are used, (3) the potential demands for the SEC to accommodate non-IASC standards without reconciliation, and (4) questions about the future interaction of the SEC, the IASC, and others. Each of those factors is described in more detail below.

Quality and Comparability of Reported Financial Information Prepared Using the Core Standards

The success of capital markets in the United States is in part due to a long tradition of requiring those that seek capital to provide relevant, reliable, and transparent information so that investors can compare

alternative opportunities and make informed economic decisions about the allocation of capital. A major component of the information package that investors rely on is financial reporting. In the United States, the objective of financial reporting is to provide decision-useful information to assist investors in making rational investment decisions. We believe that the IASC's objective for financial statements, "to provide information . . . that is useful to a wide range of users in making economic decisions," as stated in paragraph 12 of its "Framework for the Preparation and Presentation of Financial Statements," and reiterated in the IASC's proposed new constitution, is consistent with the objective of financial reporting in U.S. markets.

Consequently, we believe that IASC standards, when appropriately interpreted and applied, can produce financial information that is more relevant, comprehensive, transparent, and of higher quality than financial information prepared based on the national standards of countries that do not share that objective. However, we are not convinced that is the case when financial information prepared under IASC standards is compared with financial information prepared in accordance with U.S. GAAP. We were unable to arrive at a positive conclusion about the quality of the IASC's core standards for a number of reasons. Among the most compelling are the following:

- IASC standards lack widespread use as a comprehensive basis for the preparation of financial reports. While we do not know the exact number of companies that use IASC standards as the primary basis for financial reporting, the IASC's website identifies fewer than 1,000 IASC-based companies that list on stock exchanges worldwide. Further, many of the core standards have only become effective in the last couple of years or are not yet effective. There is insufficient evidence or experience to conclude that IASC standards constitute a comprehensive, generally accepted basis of accounting; are of high quality; and can be rigorously interpreted and applied.

- Available evidence indicates that there are a number of issues that must be resolved before such a positive conclusion about the quality of the core standards could be reached. The (1) presence of differences between IASC standards and home country standards (2) differences in national accounting infrastructures, (3) ambiguities within IASC standards, and (4) newness of, and lack of experience using, IASC standards all are factors that have led to differences in how IASC standards are applied and enforced.

- Even if all of the IASC core standards were judged to be of sufficiently high quality for use by foreign issuers without reconciliation to U.S. GAAP, there would not be comparable application of IASC standards because the other elements of a high-quality global financial reporting infrastructure identified by the SEC in the Concept Release are not presently sufficient to support the rigorous interpretation and application of IASC standards. The potential for lack of comparability among foreign issuers that use IASC standards is increased by the existence of implicit and explicit alternatives, the ambiguousness of the guidance, and the lack of sufficient implementation guidance in many IASC standards.

- Even if the IASC core standards were rigorously interpreted and applied so that financial

> reporting among foreign issuers was comparable, there are significant differences between IASC standards and U.S. GAAP. Thus, permitting use of IASC standards without reconciliation would decrease the comparability of financial information reported by foreign issuers that used IASC standards without reconciliation and financial information reported by other foreign and domestic issuers using or reconciling to U.S. GAAP.

Based on that evidence, the IASC's core standards do not meet the criteria set forth in the Concept Release to be considered of sufficiently high quality for use without reconciliation in U.S. markets. Moreover, a lack of comparability-whether it relates to comparing the financial statements of two IASC-based foreign issuers or to comparing IASC-based financial statements to U.S. GAAP-based financial statements-can create uncertainty and confusion about the relative quality and representational faithfulness of items reported in financial statements based on those standards. Without reconciliation to a common benchmark, noncomparability also increases the costs and uncertainties related to making informed investment decisions.

Potential Costs to Users of Eliminating Reconciliation to U.S. GAAP

Current SEC requirements permit use of IASC standards by foreign issuers as an alternative to using their home country standards in preparing their primary financial statements, provided that an audited reconciliation[3] to U.S. GAAP also is prepared.[4] We believe that, because it helps to create comparability between foreign and domestic issuers, reconciliation to U.S. GAAP minimizes the costs to investors of comparing investment alternatives and making informed investment decisions.

We realize it is perceived that there are a number of benefits that would potentially result from modifications to the current requirements for foreign issuers to provide a reconciliation to U.S. GAAP when IASC standards are used. Those may include lower costs to financial statement preparers and a reduction in the variety of financial reporting bases used in U.S. markets to the extent that IASC standards are used in place of home country standards. Presumably, a decision to remove some or all reconciliation requirements would be based on an expectation that the information provided would be of equivalent or higher quality than that which is received under current reconciliation requirements. Changes to current requirements that result in higher quality financial reporting would facilitate the flow of better quality information to U.S. investors.

On the other hand, we believe it is important to acknowledge that the absence of a requirement for reconciliation of IASC-based financial statements to U.S. GAAP requirements could actually increase the costs to investors to the extent that noncomparability of reported financial information in U.S. markets is increased. The present reconciliation requirements provide U.S. investors with a basis for making comparisons among entities regardless of the accounting standards used in preparing the primary financial statements. Without such a reconciliation, new costs to users can arise because, in the absence of a single set of high-quality accounting standards that is used for *both* domestic (U.S.) and cross-border financial reporting, acceptance of IASC standards for cross-border reporting but not domestic reporting increases the noncomparability of the financial reporting basis of domestic filers and that of

cross-border filers.

The SEC will have to judge whether those new costs outweigh the benefits of allowing foreign issuers to use IASC standards without reconciliation. However, we believe that, in the absence of comparability between foreign issuers using IASC standards and those issuers using or reconciling to U.S. GAAP, even sophisticated U.S. investors may have difficulty identifying and understanding variations in measurement, recognition, and disclosure approaches.

Potential Demands for the SEC to Accommodate Non-IASC Standards without Reconciliation

A number of countries assert that their national standards are the same as, or comply in all material respects with, IASC standards. At present, based on information from the IASC's website, there are over 30 countries that have policies to adopt some or all IASC standards or to ensure that their standards comply with IASC standards. In addition, a number of other countries, such as Australia, Haiti, and Sweden, undertake to issue standards that are the same as IASC standards to the extent permitted by their national laws. If the SEC permits use of some or all IASC standards without reconciliation, it is likely to receive requests from foreign issuers of many of those countries to likewise be afforded elimination of the reconciliation requirements if they are using home country standards that purport to comply with similar IASC standards. If accommodations are made for those foreign issuers, tension might be created with foreign issuers from other countries (whose standards are not based on, or compliant with, IASC standards) that would still be required to reconcile their financial reports to U.S. GAAP. Those countries may have a longer-standing and more-rigorous national accounting infrastructure than exists for IASC and IASC-based home country standards-and may believe their standards are superior to IASC standards. That issue is further complicated by the fact that IAS 1, *Presentation of Financial Statements,* permits an entity to look to other accounting frameworks in the absence of an IASC standard or interpretation of the IASC's Standing Interpretations Committee (SIC). Countries that adopt IAS 1 as a home country standard can essentially look to another country's accounting principles in the absence of a home country standard of their own and still be considered to comply with IASC-based standards.

We note that at the time the SEC accepted aspects of IAS 22, *Business Combinations,* without reconciliation, foreign issuers from the United Kingdom (UK) and from Canada requested that the SEC recognize their similar home country standards on that topic. In those cases, the onus was on the SEC to investigate and reach a conclusion as to whether the national standards in question were, in fact, consistent with IAS 22. Further, when the SEC concluded that a UK foreign issuer would not be required to reconcile UK accounting for certain aspects of amortization of goodwill that were deemed consistent with requirements in IAS 22, the SEC staff was required to provide further guidance to indicate the conditions that must be met before that accounting would be considered acceptable. Such requests inevitably use up valuable time and resources and, thus, create costs that offset the benefits expected to be obtained by modifying the reconciliation requirements to accept some or all IASC standards without reconciliation.

We believe it is inevitable that the acceptance of some or all IASC standards without reconciliation will lead to demands on the SEC to consider particular national standards for acceptance on an ad hoc basis. Thus, the SEC might be better served to address the implications of modifications to reconciliation requirements in a larger context, not just in terms of using IASC standards. In that vein, if the usefulness of reconciliations is in question, that may indicate that, rather than eliminate reconciliation requirements, the quality of reconciliations should be improved.

