



U.S. Securities and Exchange Commission

Speech by SEC Staff: IFRS and U.S. Companies: A Look Ahead

by

John W. White

*Director, Division of Corporation Finance
U.S. Securities and Exchange Commission*

Financial Executives International
Global Financial Reporting Convergence Conference
New York, New York
June 5, 2008

Thank you very much Michael [Cangemi]. Good morning. What a great title for the program — "The World Is Moving to IFRS: Are You?" This is exactly the topic I want to focus on this morning: the acceptance of International Financial Reporting Standards, or IFRS, in the United States. Among all of the Commission's current initiatives, and there are many, I believe that this one has the potential to be the most far-reaching, affecting all U.S. capital markets participants:

- issuers, which report financial results;
- accountants, who audit those results;
- intermediaries, who play many roles; and
- especially, investors, who analyze and most importantly make investment decisions based on those results.

Before getting into the substance of my remarks, however, I need to remind you that as a matter of policy, the U.S. Securities and Exchange Commission disclaims responsibility for any private statements of any SEC employee. Accordingly, the views I express today are solely my own and do not necessarily reflect the views of the SEC or of any members of the staff other than myself.

Where We Are Today

So with that, let me start by setting the stage for what the Commission has done recently relating to IFRS. On the foreign issuer front, during 2007, the staff held a roundtable on the use of IFRS by foreign companies¹ and published a report that provided observations on the staff's reviews of IFRS

financial statements in the filings of over 100 foreign issuers.² More significantly, this past November, after issuing a proposing release in July,³ the Commission voted to eliminate the U.S. GAAP reconciliation requirement for foreign private issuers that file their financial statements with the SEC using IFRS as issued by the International Accounting Standards Board, or the IASB.⁴

As a result, since early this year, the U.S. GAAP reconciliation is no longer required in foreign issuer filings with the SEC when the issuer asserts, and the auditors agree, that the financial statements are in accordance with IFRS as issued by the IASB. Even though there was little fanfare, I cannot emphasize enough the significance and the historic nature of this action. Actually, we recognized the event in Corp Fin on January 28 when Novartis AG filed its Form 20-F without a U.S. GAAP reconciliation, becoming the first foreign issuer to do so. For as long as any of us can remember, foreign issuers and their advisers have argued against the necessity of the U.S. GAAP reconciliation. Well, with the development of the high quality and globally accepted accounting principles embodied in IFRS, as issued by the IASB, as well as other important progress in this area, the Commission was able to come to the conclusion that the reconciliation was no longer necessary when the financial statements are prepared in accordance with these standards.

But enough about foreign issuers. This is principally a domestic issuer audience, and the question of far greater importance, and of much more significance to this audience, is the use of IFRS by U.S. companies. Following on our proposal in July relating to foreign companies, in August the SEC published a concept release asking a series of questions on whether U.S. issuers should be allowed to choose, or should be required, to prepare financial statements under IFRS as issued by the IASB.⁵ We have received over 80 comments on that release,⁶ which were both thoughtful and thought-provoking. To receive further input on this important issue, the Commission held two roundtables in December,⁷ with the participation of over two dozen experts from varying constituencies on the topic of U.S. issuers using IFRS. The transcript and archived webcast are available on our website — these were very thought provoking sessions and I recommend taking a look at the materials. And earlier this year, Chairman Cox charged staff members in the Division of Corporation Finance and the Office of the Chief Accountant with developing a roadmap for the Commission's consideration. It is likely that this roadmap would formally propose a schedule and appropriate milestones for continuing the progress that the U.S. is making to more fully accept IFRS in this country, not just from foreign companies but also from U.S. companies.

Among all those comment letters we've received, I am pleased to report that we have received input on the Concept Release from two groups within FEI: there are separate comment letters from the Committee on Finance & Information Technology and from the Committee on Corporate Reporting. While CFIT addressed the technology implications of the release, CCR focused on many of the broader questions, and was supportive of giving U.S. issuers

the option to publish financial statements in accordance with IFRS.

