

FINANCIAL ACCOUNTING FOUNDATION

401 Merritt 7, P.O. Box 5116, Norwalk, Connecticut 06856-5116 | 203-956-5307 / Fax: 203-956-5310



JOHN J. BRENNAN
Chairman

November 15, 2011

Ms. Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: SEC Staff Paper, *Exploring a Possible Method of Incorporation* (File No. 4-600)

Dear Ms. Murphy:

This letter responds to the request for comment by the staff of the U.S. Securities and Exchange Commission (SEC) on its paper: *Exploring a Possible Method of Incorporation*, issued May 26, 2011 (Staff Paper), under the SEC's *Work Plan for the Consideration of Incorporating International Financial Reporting Standards* (IFRS) into the Financial Reporting System for U.S. Issuers.

The Financial Accounting Foundation (FAF), organized in 1972, is the independent, private-sector organization with responsibility for the oversight, administration, and finances of the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB). Through its standard-setting Boards, the organization establishes and improves financial accounting and reporting standards, fostering financial reporting that provides decision-useful information to investors and other users of financial reports.

IFRS Incorporation—The Path Forward for the U.S.

The FAF Board of Trustees (Trustees) has refined its views on the appropriate path forward for financial accounting and reporting standard setting for the U.S. capital markets. The Trustees support the incorporation of IFRS into U.S. GAAP as the appropriate path forward for the continued development of high-quality, investor-focused, international financial reporting standards. Consistent with this support, the Trustees are recommending a number of modifications to the IFRS incorporation approach (colloquially referred to as Condorsement) set forth in the Staff Paper. The Trustees' recommended approach (described in more detail below) is based on the premise that, over time, international standards will become the foundation of U.S. GAAP.

The Trustees' views reflect: (1) the valuable and substantial progress made in recent years on converging IFRS and U.S. GAAP; (2) the level of adoption/incorporation of IFRS in other countries; (3) the SEC Work Plan, including the Staff Paper; (4) discussions with stakeholders and review of comment letters filed with the SEC; and (5) ongoing discussions with the SEC.

SEC Staff Condorsement Approach

The Trustees understand that the key objectives of the SEC staff's Condorsement approach are: (1) advancing progress toward a single set of global accounting standards based on IFRS over an extended timeframe; (2) ensuring continuing key roles for the SEC and the U.S. standard setter (presumed by the SEC staff, and by the FAF for purposes of this comment letter, to be the FASB) in the ongoing

development of international standards; and (3) maintaining U.S. GAAP and providing flexibility with respect to the authority for U.S. standard setting in order to address the uncertainty of the future progress of global standards.

The SEC staff's Condorsement approach sets forth several sound fundamental concepts for U.S. incorporation of IFRS. In our view, further refinements can improve upon that model and address many of the concerns raised by U.S. stakeholders. We have summarized below what we believe are the major fundamental concepts of Condorsement, as well as certain aspects of the Condorsement approach that we believe would benefit from further refinement:

Fundamental Incorporation Concepts:

- (a) Demonstrates U.S. commitment to continued development of global accounting standards.
- (b) Retains U.S. GAAP as the statutory basis for U.S. financial reporting, thereby mitigating the costs and complexity of introducing a new set of standards under U.S. laws, regulatory regimes, and contractual documents under which compliance with U.S. GAAP is often specifically required.
- (c) Retains U.S. sovereignty over standards applicable in the U.S. capital markets. The Condorsement approach provides for a U.S. endorsement mechanism for incorporation of IFRS.
- (d) Recognizes that, even as progress is being made toward a global financial reporting system, jurisdictional and cultural differences are likely to continue. As a result, a practical interim goal may be to achieve highly comparable, high-quality accounting standards that are based on a common set of financial reporting standards.
- (e) Provides for a gradual transition of U.S. GAAP to a common platform of international standards based on IFRS.

Areas for Refinement: U.S. stakeholders have raised several important concerns about the Condorsement approach that we believe should be addressed. These concerns are that the Condorsement approach:

- (a) Diminishes the SEC's ability to continue to ensure investor protection in the U.S. capital markets as standard setting for U.S. GAAP moves to an international body. Under Condorsement, the SEC moves from being the sole regulator with direct influence over U.S. standard setting, to one of several international regulators with indirect and shared influence over international standard setting.
- (b) Transfers significant authority to an international governance structure early on. Current adoption/incorporation of IFRS around the globe, as well as the current financial reporting regimes among many of the world's national economies, is still evolving. There remains limited agreement around the world as to the purposes of financial reporting standards and limited global consistency in the application, auditing, and enforcement of IFRS financial reporting. Transferring primary authority for U.S. standards to an international body at this stage may expose the U.S. capital markets to risks that can be mitigated through a more incremental approach to the transitioning of U.S. standard-setting authority.