Future Interaction between the SEC, the IASC, and Others

Inconsistencies already have been observed in the application of IASC standards. In *The FT International Accounting Standards Survey 1999*, a survey that assesses the use of IASC standards by companies, national standard setters, regulators, and stock exchanges, David Cairns observes that "there is considerable variety in the approaches adopted by survey companies to compliance with IASs and the levels of compliance." He further notes that "even among the companies which claim full compliance, there are material omissions or other non-compliance."[5] If the SEC accepts financial statements prepared using IASC standards without reconciliation, the SEC will have to specify the level of compliance with IASC standards that is necessary to be acceptable for U.S. markets. To do so will require interpretations of IASC standards. Because IASC standards are not consistently applied, it is likely that those interpretations will differ from what may be acceptable outside the United States. That raises the possibility that a company that has been preparing IASC-based financial statements for filing purposes for non-U.S. exchanges may be required to file IASC-based financial statements with a different application of IASC guidance for purposes of filing in the U.S. markets.

Given those observations and the absence of a global regulatory body to coordinate efforts to ensure that IASC standards are consistently interpreted and applied, it seems that an increasing emphasis on the SEC's interpretive role through enforcement would be necessary to compensate for effects of deficiencies in the present global financial reporting infrastructure. Further, it seems inevitable that the SEC's enforcement of IASC standards on a case-by-case basis, even in the limited context of their use in U.S. markets, could lead to jurisdictional questions such as the following:

- How would disputes among national regulators or stock exchanges be settled when there are differences in the interpretation and enforcement of IASC standards used in different nations?

- Would interpretations by the SEC regarding the appropriate use of IASC standards for purposes of U.S. markets potentially limit the independence of the IASC Board and of the SIC to subsequently address the underlying issue and arrive at different conclusions?

- If the SEC decides to accept IASC standards without reconciliation and enforce those standards by providing interpretations, would it then also be bound to accept the future amendments or interpretations of those standards by the IASC Board or by the SIC when those amendments or interpretations differ from SEC interpretations?

It is not clear how the issues related to national policy and process for accounting standard setting, interpretation, and enforcement can be reconciled in the current stage of development of a global financial reporting framework. No body of accounting standards is immutable, and, ideally, the organization responsible for those standards-the IASC-also should ultimately be responsible for their interpretation and amendment. However, ASR No. 150, *Statement of Policy on the Establishment and Improvements of Accounting Principles and Standards,* does not currently recognize the IASC as a source for establishing accounting principles for use in the United States. Yet, if the SEC accepts IASC standards without reconciliation-especially standards that have not yet been implemented because they are new-that would implicitly endorse the past IASC standard-setting process and structure. If the SEC does not endorse the restructured IASC process for future interpretations, absent both a global regulation and interpretation function, a potential danger of the SEC accepting IASC standards without reconciliation is that there will be two (or more) versions of IASC standards-those that are acceptable to the SEC and those that are acceptable in non-U.S. markets.

We believe that the IASC, through its SIC and the successful completion of its plan for restructuring, will strengthen its ability to reduce the possibility of various interpretations of IASC standards in the future. Nonetheless, we believe that to the extent that the SEC rigorously interprets and enforces IASC standards in the meantime and other countries do not, the SEC may find itself de facto in the role of a global regulator. Thus, although the SEC's acceptance of IASC standards need not be conditioned upon the success of the IASC's restructuring, we believe it is important to contemplate how the SEC, the new IASC Board, and the SIC would interact when issues of application and enforcement of IASC standards arise.

Assessing Alternatives for Modifications to the Current Reconciliation Requirements for IASC-based Financial Reports

The foregoing discussion has focused on our conclusion, and the reasons for our conclusion, that the SEC should continue to require foreign issuers that use IASC standards to reconcile their financial statements to U.S. GAAP. We do not support any of the alternatives presented in the Concept Release that would result in modifications to the current reconciliation requirements for foreign issuers. However, the SEC will undoubtedly receive different viewpoints and may find compelling reasons to explore whether one or more IASC standards would be acceptable without reconciliation. Therefore, we provide in this section some thoughts on the possibility of modifications to the reconciliation requirements.

As indicated in the Concept Release, the SEC will be assessing the quality of the IASC's core standards both on a standard-by-standard basis and as a set. The maximum benefits of using a set of international accounting standards are possible only if those standards, as a set, are sufficiently comprehensive, are judged to be of high quality, and are rigorously interpreted and applied. If the quality of one or more of the core standards is found unacceptable on an individual basis, that would seem to preclude a decision to accept the whole set of core standards without reconciliation. Thus, the SEC likely will explore whether any individual IASC standards would be acceptable without reconciliation for cross-border financial reporting. Under such a standard-by-standard approach, reconciliation to U.S. GAAP would be

required for some IASC standards (or aspects of some IASC standards), but not for others. Some believe that there are incremental benefits that would be obtained from modifying the current reconciliation requirements for individual IASC standards that are of sufficient quality, including:

- Reducing costs to foreign issuers with multiple listings based on IASC standards
- Facilitating the use of IASC standards instead of home country standards when using IASC standards to increase the overall quality and comparability of financial information reported by foreign issuers
- Increasing the prominence of IASC standards worldwide, which, in turn, would assist in developing more widespread expertise in the interpretation, application, and enforcement of those standards.

With those perceived benefits also come costs associated with the loss of information provided by a reconciliation requirement, such as those identified earlier in this letter. Ideally, only those IASC standards that maintain or increase the quality and comparability of reported financial information relative to what U.S. investors currently receive would be judged to be acceptable for use without reconciliation in preparing financial reports for U.S. markets. The assessment of an individual IASC standard should be based not only on recognition and measurement requirements, but also on disclosures, and it should look not only to the "black letter" standards, but also to the "gray letter" background and implementation guidance contained within the standard.

For a number of the IASC standards, it would be difficult to assess whether the standard would consistently result in comparable, high-quality, transparent financial reporting. For example, an IASC standard with any of the following characteristics creates special problems for determining whether that standard is of sufficient quality or comprehensiveness or will result in comparable financial reporting:

- An IASC standard that has not yet gone into effect or has only been in effect for a short time
- An IASC standard that explicitly permits alternative treatments
- An IASC standard that contains ambiguities that introduce implicit accounting alternatives
- An IASC standard that requires accounting that is specifically prohibited under U.S. GAAP (or under SEC rules).

Each of those characteristics can contribute to a decrease in either the quality or the comparability of financial information reported using IASC standards relative to that reported using U.S. GAAP or a reconciliation to U.S. GAAP. For an IASC standard that has not yet gone into effect or has only been in effect for a short time, it may not be possible to determine whether the standard is of sufficient quality or comprehensiveness until more experience is gained through the use of the standard over time. Further, as

a general rule, accounting standards should minimize the possibility of alternative treatments in order to ensure comparability. For an IASC standard that contains explicit alternatives, the SEC would have to determine the extent to which more than one alternative is acceptable and, if not, explicitly select the alternative that would be acceptable for U.S. markets. Such an approach decreases the overall global benefits of using IASC standards because non-U.S. markets that permit use of IASC standards may accept all explicit alternatives. An IASC standard that implicitly provides accounting alternatives poses even more difficulty because the alternatives may not be apparent until various interpretations and applications are evident. In those cases, the SEC may have to provide detailed interpretations to ensure comparability. Finally, an IASC standard that requires a treatment that is currently prohibited under U.S. GAAP, by definition, will not result in financial reporting that is comparable to that which results under U.S. GAAP.

In exploring the possibility of accepting IASC standards on a standard-by-standard basis, we believe that the SEC should consider requiring reconciliation in each of those circumstances identified above, as well as for topics covered by U.S. GAAP that are not covered by IASC standards (including guidance for specialized industries) to the extent that they are relevant to a particular entity.

On the other hand, in some cases-notwithstanding the lack of comparability that would result from the use of standards that differed from U.S. GAAP-an individual IASC standard might be considered to maintain or increase the quality and comparability of reported financial information when foreign issuers use IASC standards. In theory, certain individual standards could be judged to be of sufficiently high quality to be used without reconciliation to their FASB counterparts if either:

- The particular IASC standard has been proven through use to be sufficiently comprehensive and of sufficient quality to provide comparable, relevant, reliable, and transparent financial information (for example, because it already is accepted by the SEC without reconciliation) or

- For a new IASC standard (that is, one that has only recently gone into effect or has not yet gone into effect), there is other evidence that supports a presumption that it would be sufficiently comprehensive and of sufficient quality for use in a U.S. financial reporting environment (for example, because the standard is substantially the same as an FASB standard that is being used for financial reporting in U.S. markets).

The SEC also might consider acceptance of an IASC standard without reconciliation when there is no U. S. GAAP counterpart. We would like to clarify that should the SEC find some individual IASC standards acceptable without reconciliation, in circumstances in which SEC requirements supplement a particular FASB standard or other GAAP, the SEC should strive to maintain the amount and quality of information provided by the existing combination of accounting standards and SEC regulatory requirements.