Policy Questions

In any discussion relating to IFRS, there are many worthwhile areas to delve into. Many of you are accountants. I am just a lawyer, so I am not going to risk venturing into a discussion of the substantive requirements of any of the accounting standards under IFRS, or even compare them with U.S. GAAP. There are many practitioners and others who are much more qualified than I am to address this topic. One could spend quite a bit of time on areas such as the accounting for liabilities and equity, revenue recognition, or even consolidation, discussing the principles underlying the standards and how the standards are being applied in practice.

I will limit myself this morning to the policy level implications of the possible use of IFRS by U.S. companies. And I think there are a number of policy issues that need to be the subject of public discussion and input. Among the more interesting questions are:

- Should U.S. companies be permitted to prepare their financial statements using IFRS for purposes of their SEC filings?
- Should U.S. companies be required to prepare their financial statements using IFRS?
- And for both of those questions:
 - Should only some subset of U.S. companies be permitted, or required, to use IFRS, or should any movement to IFRS be available or required of all companies?
 - And, if it is desirable to have only a subset go first, then how should that subset be defined?
 - What kind of timeframe and what kind of transition procedures should be involved for either permissive or universal use of IFRS for U.S. companies?
- And, let us not overlook, what is the SEC's role in answering these questions?

More generally, I think it is also a fair question to ask: why is the Commission even considering allowing, much less requiring, U.S. companies to use IFRS? U.S. companies and the U.S. market have been using U.S. GAAP for decades, and although some may complain about one aspect or another of U.S. GAAP, on the whole, U.S. GAAP has served the U.S. capital markets extremely well, giving investors transparent and comparable financial information over a wide range of issuers and industries, on which they can base their investment decisions. If the financial reporting scandals of the early part of this decade taught us anything, it is that investor confidence is essential to the functioning of a liquid capital market, and that the cornerstone of investor confidence is a sound financial reporting infrastructure, which includes a process through which high quality

accounting standards are applied by public companies in their preparation of their financial reports. And so some may ask: why should we even be thinking about these standards coming out of London, from this group called the IASB? That group in its current formation has been in existence for only about seven years. In contrast, U.S. GAAP, and what is known as the "accounting literature," have been building up for decades, becoming refined and improved over the course of time.

There is no single rationale for why the Commission should be looking at IFRS for U.S. companies. But I think it would be a disservice to U.S. issuers and investors, and the American market as a whole, if the SEC were not looking at IFRS for U.S. companies. Clearly, the use of IFRS has become a global movement. After the European Union adopted IFRS as its financial reporting standard in 2002, country after country has followed suit, and now there are over 100 countries that require or permit the use of IFRS in their markets. Many of the countries that have moved or are moving to IFRS, such as Australia, Canada and Israel, as well as the EU, have strong capital markets and strong support for the notion of providing investors with full and fair information. And so it is incumbent upon us at the SEC to look at this phenomenon called IFRS, and to examine it closely, and to assess whether it truly is the future of global financial reporting. It would not be appropriate for the U.S. capital markets, and the SEC as its regulator, to simply follow the herd. The herd may be running off a cliff. But the herd may also be running to better, greener pastures. The SEC can learn a great deal from observing what happens in other markets around the world as well as what happens in the U.S., and using those observations to make informed judgments as to whether certain changes taking place outside the U.S. might be suitable for the U.S. markets. I think this lies at the core of the SEC's current considerations on IFRS.

It is worthwhile to step back a bit and put the development of IFRS into a much broader context. For years the capital markets community has talked about the desire to have a single set of high-quality, globally accepted accounting standards. One can look back to Commission statements from over 20 years ago in which this goal is embraced. Uniform global standards would provide significant benefits to all stakeholders in the global capital markets, including those in the U.S. capital markets, ranging from increased comparability to reduced regulatory and compliance costs. Assessing a company's financial results should not depend on what country a company is from. Also, financial reporting today is no longer just about the bottom-line numbers on an income statement. Financial reporting in 2008 has a large informational or disclosure component, which is likely to continue to increase over time, as the audited financial statements become an ever increasing source of information that allows investors to evaluate the quality of a company's earnings.