- (c) Reduces the role and influence of the U.S. standard setter, which could affect the quality of financial reporting standards in the U.S. and elsewhere. The U.S. capital markets have uniquely benefitted from a well-established financial reporting regime, with a strong and proactive investor-protection-focused regulator, a long history of independently developed and investor-focused accounting standards, and a vigilant audit compliance regime. IFRS development will continue to endure pressures to meet the needs of various markets that are not yet as robustly developed as the U.S. and other major capital markets. The reduced role of the U.S. standard setter, as set forth in the Staff Paper, may weaken the positive leverage that U.S. GAAP and U.S. standard setting have provided to improving accounting standards for investors in the world's most robust and transparent capital markets.

The FAF's Recommended Approach to Incorporation

The Trustees are recommending an IFRS incorporation approach that embraces the concepts of the SEC staff's Condorsement framework while addressing concerns raised by various U.S. stakeholders. The recommended approach is premised on the belief that although the pursuit of a single set of global accounting standards is a worthy objective, a more practical goal for the foreseeable future is to achieve highly comparable (but not necessarily identical) financial reporting standards among the most developed capital markets that are *based on* a common set of international standards.

U.S. Incorporation Commitment. The recommended approach is a model for incorporating into U.S. GAAP independently developed and investor-focused international standards that improve financial reporting in the U.S. or that maintain the quality of financial reporting under U.S. GAAP but also advance global comparability of standards. Under this recommended approach, the U.S. would retain sovereign authority over financial reporting and standard setting for U.S. capital markets, with influential roles for the SEC and FASB that recognize the benefit of the global harmonization of financial reporting standards based on the common platform of IFRS. The FASB and the International Accounting Standards Board (IASB) would continue to work together to complete the projects under joint development on their memorandum of understanding (MoU). The FASB would refrain from separately engaging in standard setting on new technical projects added to the IASB's agenda. The U.S. would look to the IASB to set those new standards with active involvement by the FASB. In addition, the FASB would develop a process to address substantial differences that remain between U.S. GAAP and IFRS. The Trustees view this approach as a significant but measured change in the way the FASB participates in the global accounting standard-setting process. Each of these elements is discussed in more detail below.

Instrumental in ensuring that IFRS meet the information needs of U.S. investors is ensuring active U.S. involvement in and support of the standard-setting activities of the IASB. The recommended approach also envisions a robust set of criteria for the FASB's evaluation of the appropriateness of an IFRS standard for the U.S. capital markets:

Active U.S. Involvement in and Support of International Standard Setting. Active U.S. involvement would be a multifaceted program and would likely include the following:

- Members of the FASB (as well as other major market national standard setters) having nonvoting observer rights on the IASB, with rights to participate in the IASB's deliberations.
- Regularly scheduled meetings between the FASB and the IASB to discuss, review, and provide input on the IASB's technical agenda and technical projects, including due process, investor and other stakeholder outreach, and deliberations.

- The FASB conducting (in cooperation with the IASB) the due process, stakeholder outreach, and post-implementation review in the U.S. with respect to all IASB agenda items and standards. Mechanisms would need to be established for the IASB's participation in such due process in the U.S. and for the FASB to provide regular feedback to the IASB on its due process and outreach activities. National standard setters of other major capital markets that possess the requisite infrastructure, technical capabilities, and resources, might, in consultation with the IASB, similarly assume responsibility for conducting the due process, stakeholder outreach, and post-implementation review of IASB agenda items in their local jurisdictions.

Evaluation Criteria. Under the recommended approach, the FASB would seek broad agreement on the appropriate criteria for its good faith evaluation of international standards and the IASB's standard-setting process in determining whether to incorporate an international standard into U.S. GAAP. A new major international standard should be incorporated into U.S. GAAP if that standard improves the quality of financial reporting already in place in the U.S. This notion of improvement has been a guiding principle of the FASB's standard-setting activities. Other international standards would be incorporated that maintain the quality of financial reporting in the U.S. but that also advance global comparability of financial reporting. Below are elements of potential evaluation criteria consistent with those that have guided the standard-setting activities of the FASB throughout its history that may suggest a standard improves, or at a minimum, maintains, the quality of financial reporting:

- ***Investor Primacy*** — The primary purpose of external financial reporting is to provide decision-useful information to investors and other providers of capital. Therefore, when evaluating a standard for incorporation, consideration must be given to whether the standard meets the primary objective of financial reporting (i.e., it is designed to meet the information needs of investors and other providers of capital in the most robust and transparent capital markets, rather than to serve prudential or other public policy interests).
- ***Independent Standard Setting*** — The integrity of U.S. GAAP is dependent upon standards being set by an independent body that demonstrates objectivity and independence in its decision making. Consideration should be given to whether the standard being evaluated for incorporation was significantly altered or quality substantially reduced by political pressures surrounding the standard's development.
- ***Robust and Participatory Due Process*** — Robust, thorough, and transparent due process that engages active stakeholder participation is more likely to result in high-quality, generally accepted standards. In evaluating a standard for incorporation into U.S. GAAP, consideration should be given to the thoroughness of due process afforded the standard, including the scope of the research and the various reporting models considered, the robustness of stakeholder (i.e., investors, other capital providers, preparers, and auditors) outreach and participation, and the openness and rigor of the deliberative processes.
- ***Benefits Exceed Costs*** — Critical to evaluating whether to issue a new standard is determining that the expected benefit of effecting the proposed changes are cost beneficial and will enhance the body of standards already in place. Consideration should be given to whether the changes to U.S. GAAP resulting from incorporation of a proposed standard will be cost beneficial for the U.S financial reporting system.

- *Clarity and Adequacy of Guidance* — A principal goal of financial reporting standards is consistent and comparable financial reporting. Accordingly, a critical consideration in the evaluation of a proposed standard for incorporation into U.S. GAAP is assessing whether the standard, as issued, provides sufficient clarity and guidance such that it is capable of being consistently and uniformly applied.

Standard-Setting Role of the FASB Post-MoU and Related Projects. Under the recommended incorporation approach, following the completion of the MoU projects under joint development by the IASB and the FASB (and related projects such as Insurance), the FASB would agree (subject to its active involvement in the IASB's activities described above) to refrain from separately engaging in standard setting for projects on the IASB's technical agenda. In this regard, the U.S. would look to the IASB to set those standards with active involvement by the FASB. Following completion of the MoU and related projects, the FASB would also embark on a process of reviewing with investors and other stakeholders the remaining substantial differences between U.S. GAAP and IFRS. When substantial differences are identified and it is reasonably believed that the international standard is an improvement to U.S. GAAP or would advance global comparability and maintain the quality of financial reporting under U.S. GAAP, the FASB would conduct thorough due process on that international standard for potential incorporation into U.S. GAAP.

Authority of the U.S. Standard Setter. Subject to its commitment to incorporate into U.S. GAAP international standards that meet the incorporation criteria, the FASB would retain its independent standard-setting authority, including the authority to set its own technical agenda for projects of considerable importance to the U.S. capital markets that are not active projects on the IASB's technical agenda and to provide implementation guidance if international guidance is not timely or does not provide the detail needed for appropriate investor protection in the U.S.

Expanded Role of National Standard Setters. Currently, other national standard setters from major capital markets around the world are seeking more active and influential roles with the IASB. Although the proposed approach does not specify a model for enhancing the role of all national standard setters in international standard setting, the development of such a model should be encouraged.

U.S. Funding for International Standard Setting. The Trustees envision that if the U.S. were to decide to incorporate IFRS into U.S. GAAP, the U.S. should establish an appropriate means of funding an appropriate share of the IASB's annual operating budget. Although IASB funding is outside the authority and purview of the FAF, the FAF would lend its support to efforts to develop a suitable funding mechanism for an appropriate U.S. share of the IASB's annual operating expenses.

Periodic Review of U.S. Standard-Setting Functions. The recommended incorporation approach contemplates that movement toward a single set of global accounting standards is an evolutionary process that realistically will take years before global standards achieve their ultimate state of uniformity and comparability across jurisdictions. Periodically, the FAF, the SEC, and the FASB should continue to revisit the role of the U.S. standard setter to determine whether international standards and the application, enforcement, and audit practices around those standards have achieved the level of consistency globally that would merit further changes in the role of the U.S. standard setter. One approach would be to conduct an initial review five years after a U.S. decision to move to an incorporation approach.

Ms. Elizabeth M. Murphy
November 14, 2011
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Conclusion

The Trustees fully support an incorporation approach that advances improvements to U.S. GAAP and furthers the comparability and consistency of high-quality, investor-focused financial reporting standards throughout the globe. The incorporation approach recommended in this letter offers a defined and practical course forward toward fulfilling those objectives.

The recommended approach complements the SEC's primary responsibility of facilitating investor protection in the U.S. capital markets and reinforces the U.S. standard setter's mission of setting standards that provide necessary financial information to investors in the U.S. capital markets. Importantly, we believe that the approach recommended in this comment letter achieves the objectives of the Condorsement framework and represents an appropriately measured step forward in the ongoing U.S. commitment to the development of global standards.

The Trustees appreciate the opportunity to share our views and would be pleased to discuss them further if that would be helpful to the Commission.

Sincerely,

A handwritten signature in black ink, appearing to be 'J. Brennan', with a long horizontal line extending to the right.

John J. Brennan
Chairman
Financial Accounting Foundation