We propose the above as a guideline for identifying potential IASC standards that might be candidates for consideration for use without reconciliation to their U.S. GAAP counterparts but believe that the

implications of modifications to reconciliation requirements should be carefully assessed. We are aware of the SEC's experiences with the acceptance of aspects of IAS 22, related to the methods of accounting for a business combination. At the time that the reconciliation requirement was removed, it had been judged that the criteria articulated in IAS 22 with regard to the circumstances in which the uniting-of-interests method could be used were sufficiently clear and rigorous to ensure their consistent application. However, as experience was gained with the use of IAS 22, it became obvious that many and varied "acceptable" interpretations of that standard resulted in a lack of comparability in the accounting for similar transactions worldwide. As a result, removing the requirement for foreign issuers using IAS 22 to reconcile to U.S. GAAP decreased the comparability of financial reporting related to business combinations in the United States. Such circumstances undermine the perceived benefits of eliminating reconciliation requirements, make demands on the SEC's scarce resources, and create political tensions to the extent that the SEC is perceived to be overstepping its jurisdiction.

Experiences like the one surrounding IAS 22 highlight the difficulty of predicting whether today's expectations about the quality of financial information reported using IASC standards will be met in reality.

Closing Remarks

We reiterate our support for the IASC's past and future efforts to improve the quality of international accounting standards. Those standards are only one element of a global financial reporting infrastructure. Other elements of the global financial reporting infrastructure are not yet sufficiently developed to be relied upon for the rigorous interpretation and application of the IASC's core standards. Thus, the SEC would necessarily have to rely on the methods and means available within its own jurisdiction with regard to application and enforcement of the core standards. In that situation, the optimal conclusion about the acceptability of IASC standards would be the one that provides a net benefit to U.S. investors by maximizing the quality and the comparability of financial information reported by foreign and domestic issuers in U.S. markets. A requirement to reconcile IASC-based financial statements to U.S. GAAP provides that benefit while simultaneously helping to mitigate some of the risk and uncertainty associated with IASC standards. For example, requiring reconciliation would be beneficial because it would:

- Provide U.S. investors with a basis for making comparisons of the financial statements of foreign issuers using IASC standards with those of other foreign issuers (whether using IASC standards or other national standards) and with those of domestic issuers using U.S. GAAP without increasing the costs to users of obtaining that information.

- Highlight areas of financial reporting that would benefit from future standard setters' efforts to converge their standards toward the highest quality solutions and provide a source for measuring progress.

- Help to identify areas or topics in IASC standards that need improvement without the risk

associated with adopting an as-yet-untested accounting regime.

- Provide the opportunity to test and strengthen or, if necessary, create mechanisms for the appropriate application, interpretation, and enforcement of IASC standards.

Irrespective of the SEC's conclusion about the extent to which reconciliation should continue to be required for IASC standards, we are concerned about the implications of the increased pressure on the SEC to interpret IASC standards on a case-by-case basis if they were accepted without reconciliation for use in U.S. markets. That approach ultimately could interfere with the development of a sound, independent international accounting standard-setting body of the type identified in the Concept Release. That issue is discussed in more detail in the joint comment letter from the FAF and the FASB.

Our conclusions are based on our observations of the current status of the various elements identified by the SEC as necessary to a high-quality global financial reporting framework and the need for the SEC to continue to effectively carry out its mandate of investor protection. We believe that continued full reconciliation requirements are necessary to facilitate and accelerate the convergence efforts of national standard setters (like the FASB) and the IASC toward high-quality international solutions. Successful convergence efforts will decrease the differences between national and IASC standards.

To the extent that convergence efforts are successful, there is no need for the SEC to selectively accept IASC standards because there will be a natural decline in the amount and type of reconciling items that prevail when IASC standards are reconciled to U.S. GAAP. We believe that some of the issues identified in this letter likely will be resolved over time as more experience is gained with IASC standards and as standard setters around the world work together to achieve greater convergence.

We hope that our comments are helpful. We would be pleased to discuss any aspects of our comments at your convenience.

Sincerely,

Edmund Jenkins

Appendix-FASB's Responses To Questions Posed In The Concept Release

The cover letter to this appendix provides a summary of the FASB's conclusions about the conditions for acceptability in U.S. markets of foreign issuers' financial reports prepared based on standards promulgated by the International Accounting Standards Committee (IASC). This appendix provides the FASB's responses to the individual questions raised in the Concept Release. The views expressed herein are solely those of the FASB. The FAF was not asked to comment on any of the FASB's views that are the subject of this appendix. When used in this appendix, the terms "we," "us," and "our" refer only to the FASB.

Our comments on the Concept Release are naturally and necessarily restricted mostly to those questions that address the IASC's core standards themselves and to those related to the international standard-setting structure. We have not responded to some other questions because we are not in a position to provide information, for example, about first-hand experience in the application of IASC standards or about the quality control mechanisms for financial reporting in other countries. On the other hand, we are confident that the first-hand experiences that many of our Board and staff members have had (1) participating in the IASC's standard-setting process, (2) comparing and analyzing similarities and differences between IASC standards and U.S. generally accepted accounting principles (GAAP) as part of the FASB's IASC-U.S. comparison project, (3) cooperating with standard-setting organizations of other nations, and (4) setting high-quality accounting standards in the United States allow us to offer an important and unique perspective on the issues we have chosen to respond to.

Questions and Responses

Q.1 Do the core standards provide a sufficiently comprehensive accounting framework to provide a basis to address the fundamental accounting issues that are encountered in a broad range of industries and a variety of transactions without the need to look to other accounting regimes? Why or why not?

We are aware that the core standards are intended to cover a population of topics that were identified by the International Organization of Securities Commissions (IOSCO) as the *minimum* number of topics that must be covered to be sufficiently comprehensive to be considered for endorsement by IOSCO members. In that context, one might conclude that to the extent that all areas identified by IOSCO are covered, the core standards are sufficiently comprehensive.

On the other hand, the FASB report, *The IASC-U.S. Comparison Project: A Report on the Similarities and Differences Between IASC Standards and U.S. GAAP*, (the Comparison report) identifies a number of areas that either are not covered by the core standards or for which the core standards provide little or no implementation guidance. For example, there is guidance in the United States for a number of specialized industries (insurance, financial institutions, utilities, and so forth) for which there is no comparable guidance in the core standards. There also is guidance in the United States for specialized transactions that are not confined to a particular industry (such as equity-based employee compensation) that are not dealt with under IASC standards. Sometimes a core standard will cover the same topic as its U.S. GAAP counterpart but at a more-general level. For example, IAS 39, *Financial Instruments: Recognition and Measurement*, in a single document ostensibly covers most of the topics that are addressed in well over 10 FASB Statements and in a wide range of interpretive guidance. We understand that the core standards were never intended to be as comprehensive as some national accounting regimes. However, while some may argue that U.S. GAAP is overly detailed, in the absence of equivalent guidance under IASC standards it is not clear that IASC standards are sufficiently comprehensive to address fundamental issues in a broad range of industries and for a variety of transactions.

Assessing the sufficiency of the accounting issues covered by the core standards is further complicated by the fact that the newest core standards have not been applied on a widespread basis or for an extended period of time-one can only speculate as to whether implementation questions might arise and how those questions might be resolved. In the absence of guidance in an IASC standard or an interpretation of the IASC's Standing Interpretations Committee (SIC), IAS 1, *Presentation of Financial Statements*, permits an entity to look to other accounting frameworks for guidance (such guidance is not limited to U.S. GAAP). Thus, IAS 1 seems to provide guidance for filling the gap when IASC standards do not cover a particular topic. IAS 1 does not, however, provide specific guidelines for selection of an appropriate alternative source of guidance, other than to indicate that the resulting accounting treatment must be consistent with the IASC "Framework for the Preparation and Presentation of Financial Statements" (Framework). There may be any number of alternatives that are deemed to be consistent with the IASC Framework (indeed any conceptual framework). For example, both expensing and capitalizing items are recognition methods that are consistent with the IASC's conceptual framework, as are both historical cost and fair value measurements. A liberal interpretation of the guidance in IAS 1 can negatively affect the comparability that might otherwise be achieved among different entities applying IASC standards "comprehensively," that is, entities applying the guidance in IAS 1 for selection of accounting policies. The extent to which entities using IASC standards (especially the new standards) will rely on the guidance in IAS 1 for selection of accounting policies in the absence of specified guidance is unknown.

We view the core standards as minimum standards created for general use in non-specialized financial reporting of non-specialized transactions. It may be possible, on a standard-by-standard basis, to conclude that some standards are sufficiently comprehensive in terms of providing sufficient guidance to consistently arrive at comparable and transparent financial information. Nevertheless, there are other standards in which the guidance provided is not sufficiently comprehensive because it is too general or ambiguous, does not cover a particular topic, or lacks sufficient implementation guidance. (More detail is provided in our response to Question 4.) In those cases, we believe that an entity would be required to apply the guidance in IAS 1, which essentially requires the use of non-IASC standards. Our opinion, based on the present body of IASC standards and SIC interpretations, is that the set of core standards will not prove to be sufficiently comprehensive for many enterprises to prepare financial statements without looking to other accounting regimes for additional guidance.

