International
Accounting Standards
Committee ®

166 Fleet Street, London EC4A 2DY, England
Telephone: +44 (020) 7353 0565 Facsimile: +44 (020) 7353 0562
E-mail: iasc@iasc.org.uk Internet: http://www.iasc.org.uk

---

25 May 2000

Mr Jonathan G Katz
Secretary
Securities and Exchange Commission
450 Fifth Street NW
Washington, DC 20549-0609
USA

Dear Mr Katz

SEC Concept Release: International Accounting Standards (File No S7-04-00)

Introduction

We welcome the SEC's publication of the Concept Release on International Accounting Standards and have pleasure in submitting the following comments on the Release. We make this submission in our personal capacities: it has not been debated by the IASC Board. IASC was formed in 1973 to prepare and promote the adoption of International Accounting Standards (IAS). Its members comprise today about 140 professional accounting bodies from over 100 different countries. Its Board establishes IAS and comprises 13 country members and 3 international organisations, together with some observer members, including the International Organization of Securities Commissions (IOSCO).

The IASC Board shares the SEC's concept of high quality accounting standards as standards that enable the efficient working of capital markets, achieving efficiency of resource allocation, through the provision of transparent financial information relevant to the needs of investors and creditors. IASC has adopted a "Framework" for financial reporting that is similar to the Concepts Statements of the US Financial Accounting Standards Board (FASB) in its broad principles and, in particular, in its view that the objective of financial reporting is to help investors and others to assess future cash flows. IASC has shown its commitment to high quality accounting by:

(1) agreeing with IOSCO, in July 1995, a work programme to complete a core set of international accounting standards, involving the improvement of a number of existing standards and the development of several new standards, including standards

on subjects on which no national standard setter had a comprehensive standard at the time;

(2) agreeing, in March 1996, to accelerate the agreed work programme by holding more and longer Board meetings. Board Members agreed to give significant extra time to IASC, meeting four times in 1997 and five times (for a total of 25 days) in 1998, compared to the usual number of three times a year, with the objective of completing the core set of standards in 1998 and completing the major projects in the set in December 1998;

(3) establishing a Standing Interpretations Committee to produce authoritative interpretations of IAS;

(4) opening Board meetings to public observation; and

(5) establishing a Strategy Working Party to review IASC's structure and operations with the aim of meeting the highest modern standards of structure and process and approving the new structure recommended by that Working Party.

The issue of acceptance of International Accounting Standards in the United States has global importance. The G7 finance ministers and central bank governors, in a communiqué in October 1998, drew attention to the importance of accounting in order to promote global financial stability: volatility of investment flows is a cause of instability and poor quality accounting contributes to that volatility because, lacking confidence in accounting, investors seem to over-react to both good and bad news. The G7 urged IASC to complete work on the core standards and urged IOSCO to complete a review of those standards in a timely manner. The ministers said that they would endeavour to secure compliance with those standards in the private sectors of their economies. They thereby implicitly recognised that use of IAS would represent a significant improvement in the quality of accounting in many countries. This is of importance to the United States partly because the United States is a large part of the global economy and at risk of being affected by global instability. And further acceptance of IAS for use in cross-border listings in the United States would be an encouragement to their use in other countries. Furthermore, US citizens undertake large direct investments in foreign undertakings that are beyond the jurisdiction of the SEC. Use of IAS in such undertakings would improve the quality of information available to those US investors.

More generally, the accelerating globalisation of the capital markets is increasing the potential benefits from global accounting harmonisation. The efficiency gains, cost savings and other benefits, from being able to use one system of accounting throughout multinational companies, are likely to amount to billions of dollars each year, before taking account of reductions in the cost of capital. Efficiency gains for investors and other users seem likely to have a similar scale. The benefits for the global allocation of resources through encouraging frictionless international trade are likely to be very large. It is widely believed that adoption of global standards is inevitable. However, the longer adoption is delayed, the less the benefit, because available efficiency gains are lost and the eventual transition costs will be greater. It is futile to wait for development of an ideal system – no present system, including US GAAP, is ideal and delay will cause greater losses than gains. The aim should be to encourage global accounting standards by making a significant step towards IAS and thereby creating a base for further positive developments.

As noted in the Concept Release, the goal of the core standards project has been to develop a high quality set of generally accepted international accounting standards that ultimately would reduce or eliminate the need for reconciliation to national accounting standards. We believe that this goal needs to be pursued as a matter of urgency. We have been encouraged by the resolution of the Presidents Committee of IOSCO, announced on 17 May, recommending that IOSCO members permit incoming international issuers to use the core standards (the 30 IASC 2000 standards) to prepare their financial statements for cross-border offerings and listings and we note the provision for supplementation by reconciliation of "certain items", disclosure and interpretation. While we put forward below our view that IAS are now fit for use without reconciliation, limiting reconciliation to certain items, where it can be shown that investors have a need for additional information, would be a major step forward.

Answers to Questions

We offer the following comments on questions given in the Concept Release. Where a question is calling for information more in the field of experience of another type of organisation, we sometimes omit the question and sometimes offer comments on some aspects of the question while omitting others.

