Council of Institutional Investors
The Voice of Corporate Governance

Via Email

October 18, 2010

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. 4-607—Notice of Solicitation of Public Comment on Consideration of Incorporating IFRS into the Financial Reporting System for U.S. Issuers ("Notice")[1]

Dear Ms. Murphy:

I am writing on behalf of the Council of Institutional Investors ("Council"), a nonprofit association of public, union and corporate pension funds with combined assets that exceed three trillion dollars. Member funds are major shareowners with a duty to protect the retirement assets of millions of American workers.[2]

The Council appreciates the opportunity to provide its views on the above referenced Notice. The Council staff is continuing to reach out to its members in an effort to educate and solicit feedback on issues relating to the United States ("U.S.") Securities and Exchange Commission's ("Commission") ongoing consideration of incorporating International Financial Reporting Standards ("IFRS") into the financial reporting system for U.S. issuers.[3] The Council's interest in those issues is, at least in part, a result of our membership-approved policy entitled "Independence of Accounting and Auditing Standard Setters" ("Policy").[4]

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[1] Notice of Solicitation of Public Comment on Consideration of Incorporating IFRS into the Financial Reporting System for U.S. Issuers, Securities Act Release No. 9,133, Exchange Act Release No. 62,699, at 1-8 (Aug. 12, 2010), http://www.sec.gov/rules/other/2010/33-9133.pdf [hereinafter Notice].
[2] For more information about the Council of Institutional Investors ("Council") and its members, please visit the Council's website at http://www.cii.org/about.
[3] *See, e.g.*, Council, International Convergence, http://www.cii.org/resourcesKeyGovernanceIssuesInternationalConvergence.
[4] Council, Statement on Independence of Accounting and Auditing Standards Setters 1-2 (Adopted Oct. 7, 2008), http://www.cii.org/UserFiles/file/Statement%20on%20Independence%20of%20Accounting%20and%20Auditing%20Standard%20Setters.pdf [Hereinafter Policy].

The Policy generally supports the Financial Accounting Standards Board ("FASB") and the Financial Accounting Foundation ("FAF") working cooperatively with the International Accounting Standards Board ("IASB") and the IFRS Foundation "toward a common goal of convergence to a single set of high quality standards designed to produce comparable, reliable, timely, transparent and understandable financial information that will meet the needs of institutional investors and other consumers of audited financial reports."[5] Importantly, however, the Policy does not support replacing U.S. Generally Accepted Accounting Principles ("GAAP") with IFRS or replacing the U.S. standard setting structure, including the FASB and the FAF, with the IASB and the IFRS Foundation, respectively, unless and until seven criteria or milestones have been addressed and resolved to the satisfaction of investors.[6]

The Council has commissioned a white paper that would, at least in part, attempt to identify and summarize information that might be relevant to evaluating whether progress has been made in addressing and resolving the Council's seven criteria or milestones. When completed, we plan to provide the white paper and other relevant information we may have collected from our members to the Commission for your consideration. In the meantime, we would like to reiterate, consistent with the Policy, our current views on the following two areas of inquiry raised in the Notice:

- **To what extent and in what ways would any of the current differences between U.S. GAAP and IFRS affect an investor's use of information reported in the financial statements? How would completion of the convergence projects being jointly undertaken by the FASB and the IASB affect an investor's use of those financial statements?**[7]

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[5] *Id*. at 1.
[6] *Id.; cf.* Donna L. Street, International Convergence of Accounting Standards: What Investors Need to Know 16 (Oct. 2007), http://www.cii.org/UserFiles/file/resource%20center/publications/CII%20White%20Paper%20-%20International%20Convergence%20October%202007.pdf (Noting surveys of financial statement preparers and users generally agreeing that U.S. control over accounting standard setting for U.S. listings should be retained).
[7] Notice, *supra* note 1, at 4.

We note that the Policy includes the criterion that "[i]n the aggregate, the information that results from the application of international accounting standards is, at a minimum, of the same quality as the information resulting from U.S. accounting . . . standards . . . ."[8] We continue to have some concerns that there may be "fundamental deficiencies" in IFRS that, if not corrected prior to replacing U.S. GAAP with IFRS, could lower the overall quality of information available to investors and consequently affect, at least for some period of time,[9] investors use of the information reported in the financial statements.[10]

As we noted in our April 20, 2009, letter to the Commission, four specific areas of concern that the standard setters themselves have identified are revenue recognition, fair value measurement, consolidation policy and derecognition ("April Letter").[11] More recently, some investor/accounting experts have identified four additional areas of equal or higher priority: financial instruments; statement of comprehensive income; financial statement presentation; and insurance.[12]

Each of the above eight areas are addressed by standard setting projects currently listed on the IASB's work plan.[13] It, however, remains unclear whether the results of those projects will resolve the financial accounting and reporting deficiencies that have been identified in those eight areas.