It has long been maintained that the hodgepodge of national accounting systems around the world has worked to the detriment of investors and issuers, brought on by the inefficiencies and uncertainties of dealing with dissimilar accounting principles. Perhaps because for so long the idea of a single set of accounting standards seemed only like a far off dream, many do

not appreciate the progress we have made toward realizing that dream. Or maybe it is because we in the U.S. always thought that U.S. GAAP would become the single global standard. I have noted before that it is an "inconvenient truth" that the world is not looking to U.S. GAAP as the global standard. We need to wake up from that part of the dream.

Staff Experience and Review

This audience is already well aware of these developments — the membership of the FEI has a very international mindset, and you have been following IAS and now IFRS for years. But to many in the U.S. market, the concept of a single set of high quality globally accepted accounting standards is a new idea, or at least an idea that seemed so far-fetched, it was not worth learning about. I first want to assure you that the SEC is not in this category. The SEC's staff, through IOSCO and otherwise, has been involved with the development and use of IAS and IFRS for over 20 years. We have been, and continue to be, an active participant relating to IFRS. Foreign companies have been using IAS or IFRS in their filings with us for two decades, and we have gained, and will continue to gain, a deeper experience and understanding in the application of IFRS.

All of you know that our staff routinely reviews U.S. GAAP financial statements and gives comments to issuers when we have questions on the application of U.S. GAAP. We have been doing the same thing with IFRS, and in 2006 and 2007, the staff undertook targeted reviews of first-time adopters of IFRS. The SEC's review program of periodic reports of registered companies is a key component to how the Commission seeks to protect investors, by helping assure that companies provide investors with full and fair disclosure and that their financial statements appropriately apply relevant accounting principles. Prior to the enactment of the Sarbanes-Oxley Act in 2002, the SEC staff's aspirational goal was to review the filings of registered companies every three years. Congress transformed this goal into law in Section 408 of Sarbanes-Oxley, and the Corporation Finance staff has met its obligations under that section of Sarbanes-Oxley in each rolling three-year period since the passage of SOX.

The Corp Fin review program is fairly unique — until recently only a very few other countries had ongoing non-enforcement based reviews of corporate filings. Corp Fin reviews are not focused on assessing sanctions or penalties. We review company disclosure and financial information and make suggestions for improved disclosure or enhanced compliance with our requirements and the relevant accounting standards. We may ask a company to amend its filing or we may ask it to improve its disclosure or presentation in a future filing. Then we, and the company, generally move on.

We look at over 4,000 companies every year. In addition to the various parties that take a role in preparing a single periodic report, Corp Fin provides one more set of eyes — and an independent set at that — to review company disclosure for compliance not only with the specific line-item requirements under our rules or GAAP, but also with the broader accounting

and disclosure principles that those requirements are meant to embody and promote. A benefit Corp Fin brings to the table in reviewing disclosure and financial statement presentation is our significant experience in dealing with a large cross-section of companies and a broad range of difficult issues.

Our intention is to apply the same processes in the review of filings, whether they are from U.S. companies or foreign companies and whether they use U.S. GAAP or IFRS:

- When we have questions, we will ask them;
- If something is not clear, we will ask for clarification; and
- If something seems inconsistent with an accounting standard, we will ask company management to explain its thinking.

We will not be shy about asking the tough questions. And, if previously filed financial statements should be corrected because they contain material errors, we will ask that the company do so. This goes for any of the SEC's disclosure standards under Regulation S-X or S-K, any U.S. GAAP standard, as well as any standard under IFRS.

Two matters to note here: first, the staff is aware that IFRS is a less prescriptive set of accounting standards that permits company management more judgment in applying a particular standard. As the Corp Fin staff has reviewed the IFRS financial statements of foreign private issuers, the staff has been mindful not to carry over concepts or practices from U.S. GAAP. Issuers should do the same. If IFRS as issued by the IASB is to constitute a single set of globally accepted accounting standards, it is vitally important not to promote separate national versions of IFRS, including a U.S. version.