Q1. We believe that the core standards do represent a sufficiently comprehensive accounting framework: the contents of the core standards were agreed between IOSCO and IASC in 1995, after significant study by both organisations, without any dissent on either side. Nothing has happened since 1995 to indicate that any modification of the content of the core set of standards is necessary. The standards produced have been more detailed than previous IAS, with choices kept to a minimum.

Q2. Where IASC does not have a standard covering major activities of a specialised industry, IAS 1, paragraphs 20 to 22 apply. This calls for application of the general principles given in other standards, application of the concepts in the IASC Framework and application of the pronouncements of other standard setting bodies, where they are not inconsistent with IASC concepts and other standards. We recognise that SEC may feel a particular need to call for additional disclosures in relation to specialised industries. We should like to emphasise that IASC is giving high priority to completing standards for important specialised industries, in particular insurance and extractive industries, and that we would hope to have these standards accepted for use in cross-border listings in the United States when they have been completed. Our standards on financial instruments deal with a large proportion of the matters that are important in banking and we also have a standard on bank disclosures. We would hope that our standards would be accepted for cross-border listings for banks and point out that our standards were supported in a recent report of the Basel Committee of bank supervisors to the G7 finance ministers and central bank governors.

Q4-7. We believe that IAS are high quality standards and suitable for acceptance for cross-border listings in the United States. One indicator of this, as noted above, is that IASC has adopted a conceptual framework – we call it simply "The Framework" – that is similar in its main approaches to the Concepts Statements issued by FASB in the United States; it has the same perspective as the FASB Statements in the view, which is pivotal, that the fundamental objective is to help users assess the amounts, timing and (un)certainty of future cash flows. Furthermore, IASC has eliminated most of the choices that used to exist in its standards. The fact that some remain is not an indicator of poor quality – some choices are to be found in US GAAP, for example in accounting for pension liabilities (the spreading of actuarial gains and losses) and in oil and gas accounting (full cost versus successful efforts). The choice may be immaterial to usefulness to investors and provision of choice may actually provide a possibility of useful extra information where it allows for some supplement to a basic requirement (for example updating the measurement of real property to fair value). The most important factor is that there should be a requirement to disclose the effect of the exercise of choice and, in particular, the difference from the basic requirement (for example, the difference between the depreciated cost of a property and its fair value).

The existence of differences between IAS and FASB standards does not in itself indicate differences in quality. Accounting standards are controversial, perhaps particularly because of the difficulty in knowing how to make the trade-off that is sometimes necessary between relevance and reliability of information and also because of the difficulty in establishing with confidence the predictive ability of different kinds of information. Independent experts within one country, such as the United States, will often disagree on accounting approaches. Members of the IOSCO Working Party Number 1 often express different opinions. SEC staff know from having attended IASC Board meetings that decisions are based on careful analysis of comments on published drafts and detailed consideration of comments from, among others, SEC and other IOSCO members; but different comments pull in different directions. IAS are the result of tough and thorough debate among experts from around the World and at least 24 out of 32 voting representatives (positive votes from at least 12 out of 16 voting members, each with two voting representatives: if the representatives disagree, the member abstains) must support a standard before it can be approved.

Section 2 of the Concept Release lists some standards that have been the subject of SEC staff concerns while indicating that the list is not exhaustive. In most of the cases listed, the IAS requires disclosure of the effect of adopting the treatment concerned in a manner that enables users to calculate the difference between IAS and US GAAP, thus providing transparency and a basis for comparison. For example, where the very limited possibility for a “true and fair override” is used, the results under the standard overridden must be disclosed; where property is re-valued, the depreciated historical cost number must be shown; and the amount of unrecognised pension obligations must be shown. Such disclosure requirements provide a protection against loss of information when IAS are used. The case of internally generated intangible assets represents an important example. Some of the costs of such intangibles produce value and are relevant to the prediction of future cash flows; accounting serves users poorly if it gives no information about such value. The IASC Board took the view that a strict rule, requiring capitalisation in certain circumstances, together with disclosures that would enable users to see the difference to results caused by such capitalisation, would provide more and better information to users than a blanket prohibition of capitalisation. The same is true of the amortisation period of goodwill. In comparing the requirements of IAS and US GAAP on impairment, one needs to keep in mind that under US GAAP, because the sum of undiscounted cash flows is used as a trigger, some assets may be carried at amounts considerably in excess of fair value for a considerable period of time.

With regard to the above comments on differences between IAS and US GAAP generally, and with particular regard to Q6 on possible competitive disadvantage from using US GAAP alongside IAS, we urge the SEC to take full account of the importance of transparent disclosures. If information is disclosed, it is taken into account efficiently in setting stock market prices. For example, if IAS leads to a different income number from US GAAP, but disclosures provide enough information to calculate the number that would have been reported under US GAAP, the share price will be at least as “appropriate” under IAS as under US GAAP: the business reporting under US GAAP would not have a different share price, and a different cost of capital, possibly suffering competitive disadvantage, unless IAS provided additional relevant information. We are not arguing that a liberal attitude towards income measurement is justifiable. But where a finely balanced choice has to be made between alternative accounting approaches, perhaps because the choice involves a trade-off between relevance and reliability, the total package of disclosure requirements should be considered in assessing the results. Within the range of issues covered by differences between IAS and US GAAP, concern would be justified only if the total package of information required under IAS has significant omissions relative to US GAAP. And, if there are any such omissions, disclosures provide a suitable remedy.