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[8] Policy, *supra* note 4, at 1.

[9] We acknowledge that over time institutional investors may be able to identify adjustments that allow them to compensate for the potential loss of information.

[10] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors to Florence E. Harmon, Acting Secretary, Securities and Exchange Commission 4 (Attachment Apr. 20, 2009), http://www.cii.org/UserFiles/file/resource%20center/correspondence/2009/Attachment%20to%20Letter%20on%20Proposed%20Roadmap%20(final).pdf.

[11] *Id.*

[12] *See* Letter from Michael Moran, Member, Investors Technical Advisory Committee to Mr. Robert H. Herz, Chairman, Financial Accounting Standards Board 2 (May 24, 2010), http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176156905681.

[13] Work Plan for IFRSs 1-4 (last visited Oct. 18, 2010), http://www.ifrs.org/Current+Projects/IASB+Projects/IASB+Work+Plan.htm.

For example, existing IFRS derecognition standards have been described by the standard setters as "internally inconsistent and . . . inconsistently applied in practice."[14] In October 2010 the IASB issued new standards to improve the disclosures surrounding transferred financial assets.[15] The IASB, however, does not appear to have any current plans to repair the remaining flaws in the derecognition standards that impact the information reported on the face of the financial statements.[16]

In addition, in the area of financial instruments, the IASB issued a standard on classification and measurement in November 2009. That standard appears to be moving the existing measurement approach further away from measuring all financial instruments at fair value.[17] Thus, the IASB standard, in contrast to the related FASB proposal, appears to be directionally inconsistent with a prior conclusion of the Commission staff that measuring all financial instruments at fair value "would appear to have benefits in terms of reduced complexity, more understandability, and less motivation to structure transactions to meet accounting goals."[18] Perhaps more importantly, the IASB standard appears to be directionally inconsistent with the view of some investor/accounting experts,[19] and many others,[20] that have long favored a single fair value model for the measurement and reporting of all financial instruments.

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[14] Information for Observers to FASB/IASB Meeting ¶ 34 (Apr. 21, 2008), http://www.iasplus.com/resource/0804j03obs.pdf.

[15] Work Plan for IFRSs at 3.

[16] *See id.* at 1-3; IASB Toughens Standards for Securitizations, WebCPA 2 (Oct. 7, 2010), http://www.webcpa.com/news/IASB-Toughens-Securitization-Standards-55909-1.html (Commenting that "in response to the feedback received, the IASB decided to retain the existing derecognition requirements").

[17] *See, e.g.,* Bill Kenealy, FASB Might Budge on Fair Value, Insurance Networking News 1 (Oct. 7, 2010), http://www.insurancenetworking.com/vwc/insurance_accounting_standards_board_fair_value-26038-1.html (Noting the IASB's preference for valuing many financial instruments at amortized cost).

[18] Staff of the U.S. Securities and Exchange Commission, Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 On Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers 111 (June 15, 2005), http://www.sec.gov/news/studies/soxoffbalancerpt.pdf [Hereinafter SEC Report].

[19] *See, e.g.*, Letter from Jack Ciesielski, Member, Investors Technical Advisory Committee to Mr. Robert Herz, Chairman, Financial Accounting Standards Board 2 (Sept. 30, 2010), http://www.fasb.org/cs/ContentServer?site=FASB&c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176157551463 ("The ITAC has long favored a single model for the measurement and reporting of financial instruments"); *cf.* Stephen G. Ryan, Fair Value Accounting: Issues Raised by the Financial Crisis 16-18 (July 2008), http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/CII%20Fair%20Value%20Paper%20(final)%20%20071108.pdf (Providing a summary list of compelling reasons why fair value accounting for all financial instruments benefits investors).

[20] *See, e.g.,* SEC Report, *supra* note 18, at 111 ("[M]any believe that fair value is simply the most relevant measure for financial instruments").

