

MEMO# 21506

August 23, 2007

SEC Issues Concept Release Seeking Comment on Allowing U.S. Issuers to Prepare Financial Statements Under IFRS

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TO: ACCOUNTING/TREASURERS COMMITTEE No. 18-07
INTERNATIONAL COMMITTEE No. 24-07 RE: SEC ISSUES CONCEPT RELEASE SEEKING
COMMENT ON ALLOWING U.S. ISSUERS TO PREPARE FINANCIAL STATEMENTS UNDER IFRS

The Securities and Exchange Commission has issued a concept release requesting comment on allowing U.S. issuers, including investment companies, to prepare their financial statements in accordance with International Financial Reporting Standards ("IFRS") as published by the International Accounting Standards Board ("IASB"). [\[1\]](#) U.S. issuers currently prepare their financial statements in accordance with generally accepted accounting principles ("GAAP"). The SEC's Concept Release seeks input on providing U.S. issuers with the option to prepare their financial statements in accordance with IFRS rather than GAAP.

Comments on the Concept Release are due to the SEC on November 13th. The Institute will hold a conference call on Monday, September 17th at 10:00 a.m. Eastern time to discuss the Concept Release. If you plan to participate in the call, please let Agnes Thomas know via email (agnes@ici.org) no later than September 15th. The dial-in number for the call is 800-857-9600 and the passcode is 18857.

Background

According to the Concept Release, the SEC has long advocated reducing disparity between the accounting and disclosure practices of the U.S. and other countries as a means to facilitate cross-border capital formation while providing adequate disclosure for the protection of investors and the promotion of fair, orderly and efficient markets. In 1997 the Commission encouraged the development of a core set of accounting standards that could

serve as a framework for financial reporting in cross-border offerings. In 2000 the SEC issued a concept release seeking input on convergence to a high quality global financial reporting framework. The 2000 concept release sought comments as to the conditions under which the SEC should accept financial statements of foreign private issuers that are prepared using IFRS. In 2002 the SEC supported the announcement by the Financial Accounting Standards Board and the IASB of their intent to converge U.S. and international accounting standards.

Almost 100 countries now either require or allow the use of IFRS for the preparation of financial statements by listed companies. According to the Concept Release, the movement towards IFRS has begun to affect U.S. issuers. For instance, certain U.S. issuers may compete for capital globally in industry sectors in which a critical mass of non-U.S. companies report under IFRS. Also, U.S. issuers with subsidiaries located in jurisdictions that have moved to IFRS may prepare those subsidiaries' financial statements in IFRS for purposes of local regulatory or statutory filings. In light of these trends, the Concept Release seeks input on the nature and extent of the public's interest in giving U.S. issuers the option to file with the Commission financial statements prepared in accordance with IFRS.

Application of IFRS to Investment Companies

IFRS are principles-based accounting standards. They typically do not provide industry specific standards or guidance. As a result, investment company financial statements prepared under IFRS are generally similar to those issued by an operating company. In contrast, GAAP provides certain industry specific standards for investment companies that recognize their unique aspects. These industry specific standards are summarized in the AICPA Audit and Accounting Guide – Investment Companies.

There are a number of significant differences between investment company financial statements prepared under IFRS and those prepared under GAAP. These differences include, for example:

- IFRS requires a statement of cash flows;
- IFRS treats open-end fund shares as liabilities (rather than equity) with distributions paid characterized as financing costs in the income statement; [\[2\]](#)
- IFRS requires the use of the bid price for long positions (ask price for short positions) when valuing securities for financial reporting;
- IFRS requires two years' balance sheets, income statements and cash flows;
- IFRS requires brokerage commissions paid on portfolio transactions to be expensed in the income statement;
- IFRS requires consolidation of majority-owned entities, which could affect master-feeder structures;
- IFRS does not require a schedule of investments;
- IFRS does not require a financial highlights table; and
- IFRS does not require separate reporting of realized and unrealized gains/losses in the income statement.

PricewaterhouseCoopers has prepared a more comprehensive analysis of the differences between IFRS and GAAP as applied to investment companies. [\[3\]](#) While this analysis relates to unregistered investment companies, it does illustrate the significant differences between IFRS and GAAP.