Q8-11. IASC has sometimes undertaken direct field testing to provide confidence about consistent application. More importantly, IAS rarely incorporate provisions that have not been used at the national level in some administration with high quality accounting and the experience gained is reflected in comments on IASC exposure drafts and in the contributions of Steering Committee and Board members. The experience in other administrations is a basis for confidence in the applicability with consistency of our standards.

Q14. We believe that the core standards should be assessed on their intrinsic merits and we note that the SEC statement of April 1996 did not call for a restructuring of IASC. Nevertheless, we recognise the importance of structure. The decision of IASC (subject to the pending final vote of members) to adopt a new structure that fully meets the highest standards of independence and process signals its determination to continue to seek the highest possible level of quality in its standards.

Q16. IASC wishes to see application of the highest standards of auditing to provide assurance that IAS are fully and fairly complied with. The recent initiative of the major international accounting firms, linked to the work of the International Forum on Accountancy Development (IFAD), for applying a worldwide system of quality control, offers the prospect that the goal of uniformly high standards of auditing is attainable. Additional initiatives planned by the International Federation of Accountants (IFAC) to establish effective oversight are equally encouraging. However, we recognise that the SEC cannot yet be confident about the standards of auditing in all countries in which reporters under IAS may be domiciled. We believe that it would be a tragically lost opportunity for the improvement of the allocation of capital worldwide if lack of confidence in auditing in certain countries were to be a reason for deferring acceptance of IAS. A lack of confidence in auditing is equally a reason for doubting the reliability of statements prepared by foreign companies under US GAAP and the basic statements which may be used under national GAAP. Where concern about auditing is the critical issue, we urge the SEC to consider some alternative solution, such as requiring a review of the financial statements by an international office or a US national office of a major audit firm.

Q17. We believe that great progress has been made recently by audit firms in developing expertise in the use of IAS. We have regular contact with individuals and offices in the major audit firms who specialise in the application of IAS. Numerous seminars and training courses are held around the world, nowadays, sponsored by the major international accounting firms, private organisations and others.

Q18. We recognise, and welcome, the fact that, if IAS are accepted in the United States, SEC staff would review financial statements prepared under IAS in the same way as statements prepared under US GAAP. Similarly, additional financial reporting requirements imposed by the SEC on domestic filers would apply to foreign filers. It would be regrettable if regulatory bodies in different countries were to review statements prepared under IAS and take different, conflicting positions. IASC stands ready to produce interpretations when requested to do so by regulatory bodies and others. We should also regard it as helpful if IOSCO could agree to establish a system for exchanging information about such matters with the objective of avoiding conflicting interpretations. We believe that Working Party No 1 of the Technical Committee of IOSCO could provide a suitable forum for such exchange of information and that the members might well respond positively to the proposal.

Q19. Accounts submitted to the SEC by foreign companies may be prepared under the national GAAP of many different countries or under IAS, in both cases with a reconciliation to US GAAP. In vetting the accounts to consider the need for enforcement action, SEC staff need to consider both the basic accounts and the reconciliation: they need expertise in national GAAP of many different countries, an almost impossible task. If more incentive were given to use IAS, the difficulty for SEC staff would be reduced.

Q23. We believe that IAS should now be accepted for use in cross-border listings in the United States, without reconciliation to results under US GAAP. IAS have been developed with strong user participation and we believe that the recognition and measurement requirements, together with the disclosure requirements, in IAS, meet the needs of the investor community as fully as US GAAP. The decisions made by the IASC Board, in carrying out the work program to complete the core set of standards, have been based fully on the IASC Framework, with its emphasis on the needs of investors and the importance of the relevance and reliability of information. Furthermore, reconciliation does not in itself provide useful information because the focus of the reconciliation is necessarily variable. For example, different US corporations, in similar positions, may report different income numbers because they select different options for dealing with actuarial gains and losses under standards for post-retirement employee benefits. The concept of reconciliation to such a variable number produces a confusing result. If IAS omit any information that is seen as important to investors – and we do not think they do – the appropriate remedy is to call for additional disclosures and not reconciliation. IAS already require extensive disclosures that are related to requirements for recognition and measurement. Disclosure requirements in FASB standards should not be substituted generally for IAS disclosure requirements because the FASB disclosures are not related to IAS recognition and measurement. However, as noted above, we accept that SEC disclosure requirements are in a different category, not being developed as an integral part of a standard, and could be added to reporting requirements under IAS.

Yours sincerely

Stig Enevoldsen	**Tom Jones**	**Sir Bryan Carsberg**
Chairman	**Chairman-elect**	**Secretary-General**