Similarly, in the area of accounting for insurance, the current IASB proposal contains “significant differences between the approach” of the FASB.[21] Those differences raise doubts about whether the accounting in this area can be appropriately resolved in 2011 as listed on the IASB’s current work plan.[22] Finally, we note that looking at the totality of IASB/FASB projects that are scheduled to be finalized in 2011, some investor/accounting experts believe that the compressed timing for completing such an unprecedented number of significant standards is “unrealistic” and will likely “serve to produce standards that would reduce the quality and transparency of financial reporting . . . .”[23]

- **Are there ways to improve the representation and communication of investors’ perspectives in connection with accounting standard setting?**[24]

  Our Policy includes the following two criteria that focus directly on improving the representation and communication of investors’ perspectives in the accounting standard setting process:

  - The international standard setter has demonstrated a clear recognition that investors are the key customer of audited financial reports and, therefore, the primary role of audited financial reports should be to satisfy in a timely manner investors’ information needs. This includes having significant, prominent and adequately balanced representation from qualified investors on the standard setter’s staff, standard-setting board, oversight board and outside monitoring or advisory groups;
  - The international standard setter has a thorough public due process that includes solicitation of investor input on proposals and careful consideration of investor views before issuing proposals or final standards; . . . .[25]

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[21] Key points divide FASB and IASB, InsuranceERM 1 (Sept. 28, 2010), http://www.insuranceerm.com/news-comment/key-points-divide-fasb-and-iasb.html.
[22] Work Plan for IFRSs at 2.
[23] Letter from Michael Moran at 1.
[24] Notice, *supra* note 1, at 7.
[25] Policy, *supra* note 4, at 2.

As we indicated in our April Letter, and consistent with the Policy, "the most direct and effective means" of improving the representation and communication of investors' perspectives in connection with accounting standard setting is for the standard setting board to have significant representation from qualified individuals from the investor community.[26]

We acknowledge that since the issuance of our April Letter the IASB board has increased the number of board members from the investor community from one to three.[27] Three of fifteen board members, however, is simply insufficient to ensure that investor views are "given pre-eminence" in the accounting standard setting process.[28]

More specifically, we note that even if all three IASB board members from the investor community were to strongly agree that a project should or should not be added to the IASB's agenda; that a proposed standard should or should not be issued for public comment; or that a final standard should or should not be issued to the public; their view would not prevail without obtaining the support of at least five additional board members.[29] Obtaining such support is highly unlikely, particularly when the vast majority of input to the process, including input from government officials,[30] is generated largely from the preparer community whose views on financial accounting and reporting issues all to frequently are in conflict with the needs and demands of investors—the primary consumers of financial reports.[31]

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[26] Letter from Jeff Mahoney at 9.
[27] IFRS, Members of the IASB (last visited Oct. 18, 2010), http://www.ifrs.org/The+organisation/Members+of+the+IASB/Members+of+the+IASB.htm.
[28] Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission 57 (Aug. 1, 2008), http://www.sec.gov/about/offices/oca/acifr/acifr-finalreport.pdf (Recommending that "investor perspectives should be given pre-eminence . . . in standard-setting") [Hereinafter Advisory Committee].
[29] IFRS, Standard-Setting Process (last visited Oct. 18, 2010), http://www.ifrs.org/How+we+develop+standards/Setting+the+agenda.htm ("The IASB's approval to add agenda items, as well as its decisions on their priority, is by a simple majority vote at an IASB meeting").
[30] *See e.g.,* Adam Jones, IASB Head Knows All About Cross-Channel Frictions, FT.Com (Sept. 30, 2010), http://www.ft.com/cms/s/0/5c80262c-cc19-11df-bd28-00144feab49a.html (Noting that Frances' new national accounting standards body—the ANC—-will likely lobby to oppose improvements to the accounting for leases on behalf of preparer "PPR, the retailer and luxury goods group").
[31] *See, e.g.,* Advisory Committee, *supra* note 28, at 58 (Noting that "investor perspectives are often under-represented" in the standard setting process). As an aside, we note that the Advisory Committee explicitly encouraged the Financial Accounting Foundation ("FAF") to "increase the representation of investors as future Board positions become available." *Id.* at 59. We understand that the FAF has recently increased the size of the FASB board from five to seven members and is in the process of filling two open board seats.

We appreciate the opportunity to comment on the Notice. If you have any questions or need any additional information, please feel free to contact me at 202.261.7081 or jeff@cii.org.

Sincerely,

Jeff Mahoney
General Counsel