If the SEC were to permit investment companies to prepare their financial statements under IFRS, we believe it is highly likely that they would continue to require compliance with certain Regulation S-X requirements (e.g., a schedule of investments) and Form N-1A requirements (e.g., the financial highlights).

The Concept Release asks a series of questions relating to the effects of allowing U.S. issuers to prepare their financial statements under IFRS on the capital markets, investors, and issuers. The most significant questions for investment companies as issuers of financial statements are summarized below.

Possible Use of IFRS by U.S. Issuers

If the SEC were to accept financial statements prepared in accordance with IFRS from U.S. issuers, then investors and market participants would have to be able to understand and work with both IFRS and GAAP when comparing among U.S. issuers because not all U.S. issuers are likely to elect to prepare IFRS financial statements.

1. Do investors, U.S. issuers, and market participants believe the Commission should allow U.S. issuers to prepare financial statements in accordance with IFRS?
2. What would be the effects on the U.S. public capital market of some issuers reporting in accordance with IFRS and others in accordance with GAAP?
3. Would investors who have the resources to learn two sets of accounting standards (IFRS and GAAP) realize comparative advantages as compared to those who do not?
4. Are there issues unique to whether investment companies should be given the choice of preparing financial statements in accordance with IFRS? What would the consequences be to investors and other market participants of providing investment companies with that choice?

Convergence of IFRS and GAAP

In October 2002 the IASB and the FASB formalized their commitment to the convergence of U.S. and international accounting standards. At that time the two bodies agreed to the development of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting and to the coordination of their future work programs to ensure that, once achieved, compatibility is maintained.

5. What are investors', issuers' and other market participants' opinions on the effectiveness of the processes of the IASB and the FASB for convergence? Are investors satisfied with the convergence progress to date, and the robustness of the ongoing process for convergence?

Integration with the Commission's Existing Requirements

The Concept Release notes that investment companies have unique disclosure requirements. For example, Regulation S-X contains specific disclosure requirements relating to investments in affiliates, securities sold short, open option contracts written and

investments other than securities. Also, Regulation S-X permits investment companies to include a Statement of Net Assets in lieu of the balance sheet under certain circumstances. Further, the non-financial statement portion of the shareholder report may require disclosures that are based on financial statement information (e.g., the expense example and the graphical representation of holdings). According to the Concept Release, if investment companies were to prepare IFRS financial statements, these issues would need to be addressed.

6. If the SEC were to consider rulemaking to allow U.S. issuers to prepare IFRS financial statements, are there operational issues relative to existing Commission requirements on which additional guidance would be necessary? Would it be appropriate to have differing applicability for U.S. issuers of the form and content provisions of Regulation S-X depending on whether they use IFRS in preparing financial statements? Are there operational or other issues unique to investment companies?

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endnotes

[1] See SEC Release Nos. 33-8831, 34-56217, and IC-27924 (August 7, 2007). A copy of the Concept Release is available on the SEC's website at:
<http://www.sec.gov/rules/concept/2007/33-8831.pdf>.

[2] In 2006 the IASB issued proposed amendments to IAS 32 that would treat open-end fund shares as equity under certain circumstances. See [Memorandum](#) to Accounting/Treasurers Members No. 21-06, International Members No. 28-06 [20506] dated October 23, 2006.

[3] For a more comprehensive discussion of the differences between IFRS and GAAP see A Comparison of International Financial Reporting Standards and US GAAP for Investment Funds by PricewaterhouseCoopers,
[http://www.pwc.com/extweb/pwcpublications.nsf/docid/7FD21F10E3D4300B8525730400674531/\\$File/0607IFRScomparisons.pdf](http://www.pwc.com/extweb/pwcpublications.nsf/docid/7FD21F10E3D4300B8525730400674531/$File/0607IFRScomparisons.pdf). For illustrative financial statements see Illustrative Financial Statements 2006 – Investment Funds,
<http://www.pwc.com/gx/eng/about/svcs/corporatereporting/IFSFunds2006.pdf> by PricewaterhouseCoopers.