Q.2 Should we require use of U.S. GAAP for specialized industry issues in the primary financial statements or permit use of home country standards with reconciliation to U.S. GAAP? Which approach would produce the most meaningful primary financial statements? Is the approach of having the host country specify treatment for topics not addressed by the core standards a workable approach? Is there a better approach?

This issue poses special problems because home country standards for specialized industries in other nations (like the IASC core standards) may be incomplete or nonexistent. To the extent that there are differences between national accounting requirements for specialized industries, those differences are not attributable to use of IASC standards. That is, using IASC standards is unlikely to either increase or decrease comparability as it relates to this issue. Because the core standards do not address specialized

industry issues, the guidance in IAS 1 would apply and an entity using IASC standards likely would apply its specialized home country standards and still be considered to be in compliance with IASC standards. (See, however, the question raised in the last paragraph of our response to Question 2 below).

That result is essentially the same as the result of permitting use of home country standards without reconciliation. Home country standards for specialized industries can vary due to differences in national or local regulatory frameworks that govern or monitor the entities' activities, such as in the areas of insurance, utilities, financial institutions, and so forth. Regulatory frameworks can vary from regime to regime, and, thus, there likely would be differences among specialized industry entities in different national contexts. In the case of specialized industry accounting, a reconciliation to U.S. GAAP is necessary to achieve comparability of information reported in U.S. markets. That is consistent with current SEC requirements.

We do not believe that requiring foreign issuers to use U.S. GAAP for specialized industry issues is a workable approach. We do not believe it is appropriate for the SEC to essentially require that U.S. GAAP be used in the primary financial statements of non-U.S. entities. We observe that current SEC requirements allow those entities the choice to use U.S. GAAP.

In summary, we observe that (1) specialized industry entities from different countries using IASC standards can report that they conform to IASC standards but may have significant differences in reported financial information, (2) eliminating the requirement to reconcile would increase noncomparability of reported information among similar enterprises, (3) allowing use of home country standards with reconciliation to U.S. GAAP appears to be consistent with the SEC's current requirements for foreign issuers, and (4) requiring that U.S. GAAP be applied in the primary financial statements is inappropriate. In the absence of acceptable international standards on specialized industry issues, we suggest that the SEC cannot improve upon its current requirements. That is, the SEC should consider continuing to require foreign private issuers in specialized industries either to reconcile to U.S. GAAP or to prepare their financial reports based on U.S. GAAP. Thus, if an entity to which specialized industry guidance applies uses IASC standards, that entity would provide a reconciliation to U.S. GAAP for specialized industry requirements (whether or not it also used home country standards in its IASC financial reports). That approach minimizes the costs and maximizes the benefits to U.S. investors until such time as acceptable international standards exist for specialized industries.

We note that a more fundamental question can be raised in this context about the ability to comply with IASC standards when those standards are the basis for general accounting and home country standards are used for specialized accounting. For example, what if the home country standards for a specialized industry (such as insurance) were based on a deferral and matching approach to accounting that was inconsistent with the definitions of assets and liabilities in the IASC Framework? (We acknowledge that a similar question can be raised in the context of national accounting regimes.) That would seem to violate the requirements in IAS 1 and, thus, may result in noncompliance with IASC standards. For an entity that reports based on IASC standards, which standards should take precedence when faced with one or more conflicting accounting treatments (that question extends beyond specialized industry accounting)?

Q.3 Are there any additional topics that need to be addressed in order to provide a comprehensive set of standards?

Setting aside the issues raised about industry-specific standards, we are not confident that the IASC's core standards provide a comprehensive set of standards as indicated in our response to Question 1. Our response to this question should be viewed in conjunction with our responses to Questions 4 and 8 because we have difficulty distinguishing between (1) topics that are not covered by IASC standards and (2) the appropriate level of guidance necessary for a standard to be rigorously interpreted and applied. In addition, areas in which standards provide for alternatives or in which standards are unclear are additional areas that need to be addressed in order to provide a comprehensive set of standards.

In terms of comprehensiveness at the broadest level, the core standards address most of the fundamental accounting issues not related to specialized industries. Based on the FASB staff's examination of the core standards as part of the IASC-U.S. comparison project, the most significant topics that lack any requirements are accounting for equity-based compensation, accounting for changes in reporting entities, and accounting for not-for-profit entities. Other areas not covered by IASC standards include (1) transactions related to an entity's own stock and retained earnings, including such aspects as stock subscriptions, dividends in kind, stock splits, and so forth; (2) new basis accounting issues, including such aspects as leveraged buyouts, legal reorganizations, and distinguishing an exchange of assets from a business combination; and (3) certain consolidation issues, such as transactions involving shares of a subsidiary. Those topics were not identified by IOSCO as part of the core standards, but we believe those topics should be addressed because those items may be treated differently under different national accounting regimes.

Further, within a standard covering a given topic, the IASC-U.S. comparison project identified aspects of accounting that are not addressed or for which the implementation guidance is not sufficient to be considered comprehensive. For example, although the core standards cover the topic of income taxes, no guidance is provided for (1) measurement of income taxes when there are different tax rates for distributed and undistributed income, (2) measurement of deferred taxes in tax jurisdictions that have alternative minimum tax systems, and (3) accounting for and disclosure of income taxes in the separately issued financial statements of an entity that is a member of a group that files a consolidated tax return. Other aspects of particular topics for which no guidance or insufficient guidance is provided are listed in our responses to Questions 4 and 8.

We also believe that guidance for two very important and complex topics-financial instruments (particularly IAS 39) and leases (IAS 17, *Leases*)-is not sufficiently robust to be applied in a straightforward and consistent manner. For example, the guidance in IAS 17 for lease classification is very general; and there is no guidance for lease extensions or renewals, for transactions in which the lessor has continuing involvement, for transactions with related parties, or for transactions in which a third party participates. Furthermore, guidance for aspects of leasing such as modifications and special circumstances involving real estate leases is relatively limited.

Similarly, IAS 39 provides an explicit alternative for recognizing gains and losses on available-for-sale financial assets and does not provide guidance for grouping financial assets or liabilities for impairment testing. Further it lacks specific guidance for derecognition of assets; for deep in-the-money options, clean-up calls, wash sales, rights of first refusal, repurchase and reverse repurchase transactions, removal of accounts provisions; and for gain or loss recognition on the extinguishment or conversion of compound financial instruments. In addition, the guidance for applying the concepts to distinguish between sales and borrowings is vague. The general nature of those standards permits entities a great deal of flexibility to choose how they will be applied. While the SIC and its IAS 39 Implementation Group may address concerns to some degree, that will be done on a prospective basis. We believe that at present, IAS 17 and IAS 39 are examples of individual core standards that are not sufficiently comprehensive.

Q.4 Are the IASC standards of sufficiently high quality to be used without reconciliation to U.S. GAAP in cross-border filings in the United States? Why or why not? Please provide us with your experience in using, auditing or analyzing the application of such standards. In addressing this issue, please analyze the quality of the standard(s) in terms of the criteria we established in the 1996 press release. If you considered additional criteria, please identify them.

We do not have experience using or auditing IASC standards that we draw from in responding to this question. However, the FASB has published a list of characteristics of high-quality accounting standards and a comprehensive staff analysis of the core standards. Those are the basis for our response. Please also refer to issues discussed in our cover letter to this appendix.

Appendix B of the FASB report, *International Accounting Standard Setting: A Vision for the Future,* issued jointly by the FAF and the FASB (the FAF-FASB Vision report) describes our belief as to the key characteristics of a set of high-quality accounting standards:

> A reasonably complete set of unbiased accounting standards that require relevant, reliable information that is decision useful for outside investors, creditors, and others who make similar decisions would constitute a high-quality set of accounting standards. Each of those accounting standards should:
>
> a. Be consistent with the guidance provided by an underlying conceptual framework.
>
> b. Avoid or minimize alternative accounting procedures, explicit or implicit, because comparability and consistency enhance the usefulness of information.
>
> c. Be unambiguous and comprehensible so that the standard is understandable by preparers and auditors who must apply the standard, by authorities who must enforce the standard, and by users who must deal with the information produced by the standard.
>
> Overall, financial reporting under those standards should result in transparent information.

> Transparent information is sufficient in its content and readily comprehensible so as to provide a meaningful basis for economic decision making by financial statement users. Transparent information does not obscure information relevant to economic decision making.

Those criteria are essentially consistent with the description in Section (IV)(A)(2) of the Concept Release, "Are the IASC Standards of Sufficiently High Quality? Why or Why Not?"