Second, many of the foreign companies that now file reports with the SEC using IFRS are also subject to oversight in their home country. This is particularly true for companies from the EU. In August 2006, the SEC and CESR (the Committee of European Securities Regulators) announced a work plan relating to IFRS under which we and they would share information about our respective experiences in dealing with questions under IFRS.⁸ Under the work plan, the SEC staff would contact the appropriate home country regulator if a significant question came up with respect to the application of IFRS in a particular situation. This workplan does not require that the two regulators agree on a single answer — it establishes a framework for communication among two regulators, both of which have an interest in a particular question.

This type of communication is extremely important in our globalized capital markets. With this kind of communication, the SEC staff can make its judgments fully informed with awareness not only of what a specific registrant and its auditors thought on a particular matter, but also what the home country regulator thought.

- Might there from time-to-time be problems and inconsistencies? Yes, but hopefully not too many.

- Will the process involve a learning curve? Yes, but hopefully not for too long.

Some commenters like to focus on the worst case scenario: What is a company to do if two regulators disagree? I believe these situations will be rare. Rather than focusing on doomsday scenarios, from our perspective on the SEC staff, we are seeing regulators focusing on building up lines of communication, which of course reduces the likelihood of those scenarios arising. The CESR work plan memorializes what the Corp Fin staff has done for years — we reach out to other regulators, when appropriate. As always, however, the Commission and its staff maintain the ability to make the judgments they think are most appropriate for the U.S. marketplace.

U.S. Readiness

So, with that brief detour about the review process, let me return to the roadmap. In developing the requested roadmap, and considering the possible movement of U.S. companies to IFRS, one key consideration will likely be the readiness of the U.S. market to use IFRS financial statements that would be published by U.S. companies. Now, to some extent, this might be part of the age-old chicken-and-egg problem. What has to happen first: is it appropriate for the Commission to wait until large swatches of the investment community and other U.S. market constituencies clearly have developed a full and deep understanding of IFRS before U.S. companies are permitted or required to publish IFRS financial statements? In that case, U.S. market participants would have little incentive to spend the time and expense in learning about IFRS unless they were certain that U.S. companies would soon be publishing IFRS financial statements. And from the issuers' point of view, they would be reluctant to undertake massive company-wide projects to change their accounting systems to accommodate IFRS unless they were certain that the change would be permanent and widely accepted. The same could prevail in academia.

This is an area in which I believe it may be appropriate for the regulator to lead. The SEC could wait until all appropriate conditions were clearly in place for a move of this sort. Sort of like the opposite of the perfect storm — the perfect calm, so that there is no question that the time for transition has come. But inevitably, there will always be some market, economic, social, or political development that seems to bring into question whether moving to IFRS is appropriate. I am not sure we will ever reach that time of a perfect calm. The SEC can play a significant role in advancing the adoption of IFRS by showing leadership, and conviction, in helping to determine whether the U.S. market is ready for IFRS. U.S. investors and issuers, and their advisers, are the most savvy in the world, and I have no doubt they would be able to adapt to the transition to IFRS. They adapt to new accounting standards, such as FAS 133, FIN 46(R) and FAS 157, on an ongoing basis. Look how quickly every financial analyst, not to mention financial journalist, has up picked up on the three categories under FAS 157. Talk about quick studies. I don't think IFRS is beyond their range.

To be sure, investor understanding would be a critical component to the Commission's consideration of moving U.S. companies to IFRS. But there is strong evidence that the U.S. investment community is already working with IFRS on a daily basis in assessing investment opportunities. As countries around the world have accepted or adopted IFRS, an increasing number of companies outside the U.S. are using IFRS for their financial reporting. As you no doubt know, cross-border investment flows have increased markedly in recent years. According to U.S. Treasury statistics, at the end of 2006, U.S. equity investments in European companies totaled about \$2.2 trillion,⁹ nearly double from \$1.1 trillion three years earlier at the end of 2003,¹⁰ which was just before European companies transitioned from national accounting standards to IFRS. Just for context — these numbers represent in significant part companies that are not registered with the SEC, and were not reconciling to U.S. GAAP.