Whether the core standards are sufficiently comprehensive (the subject of Questions 1-3 of the Concept Release) is one aspect of the question of quality. If the standards (in their present form) are not sufficiently comprehensive, we do not believe it is clear to what extent an entity could or should look to alternative accounting methods outside the core standards when following the guidance provided in IAS 1. The ability to look beyond IASC standards and still be considered to be in compliance can undermine both the comparability and quality of IASC-based financial reporting.

Even if the SEC concluded that the set of core standards is "reasonably complete," the criteria identified in the FAF-FASB Vision report (relating to consistency with a conceptual framework, minimal alternatives, and unambiguousness) must be applied on a standard-by-standard basis to determine whether application of the standard is likely to result in relevant, reliable, and transparent financial reporting. We support the IASC's efforts to maintain consistency with the IASC Framework and believe that, with few exceptions, the core standards are generally consistent with the IASC Framework. However, we are concerned about the extent to which the core standards permit alternative accounting treatments to be used for similar transactions and the ambiguousness of some of the guidance in the core standards. (That concern is exacerbated by the possibility of conflicts between "black letter" standards and "gray letter" background and implementation guidance presented in each IASC standard-see our response to Question 8.)

The Comparison report identifies both alternative accounting procedures and ambiguities in some of the IASC core standards. Alternatives in IASC standards may be implicit or explicit. Explicit alternatives generally take the form of "benchmark" and "allowed alternative" treatments, although some explicit alternatives are not so labeled. Appendix D to the Concept Release in the section on "Alternatives" reiterates many of the areas identified in the Comparison report in which the core standards provide explicit alternatives. Those relate to the following IASC standards:

- IAS 2, *Inventories*
- IAS 7, *Cash Flow Statements*
- IAS 8, *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*
- IAS 11, *Construction Contracts*

- IAS 16, *Property, Plant and Equipment*
- IAS 21, *The Effects of Changes in Foreign Exchange Rates*
- IAS 23, *Borrowing Costs*
- IAS 28, *Accounting for Investments in Associates*
- IAS 31, *Financial Reporting of Interests in Joint Ventures*
- IAS 38, *Intangible Assets.*

Examples of other explicit alternatives can be found in IAS 22, *Business Combinations;* IAS 25, *Accounting for Investments;* IAS 27, *Consolidated Financial Statements and Accounting for Investments in Subsidiaries;* IAS 32, *Financial Instruments: Disclosure and Presentation;* and IAS 39.

Implicit alternatives can arise when the standards are ambiguous or silent on a particular issue or when there is a lack of adequate implementation guidance. Examples of areas in which there are alternatives, ambiguities, or a lack of implementation guidance related to particular standards that were identified by the FASB staff in the IASC-U.S. comparison project include (but are not limited to):

1. IAS 1, *Presentation of Financial Statements*:

- The guidance related to fair presentation coupled with the guidance on the selection of accounting policies in IAS 1 implicitly provides for alternatives for the preparation of financial statements that comply with IASC standards.

2. IAS 8, *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*:

- The definition of a *fundamental error* is ambiguous and may be interpreted to permit nonrecognition of material errors because they are not considered "fundamental."

3. IAS 10, *Events After the Balance Sheet Date*:

- IAS 10 provides that post-balance-sheet events be assessed from the date of the balance sheet to the date on which those financial statements are "authorized for issue." We do not believe the meaning of that term is universally understood and implementation guidance may be necessary to achieve comparability.

4. IAS 11, *Construction Contracts*:

- Limited guidance is provided on combining or segmenting contracts, accounting for contract options and additions, and determining stage of completion, which could lead to differences in application.

5. IAS 16, *Property, Plant and Equipment*:

- IAS 16 provides very limited guidance on accounting for nonmonetary transactions-that topic has become increasingly troublesome in recent years in terms of distinguishing asset exchanges from business combinations.

6. IAS 19, *Employee Benefits*:

- A lack of guidance on how to determine an employer's appropriate share of benefit obligation, plan assets, and benefit costs for a multiemployer plan may lead to variations.

7. IAS 22, *Business Combinations* (1998):

- Because guidance is subjective, application of criteria for capitalization of internally developed intangible assets can implicitly permit alternatives for whether to capitalize as an intangible asset, to include as a part of goodwill, or to expense. (This also is an issue with IAS 38.)

8. IAS 31, *Financial Reporting of Interests in Joint Ventures*:

- Limited guidance is provided on which basis to use for determining a venturer's proportionate share of assets or liabilities of a joint venture, which may raise questions when the proportionate share of voting interest or assets controlled differs from the proportionate share of resulting future economic benefits from the joint venture.

9. IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*:

- IAS 37 provides a variety of recognition criteria for different items (debits and credits) that may enter into the measurement of provisions. Amounts recognized may vary.

10. IAS 38, *Intangible Assets*:

- Subjective criteria for capitalization of development costs can lead to similar items being accounted for differently.

Each of the above-cited areas is one in which an IASC core standard would benefit from additional implementation guidance to ensure that it is consistently interpreted and applied.

Conflicts between standards within the set of IASC core standards represent another area of concern with regard to the quality of the core standards. Those conflicts may arise from explicit inconsistencies or from ambiguities that create confusion in terms of the core standards taken as a set. For example, similar terms may be defined differently in different IASC standards (or may not be defined at all), or different terms may be used to describe what appear to be similar circumstances. For example:

- The term *finance costs* is used in IAS 1 but is undefined in any IASC standard. Upon reading IAS 1, it might be concluded that that term is intended to mean interest expense. However, it might also be interpreted to be the same as borrowing costs under IAS 23. Borrowing costs include, among other things, foreign exchange gains and losses that would not qualify as interest expense in some national accounting regimes.

- The definition of *monetary item* is in IAS 21 differs from that in IAS 29, *Financial Reporting in Hyperinflationary Economies*. The definition of *monetary financial instruments* in IAS 32 is consistent with the definition of *monetary items* in IAS 21.

- *Bank overdrafts* are included as a component of cash equivalents under IAS 7, whereas for purposes of applying IAS 1 they are short-term liabilities.

- The term *probable* is used in a number of IASC standards as part of the recognition or measurement criteria for various items (for example, in IAS 8, IAS 11, IAS 12, *Income Taxes*, IAS 16, IAS 18, *Revenue*, IAS 37, and IAS 38). *Probable* is only defined in IAS 37, which states clearly that "the interpretation of `probable' in this Standard as `more likely than not' does not necessarily apply in other International Accounting Standards" (footnote to paragraph 23). *Probable* does not have a universally understood meaning throughout the world.

- IAS 12 uses the term *substantively enacted* to describe the circumstance in which a tax law is substantively enacted even though it has not yet been actually enacted. IAS 37 uses the term *virtually certain* for similarly describing pending law that has yet to be enacted. It is not clear whether the use of different terms is meant to indicate that there are differences between what appear to be similar circumstances.

Such ambiguities and inconsistencies raise questions about the quality of the set of core standards taken as a whole as well as the quality of individual standards. Further, ambiguities and inconsistencies force a greater reliance on the attestation, enforcement, and interpretive elements of an effective financial reporting system to ensure that reported financial information is of high quality. For example, in the United States, when ambiguities or inconsistencies within accounting principles raise questions about interpretation or application, the issue may be addressed through any number of channels, such as the SEC staff, the FASB or its staff, the American Institute of Certified Public Accountants (AICPA), auditing firms' national offices, or the Emerging Issues Task Force, depending on the type of issue. A similar infrastructure at the international level is only in the early stages of development. Evidence indicates that that infrastructure is not sufficiently well developed to effectively compensate for

ambiguities and inconsistencies in IASC standards. While it is possible only to speculate about IASC standards that are not yet being applied, as our response to Question 11 illustrates, experience to date indicates that IASC standards that are already being applied are not being consistently interpreted and applied.

We believe this evidence suggests that the potential quality of IASC standards is diminished because of the existence of explicit and implicit alternatives within those standards and because a lack of implementation guidance contributes to ambiguity about their appropriate application. When compared to the criteria for assessing whether a standard is of sufficiently high quality, it is clear that the set of core standards does not meet the criteria. We therefore conclude that reconciliation should be required for all IASC standards.

Despite that concern, we recognize that the SEC will consider alternatives that contemplate acceptance of the IASC core standards on a standard-by-standard basis. That approach should be avoided. As discussed in our cover letter, continued reconciliation requirements would facilitate and accelerate the convergence efforts of national standard setters (like the FASB) and the IASC toward high-quality international solutions. Successful convergence efforts will decrease the differences between national and IASC standards. Thus, to the extent that convergence efforts are successful, there is no need for the SEC to selectively accept IASC standards because there will be a natural decline in the amount and type of reconciling items that prevail when IASC standards are reconciled to U.S. GAAP.

In contrast, removing reconciliation requirements poses significant costs in terms of loss of comparability, which increases costs to users of making efficient capital allocation decision. Removing the reconciliation requirements also would create overwhelming demands on SEC's time and resources to fill gaps in global interpretation and enforcement of IASC standards and potentially would place the SEC in the position of creating standards on a case-by-case basis. To the extent that two styles of application of IASC standards emerge-SEC-IASC and rest-of-world-IASC-the credibility of IASC standards themselves are undermined, and the SEC might, in effect, become a global standard setter. Such a result could ultimately interfere with the independence of international accounting standard setting and could hinder the development of a high-quality global financial reporting infrastructure.

Q. 5 What are the important differences between U.S. GAAP and the IASC standards? We are particularly interested in investors' and analysts' experience with the IASC standards. Will any of these differences affect the usefulness of a foreign issuer's financial information reporting package? If so, which ones?

We believe that any difference between two standards covering the same topic has the potential to be significant depending on the circumstances of the reporting entity. The FASB's Comparison report provides a detailed analysis of differences between IASC standards and U.S. GAAP. While the differences identified in the Comparison report are more numerous than those listed in the Concept Release, the list of areas of concern identified by the SEC in the body of the Concept Release and those included in Appendix D to the Concept Release include what we believe to be among the most

significant differences between IASC standards and U.S. GAAP.

Identifying similarities and differences between standards can highlight potential problem areas but cannot be relied on as the sole determinant of the quality of one set of accounting standards relative to another. The true level of quality of an accounting standard can only be assessed in terms of real-world application and the quality of the resulting financial information. That level of quality cannot be assessed with respect to many IASC standards for which there has been no experience. In the absence of such experience, however, similarities and differences between the new IASC standards (those that only recently came into effect and those that are not yet in effect) and U.S. GAAP counterparts that already are acceptable (and thus implicitly acknowledged as being of sufficient quality) can provide a basis for preliminary conclusions about the quality of the new IASC standards. However, we note that both sets of standards are continually evolving. It is hoped that convergence efforts will reduce the differences between IASC standards and U.S. GAAP. Nonetheless, it is possible that some differences will remain or that new differences will arise as new standards are developed by the IASC and the FASB.

Q.6 Would acceptance of some or all of the IASC standards without a requirement to reconcile to U. S. GAAP put U.S. companies required to apply U.S. GAAP at a competitive disadvantage to foreign companies with respect to recognition, measurement or disclosure requirements?

We have no basis for responding to this question. In our experience, the arguments about the effect of financial reporting on competitive position can be expressed both in terms of providing more-detailed financial information and in terms of providing less-detailed financial information. More-detailed information is thought ultimately to reduce the costs of capital to preparers. Less-detailed information is thought to protect proprietary information. We believe that in the long-run, markets benefit from relevant, reliable, transparent and consistent information, which is facilitated by continual improvements in the quality of financial reporting.

Q.7 Based on your experience, are there specific aspects of any IASC standards that you believe result in better or poorer financial reporting (recognition, measurement or disclosure) than financial reporting prepared using U.S. GAAP? If so, what are the specific aspects and reason(s) for your conclusion?

The quality of financial reporting must be assessed in terms of its relevance, reliability, neutrality, comparability, consistency, and transparency.

We identified specific aspects of IASC standards that are ambiguous in Question 4 (also refer to our response to Question 8). We believe that the probability that poorer financial reporting would result from applying IASC standards as compared to U.S. GAAP is increased when IASC standards are ambiguous. That is because ambiguity of accounting standards decreases comparability and transparency, which, in turn, increases the possibility that poor financial performance, lack of profitability, or deteriorating asset quality can be masked.

Little evidence related to the quality of financial reporting using IASC standards is available either in support of or against IASC standards because there is relatively little widespread use of those standards for financial reporting in public capital markets. Further, there is some evidence that the quality of financial information that is provided when IASC standards are used is obscured by inappropriate or selective application of those standards. (Refer to our response to Question 11.)

Q.8 Is the level of guidance provided in IASC standards sufficient to result in a rigorous and consistent application? Do the IASC standards provide sufficient guidance to ensure consistent, comparable and transparent reporting of similar transactions by different enterprises? Why or why not?

We have identified a number of areas throughout our responses in which we believe that IASC standards provide insufficient guidance to result in rigorous and consistent application. We will not repeat those here. Our response to Question 11 indicates our belief that IASC standards are not being applied rigorously and consistently at present. Unfortunately, it is difficult to know the extent to which that is a result of insufficient guidance in the standards rather than deficiencies related to other elements of an effective financial reporting infrastructure. It is also possible that cultural differences related to corporate governance and national business reporting environments lead to different expectations and objectives for financial reporting on behalf of preparers in different nations. Those differences also can contribute to inconsistent application of standards.

As part of our response to the question of whether there is a sufficient level of guidance in IASC standards, we would like to touch upon the issue of the distinction between "black-letter and gray-letter" material within IASC standards. Determining whether the level of guidance in IASC standards is sufficient to result in rigorous and consistent application depends on what are considered to be the "requirements" in the standards. Each IASC standard notes that the standards are set in bold italic type ("black letter") and should be read in the context of the background material and implementation guidance ("gray letter") in the standard. The distinction between the requirements and guidance can be confusing in circumstances in which it appears that the gray-letter material includes "requirements" or when there are conflicts between the black-letter requirements and the gray-letter material provided. The Concept Release states the SEC's belief that compliance with both black- and gray-letter sections of IASC standards should be regarded as necessary-that is black-letter and gray-letter content should be equally applied as "requirements."

We agree that the SEC's approach is appropriate; however, we note that it does not address the situations in which there are conflicts between the two. In addition, we believe that requiring application of the gray-letter material can pose problems because the guidance often refers to multiple alternatives or is described as a suggestion for accounting for "normal" or "usual" circumstances. For example, paragraph 99 of IAS 39 provides gray-letter guidance for the use of bid-ask prices to determine fair value. That paragraph reads:

> The existence of published price quotations in an active market is *normally* the best

> evidence of fair value. The appropriate quoted market price for an asset held or liability to be issued is *usually* the current bid price and, for an asset to be acquired or liability held, the current offer or asking price. When current bid and offer prices are unavailable, the price of the most recent transaction *may* provide evidence of the current fair value provided that there has not been a significant change in economic circumstances between the transaction date and the reporting date. When an enterprise has matching asset and liability positions, it *may* appropriately use mid-market prices as a basis for establishing fair values. [Emphasis added.]

IAS 39 does not indicate the *abnormal* or *unusual* circumstances in which price quotations in an active market are not the best evidence of fair value or the bid and offer prices are not appropriate evidence of fair value. It also implies that there is more than one alternative when current bid and offer prices are unavailable or when an entity has matching asset and liability positions. The ambiguity is further compounded by the suggestion in paragraph 100 that price quotations sometimes need to be adjusted.

We might agree that the statements in paragraphs 99 and 100 of IAS 39 are true in the general sense, but that guidance is not sufficient to result in rigorous and consistent application and interpretation. The above example as just one illustration of the kinds of questions that can arise in attempting to treat as requirements information that was intended to be background material and implementation guidance. A similar issue arises for those IASC standards, such as IAS 19, that include a basis for conclusions. It is not clear whether a basis for conclusions should be considered an additional source of guidance for the implementation of an IASC standard.

Q.9 Are there mechanisms or structures in place that will promote consistent interpretations of the IASC standards where those standards do not provide explicit implementation guidance? Please provide specific examples.

There are a number of possible mechanisms or structures in place that could be used (and are being used) to promote consistent interpretations of IASC standards. For example, the SIC and the IAS 39 Implementation Group were created precisely for that purpose. In addition, IASC standards may be interpreted by various national regulatory agencies as they are used for domestic and cross-border financial reporting (although those agencies may not be as actively involved in interpreting standards as the SEC has been). The requirements established by the AICPA's SEC Practice Section for U.S. auditors to ensure that audits of foreign registrants meet U.S. requirements for accounting, auditing, and independence standards should also help to promote consistent interpretations. Current reconciliation requirements in the United States are another mechanism to promote consistent interpretations of IASC standards because foreign issuers that reconcile to U.S. GAAP often strive to minimize reconciling items.

However, there is no clear mechanism for coordinating interpretations among national regulatory agencies or between those agencies and the SIC. Nor does it seem likely that any single existing organization would be capable of addressing the volume of interpretation issues that we believe would

arise if IASC standards were accepted without reconciliation in the near term. We believe that the existing structures and mechanisms for interpretation of IASC standards will play a role in promoting the consistent use of IASC standards but would not be sufficient if IASC standards were permitted in U. S. markets without reconciliation. We believe that appropriate structures will develop over time to deal with that issue.