Most of these European companies would now be publishing IFRS financial statements. This kind of investment activity from the United States evidences that there is not only a wide acceptance of IFRS in the U.S. market, but there is also widespread understanding of IFRS as well, because I do not believe you would see this kind of investment activity in companies from an IFRS jurisdiction if U.S. investors were uncertain of the basis for financial reporting and if U.S. investors were not familiar with the accounting principles supporting financial reporting.

It is important that U.S. accounting professionals, as well as U.S. investors, academics, financial analysts, journalists, and others, have a good solid understanding of the standards under IFRS and an appreciation of how they differ from U.S. GAAP, both in terms of differences that will appear on the face of an income statement and balance sheet, as well as what will appear in the notes to the financial statements. There is an education component in the movement to IFRS, and I am glad to see that the private sector is taking the lead here. Within accounting firms and corporate issuers, and outside among the financial community at large, through programs, publications and other means, the private sector is playing an important role in getting the U.S. marketplace ready for IFRS. I think the principal role of the SEC in this area is to show leadership through encouragement and clear direction about the use of IFRS by U.S. companies.

Setting International Financial Reporting Standards

The widespread international acceptance of IFRS has raised interest in establishing a more formal oversight regime with the goal of promoting the accountability of the IASB and the IASC Foundation to those governmental authorities that are responsible for protecting investors and regulating capital markets. Last November the Commission joined other capital markets regulatory authorities to work together in this area.¹¹ Chairman Cox emphasized the importance of this initiative in his speech to IOSCO last week.¹²

In addition, in the coming months as the IASB continues its work, including

with regard to addressing possible gaps in IFRS, I look forward to the possibility that we in the U.S. will have some involvement in the standard setting process itself. And this is just one of the reasons that it is important for U.S. companies to be able to use IFRS, and maybe even be required to use IFRS. The thought here being that, in order for the U.S. to fully input in the standard setting process for IFRS, a portion of U.S. companies should be using IFRS. To the extent appropriate, our resources can be applied as IFRS are written and be persuasive or supportive of one position or another. But U.S. views and experience would likely be more persuasive if U.S. companies were using IFRS.

Transition

Assuming the Commission finds that it is appropriate for U.S. companies to start using IFRS, a key question, which I previewed earlier, is how such a transformation should be implemented? We are wrestling with this as we work on the staff's recommendations to the Commission concerning a proposed roadmap and this will be a key consideration for the Commission.

- Should all U.S. companies simply be mandated to start using IFRS in their SEC filings as of a certain date?
- Should there first be a period in which U.S. companies have the option to use IFRS in their financial statements, and if so, how long should such a period be?
- If there were such a period of optional use, would U.S. companies feel inclined to change to IFRS unless it were clear that mandated use of IFRS was in the foreseeable future?

These are important questions that should be part of the public debate about any U.S. transition to IFRS.

One observation that I came away with from the roundtables we had in December was panelists' lack of enthusiasm for a period of optional use without a date certain as to mandatory use of IFRS. In the view of these panelists, if IFRS is to be adopted in the U.S., it should be done in a manner that provides certainty to issuers and other market participants as to the path to be followed. It is perhaps worth noting that, as one looks around the world, most major capital markets that have moved to IFRS have done so on an all-at-once, mandatory basis for almost all domestic public companies in that market. Would this course work for us? Perhaps it could. On the other hand, though I of course do not know what the ultimate outcome will be, I certainly can see the value of a transition, or voluntary, period in a change of this potential magnitude.

Usually when you come to a program with someone from the SEC as a speaker, you expect to get a lot of answers, because we at the SEC are the market's regulator and we are often called upon to be the final authority on any number of often technical matters. But this has been a speech with many questions, because we are not talking about technical matters. We are talking about a matter of paramount importance to the U.S. markets: What

will financial reporting look like in the U.S. for years to come? It is a matter that should be thoroughly discussed and debated and then policy makers should move ahead, fully informed on perhaps disparate opinions, but also fully committed to one path or another. I think our time is well-spent with various parts of the issuer, auditor, financial, and investor community discussing the movement to IFRS in the U.S. I look forward to participating in those discussions and being an engaged listener and questioner myself.