Q.10 In your experience with current IASC standards, what application and interpretation practice issues have you identified? Are these issues that have been addressed by new or revised standards issued in the core standards project?

No basis for response, but refer to our comments on Question 11.

Q.11 Is there significant variation in the way enterprises apply the current IASC standards? If so, in what areas does this occur?

While we do not have experience with applying IASC standards, evidence indicates that IASC standards are not presently being applied rigorously and consistently. A survey undertaken by David Cairns, an international consultant and former Secretary-General of the IASC, examined 125 companies that use IASC standards in preparation of their financial reports. The results of the survey were published in the report, *The FT International Accounting Standards Survey 1999.*[6] In his conclusions on page 2 of that report, Cairns notes:

> There is considerable variety in the approaches adopted by survey companies to compliance with IASs and levels of compliance. There are many companies which fully comply. There are many which specify exceptions from full compliance or use IASs only for some items. And even among the companies which claim full compliance, there are material omissions or other non-compliance. In short, there are clear cases of `IAS lite.'

According to the survey, of 88 companies that claimed full compliance with IASC standards, 18 clearly stated that exceptions were made in the application of IASC standards. Those exceptions related to aspects of many different IASC standards covering a variety of topics, including classification of income statement items, research and development, deferred taxes, segment reporting, retirement benefit costs, foreign currencies, goodwill and intangible assets, related party transactions, consolidated financial statements, and joint ventures.

A further 16 companies claimed full compliance and did not indicate any exceptions, but, according to the survey, material omissions or exceptions were evident from a review of their financial statements. With regard to those companies, page 158 of the survey states:

> Material omissions by companies include the non-disclosure of segment information, cost of sales, retirement benefit costs and other information about retirement benefit obligations. Material exceptions to full compliance include the non-depreciation of

property, the non-amortisation of intangible assets, excessive provisions or other liabilities and the classification as extraordinary of items which do not meet the IAS 8 definition.

We believe that this type of evidence indicates that IASC standards are not at present being rigorously and consistently applied. As noted earlier, however, it is difficult to discern the extent to which that arises from problems with the guidance in the standards themselves or is a function of the lack of appropriate global audit and enforcement mechanisms for those standards.

Q.12 After considering the issues discussed in (i) through (iv) below, what do you believe are the essential elements of an effective financial reporting infrastructure? Do you believe that an effective infrastructure exists to ensure consistent application of the IASC standards? If so, why? If not, what key elements of that infrastructure are missing? Who should be responsible for development of those elements? What is your estimate of how long it may take to develop each element?

The Concept Release properly recognizes that accounting standards are only one element of the infrastructure necessary to achieve high-quality global financial reporting. It may be difficult to ascertain the rigor and soundness of the other elements-such as the sufficiency of record-keeping, the quality of auditing standards, the effectiveness of quality controls, and the extent of regulatory oversight-as they exist in financial reporting regimes outside the United States, but the capability of IASC standards to actually improve the quality of cross-border financial reporting (in the United States or elsewhere) must be considered in the context of those other elements. Appendix A of the FAF-FASB Vision report similarly identifies a need for an accounting infrastructure to support high-quality international standards that is generally consistent with the SEC's view. It also notes the importance of preparers' responsibility for rigorous adherence and comprehensive application of standards as an important factor in achieving high-quality financial reporting.

When considered as a set, the IASC's core standards do not meet the three criteria identified by the SEC as necessary to be considered of sufficiently high quality for use without reconciliation. That conclusion increases the importance of issues related to the current state of the other necessary elements of a high-quality global financial reporting infrastructure identified by the SEC in the Concept Release. We do not believe that the necessary elements of an effective financial reporting infrastructure for IASC standards exist at this time. In addition, when the IASC set the core standards, it had not yet adopted a standard-setting structure and process that embodied all of the characteristics identified by the SEC in the Concept Release as necessary to be an effective high-quality standard setter. The IASC is in the process of restructuring, but the new structure is not yet operating.

We also believe that expertise with regard to the audit and enforcement functions for IASC standards is still in the formative stages and will take many years to develop. In addition, effective financial reporting starts with the reporting company's management. Because of cultural differences related to appropriate corporate governance and expectations for financial reporting, it is not clear there is a global consensus on the responsibility for a reporting company's management to apply IASC standards in a way that is faithful to both the requirements and intent of the standards.

In principle, we believe that a process-oriented approach (like the SEC's approach to the FASB) to acceptance of any body of accounting standards that is to be used internationally requires that all of the elements of a high-quality global financial reporting infrastructure exist before unqualified acceptance of those standards is appropriate. There are indications that an infrastructure supporting the use of IASC standards is developing, and increased use of IASC standards worldwide would greatly facilitate that development. However, the current global financial reporting infrastructure is not sufficient, and we cannot predict how long it will take for all of the elements of an effective financial reporting structure for IASC standards to evolve to an acceptable point.

Q.13 What has your experience been with the effectiveness of the SIC in reducing inconsistent interpretations and applications of IASC standards? Has the SIC been effective at identifying areas where interpretive guidance is necessary? Has the SIC provided useful interpretations in a timely fashion? Are there any additional steps the IASC should take in this respect? If so, what are they?

The FASB is not represented on the SIC, however, the FASB staff does provide support to a U.S. representative of the SIC. Based on that involvement and our general observations, we believe that the SIC is generally effective in providing interpretations related to issues that it chooses to address. For example, the SIC was able to provide effective guidance to address some of the implementation questions related to IAS 22. However, given the many implementation questions that arise for those using IASC standards, we are concerned that the SIC's agenda does not reflect the scope and complexity of practice problems. We are not clear what the SIC's process is for prioritizing and selecting agenda items. The extent to which the SIC should be more active or deal with more significant issues is not apparent. We also are concerned that if the interpretive role of the SIC is defined too narrowly, it may not address some of the implementation questions that will arise for aspects of IASC standards that raise difficult issues because they are ambiguous or do not provide sufficient implementation guidance.

Q.14 Do you believe that we should condition acceptance of the IASC standards on the ability of the IASC to restructure itself successfully based on the above characteristics? Why or why not?

In principle, we believe that acceptance of IASC standards should be based on a process-oriented approach, conditioned not only on the conclusion that the core standards are of sufficiently high quality, but also on IASC's successful restructuring and the existence of the other necessary elements of an effective financial reporting infrastructure that are identified in the Concept Release. Establishing a quality international accounting standard setter is key to the long-term success of an international financial reporting infrastructure and to achieving the objective of a single set of high-quality international accounting standards to be used worldwide for both domestic and cross-border financial reporting. However, we recognize that the issues that the Concept Release raises about standard-setting structures, the audit function, and the regulatory oversight function are not unique to an IASC context- they apply equally to financial reporting based on other non-U.S. accounting regimes (as well as to the U. S. accounting regime).

As we have expressed publicly, we applaud the IASC's proposal to restructure as an independent, private

sector, technically competent decision-making body. We also have stated our intention to fully participate in the restructured IASC. We view a restructured IASC as an important facilitator of future efforts to converge national and international accounting standards toward high-quality international solutions. As noted in our response to Question 4, we are concerned about the implications of acceptance of IASC standards today (as a set or on a standard-by-standards basis) without reconciliation for issues related to future acceptance of IASC standards, interpretations, and amendments. That is, if the SEC is going to look to the IASC to provide standards, interpretations, and amendments in the future, the importance of a successful IASC restructuring increases considerably.

Nevertheless, the SEC should reach a conclusion about the use of IASC standards in U.S. markets independent of the successful outcome of the IASC's restructuring. As noted in our response to Question 12, we believe that more widespread use of IASC standards, particularly with reconciliation, would greatly facilitate the development of an effective financial reporting infrastructure for IASC standards. Further, whether or not the IASC will be "successful" is unlikely to be known for a few years. In the meantime, the SEC could reach a conclusion based on information about the existing state of IASC standards as they would be used in the current accounting infrastructure.

Q.15 What are the specific practice guidelines and quality control standards accounting firms use to ensure full compliance with non-U.S. accounting standards? Will those practice guidelines and quality control standards ensure application of the IASC standards in a consistent fashion worldwide? Do they include (a) internal working paper inspection programs and (b) external peer reviews for audit work? If not, are there other ways we can ensure the rigorous implementation of IASC standards for cross-border filings in the United States? If so, what are they?

No basis for response. However, in principle we believe such guidelines and standards should be in place in order to conclude that the set of core standards is acceptable without reconciliation.

Q.16 Should acceptance of financial statements prepared using the IASC standards be conditioned on certification by the auditors that they are subject to quality control requirements comparable to those imposed on U.S. auditors by the AICPA SEC Practice Section, such as peer review and mandatory rotation of audit partners? Why or why not? Why or why not? If not, should there be disclosure that the audit firm is not subject to such standards?