So in closing, I'll just leave you with this — I truly believe that the endpoint will be U.S. issuers using IFRS and that it is time to move in this direction. The SEC can provide leadership by planning now for how that result might be brought about, which in turn could provide U.S. issuers with greater clarity in this area.

Thank you for your time and attention.

Endnotes

¹See Press Release 2007-19, "SEC Staff Roundtable on International Financial Reporting Standards 'Roadmap' Set for March 6," February 13, 2007, available at <http://www.sec.gov/news/press/2007/2007-19.htm>. See *also* SEC Spotlight on: International Financial Reporting Standards "Roadmap," available at <http://www.sec.gov/spotlight/ifrsroadmap.htm> for archived webcasts, unofficial roundtable transcripts, and other materials; and "Seeing Down the Road: IFRS and the U. S. Capital Markets," John W. White, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission, March 23, 2007, available at <http://www.sec.gov/news/speech/2007/spch032307jww.htm>.

²"Staff Observations in the Review of IFRS Financial Statements," July 2, 2007, available at http://www.sec.gov/divisions/corpfin/ifrs_staffobservations.htm. See *also* "Staff Comments on Annual Reports Containing Financial Statements Prepared for the First Time on the Basis of International Financial Reporting Standards," available at http://www.sec.gov/divisions/corpfin/ifrs_reviews.htm.

³SEC Release No. 33-8818, "Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards Without Reconciliation to U.S. GAAP," July 2, 2007, available at <http://www.sec.gov/rules/proposed/2007/33-8818.pdf>.

⁴SEC Release No. 33-8879, "Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP," December 21, 2007, available at <http://www.sec.gov/rules/final/2007/33-8879.pdf>.

⁵SEC Release No. 33-8831, "Concept Release On Allowing U.S. Issuers To Prepare Financial Statements In Accordance With International Financial Reporting Standards (Corrected)," August 7, 2007, available at <http://www.sec.gov/news/press/2007/2007-33-8831.htm>.

[gov/rules/concept/2007/33-8831.pdf](http://www.sec.gov/rules/concept/2007/33-8831.pdf).

⁶See File No. S7-20-07, available at <http://www.sec.gov/comments/s7-20-07/s72007.shtml>.

⁷See SEC Press Release 2007-235, "SEC Takes Action to Improve Consistency of Disclosure to U.S. Investors in Foreign Companies," November 15, 2007, available at <http://www.sec.gov/news/press/2007/2007-235.htm>. See also SEC Spotlight On: International Financial Reporting Standards "Roadmap," for the archived webcast, unofficial roundtable transcript, and other materials, available at <http://www.sec.gov/spotlight/ifrsroadmap.htm>.

⁸See SEC Press Release No. 2006-130, "SEC and CESR Launch Work Plan Focused on Financial Reporting," August 2, 2006, available at <http://www.sec.gov/news/press/2006/2006-130.htm>.

⁹*Report on U.S. Portfolio Holdings of Foreign Securities as of December 31, 2006*, Department of the Treasury, Federal Reserve Bank of New York, Board of Governors of the Federal Reserve System, November 2007, available at <http://www.ustreas.gov/tic/shc2006r.pdf>.

¹⁰*Report on U.S. Portfolio Holdings of Foreign Securities as of December 31, 2003*, Department of the Treasury, Federal Reserve Bank of New York, Board of Governors of the Federal Reserve System, March 2005, available at <http://www.ustreas.gov/tic/shc2003r.pdf>.

¹¹See SEC Press Release No. 2007-226, "Authorities Responsible for Capital Market Regulation Work to Enhance the Governance of the IASC Foundation," November 7, 2007, available at <http://www.sec.gov/news/press/2007/2007-226.htm>.

¹²See "International Financial Reporting Standards: The Promise of Transparency and Comparability for the Benefit of Investors Around the Globe," Christopher Cox, Chairman, U.S. Securities and Exchange Commission, May 28, 2008, available at <http://www.sec.gov/news/speech/2008/spch052808cc.htm>.

<http://www.sec.gov/news/speech/2008/spch060508jww.htm>