We support the requirements imposed on U.S. auditors by the AICPA SEC Practice Section. We believe that quality control requirements are necessary to the effectiveness of an independent attestation function for IASC standards and must be in place in order to conclude that the set of core standards are acceptable *with or without* reconciliation. High-quality and ethical audit and accounting practices are essential to financial reporting in public capital markets regardless of the accounting standards used.

Q.17 Is there, at this time, enough expertise globally with IASC standards to support rigorous interpretation and application of those standards? What training have audit firms conducted with respect to the IASC standards on a worldwide basis? What training with respect to the IASC

standards is required of, or available to, preparers of financial statements or auditors certifying financial statements using those standards?

Based on our observations about how IASC standards have been applied in practice, we would need to question whether there is enough expertise globally with IASC standards to support rigorous interpretation and application of those standards.

Q.18 Is there significant variation in the interpretation and application of IASC standards permitted or required by different regulators? How can the risk of any conflicting practices and interpretations in the application of the IASC standards and the resulting need for preparers and users to adjust for those differences be mitigated without affecting the rigorous implementation of the standards?

No basis for response. In our opinion, a mechanism must be in place to coordinate practice and interpretation at the global level if the maximum benefits of using a single set of international standards without reconciliation for cross-border filing are to be realized.

Q.19 Would further recognition of the IASC standards impair or enhance our ability to take effective enforcement action against financial reporting violations and fraud involving foreign companies and their auditors? If so, how?

No basis for response.

Q.20 We request comment with respect to ways to assure access to foreign working papers and testimony of auditors who are located outside the United States. For example, should we amend Regulation S-X to require a representation by the auditor that, to the extent it relied on auditors, working papers, or information from outside the United States, the auditor will make the working papers and testimony available through an agent appointed for service of process? If not, should we require that the lack of access to auditors' workpapers be disclosed to investors? Is there another mechanism for enhancing our access to audit working papers and witnesses outside the United States?

No basis for response.

Q.21 What has been your experience with the quality and usefulness of the information included in U. S. GAAP reconciliations? Please explain, from your viewpoint as a preparer, user, or auditor of non-U.S. GAAP financial statements, whether the reconciliation process has enhanced the usefulness or reliability of the financial information and how you have used the information provided by the reconciliation. Please identify any consequences, including quantification of any decrease or increase in costs or benefits, that could result from reducing or eliminating the reconciliation requirement.

We have no direct experience with which to assess the quality and usefulness of information included in U.S. GAAP reconciliations. However a number of academic studies have been undertaken to explore

this issue, many of which were developed in response to the SEC's request for such study. In particular, Pownall and Schipper [7] provide a review of relevant academic research in the context of the SEC's assessment of IASC standards. The overall conclusions about the quality and usefulness of reconciliations are mixed, but there is evidence to support the value relevance (that is, the statistical association between market returns or prices and accounting information) of U.S. GAAP reconciliations. That evidence suggests that the disclosure of differences between non-U.S. GAAP and U.S. GAAP measures provided in U.S. GAAP reconciliations is useful to investors.

If the usefulness of reconciliations to U.S. GAAP is in question, that does not necessarily lead to a conclusion that reconciliation requirements should be eliminated. On the contrary, that may lead to a conclusion that reconciliations could somehow be improved. The SEC might consider the possibility that a more robust reconciliation requirement is necessary to improve the usefulness of the package of financial information provided by foreign issuers to U.S. investors.

As noted in the cover letter to this appendix, we believe that there are benefits to requiring reconciliation that extend beyond the inherent information content. For example, reconciliation imposes a discipline on standard setters to converge their standards and to continually improve the quality of their standards.

Q.22 Should any requirements for reconciliation differ based on the type of transaction (e.g., listing, debt or equity financing, rights offering, or acquisition) or the type of security (e.g., ordinary shares, convertible securities, investment grade or high yield debt)? Are there any other appropriate bases for distinction?

We do not believe that such distinctions would be appropriate or useful. The objective of financial reporting-to provide decision-useful information to investors-and the SEC's mandate for investor protection apply equally to all of those transactions. The quality and content of financial reporting, therefore, should be similar for all circumstances in which financial information is required to be prepared. The requirement to reconcile is not a sufficient basis for making a distinction.

Q.23 If the current reconciliation requirements are reduced further, do you believe that reconciliation of a "bottom line" figure would still be relevant (e.g., presenting net income and total equity in accordance with U.S. GAAP)?

No basis for response. However, we do not support reduction in the current reconciliation requirements, and we note that some academic research suggests that providing such information is useful to investors. (Refer to our response to Question 21.)

Q.24 Should any continuing need for reconciliation be assessed periodically, based on an assessment of the quality of the IASC standards?

We believe that the IASC's core standards are not of sufficiently high quality to be used by foreign issuers without reconciliation. One reason we reach that conclusion is that IASC standards at present

have not yet been applied extensively. As a result, there is little experience upon which to formulate a positive conclusion about the benefits of their use. Neither has there developed sufficient expertise or quality control mechanisms to ensure that IASC standards will serve markets as intended. A reconciliation requirement maintains pressure on the IASC and other national standard setters to continually strive for higher-quality standards and provides a mechanism to identify areas for focused efforts to converge national and international standards to achieve the highest-quality solutions.

As experience is gained with IASC standards, many of the present uncertainties should dissipate. If better information becomes available that would support additional or expanded use of IASC standards without reconciliation, then that information should be considered in the future and changes should be made based on the best available information. However, we note that to the extent that convergence of national and international standards is achieved, there would be a natural decline in the number of reconciling items between IASC standards and U.S. GAAP. Thus, there may be no need to periodically assess the quality of IASC standards. Nevertheless, a periodic reassessment may be a constructive way to encourage faster convergence of national and international standards toward the best international solutions.

Q.25 The IASC standards finalized as part of the core standards project include prospective adoption dates. Most standards are not required to be applied until fiscal years beginning on or after January 1, 1998, at the earliest. Should we retain existing reconciliation requirements with respect to the reporting of any fiscal year results that were not prepared in accordance with the revised standards or simply require retroactive application of all revised standards regardless of their effective dates? If not, why not?

It is our understanding that any SEC decision about the acceptance of the core standards relates to the complete package as they presently exist. We do not believe it would be appropriate to conclude that no reconciliation is necessary for previous IASC standards that have been amended or superseded by revised standards that are part of the core standards package. Entities that have applied those earlier standards in the past have had to prepare reconciliations for those prior years. We do not see any undue burden associated with retaining existing reconciliation requirements with respect to the reporting of results that were not prepared with the revised standards.

It would be difficult and inappropriate to require that all of the revised standards be retroactively applied for a number of reasons. Not all of the revised standards require a retroactive application-therefore retroactive application is not necessary in order to comply with those standards. In concluding on the appropriate transition for a particular standard, the IASC presumably would have considered retroactive application and rejected that transition method in some cases. Retroactive application can be costly and may not yield comparatively useful information. For example, it may be difficult to retroactively apply certain provisions of IAS 39 related to hedge designation or the choice to recognize gains and loses on available-for-sale financial assets in earnings or comprehensive income.

Q.26 Does the existence of a reconciliation requirement change the way in which auditors approach

financial statements of foreign private issuers? Also, will other procedures develop to ensure that auditors fully versed in U.S. auditing requirements, as well as the IASC standards, are provided an opportunity to review the financial reporting practices for consistency with those standards? If so, please describe these procedures. Alternatively, will the quality of the audit and the consistency of the application of the IASC standards depend on the skill and expertise of the local office of the affiliate of the accounting firm that conducts the audit?

No basis for response.

Footnotes

[1] The FAF is an independent body responsible for (among other things) exercising general oversight of the FASB (except with regard to the FASB's resolution of technical issues).

[2] In the FAF-FASB Vision report, *convergence* is described as different standard setters arriving at high-quality national or international standards that are as similar as possible. The process of convergence includes using all reasonable efforts to arrive at consensus, recognizing that it may be beneficial to arrive at very similar higher quality national standards when consensus on a single international standard is not possible.

[3] There are some exceptions to the reconciliation requirements for aspects of certain IASC standards.

[4] It is our understanding that the SEC is not considering a change to the requirements for foreign issuers that do not choose to use IASC standards. We support the continued option for foreign private issuers to prepare financial statements based on U.S. GAAP or based on home country standards with full reconciliation to U.S. GAAP.

[5] David Cairns, *The FT International Accounting Standards Survey 1999* (London: Financial Times, 1999), 3.

[6] David Cairns, *The FT International Accounting Standards Survey 1999* (London: Financial Times, 1999).

[7] Grace Pownall and Katherine Schipper, "Implications of Accounting Research for the SEC's Consideration of International Accounting Standards for U.S. Securities Offerings," *Accounting Horizons*, (September 1999): 259-280.