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Statement of the Shadow Financial Regulatory Committee

On

International Accounting Standards

The European Union (EU) has mandated that EU companies issuing publicly traded securities in the EU must state their accounts under International Financial Reporting Standards (IFRS or IAS) by June 2005, and non-EU companies must do so by 2006. Many U.S. companies currently issue securities in the EU under U.S. Generally Accepted Accounting Principles (U.S. GAAP). Whether this will continue to be the case after 2006 is in some doubt.

U.S. and other non-EU companies will only be able to use U.S. GAAP in issuing securities in the EU if the EU Commission determines that U.S. and other local GAAP are equivalent to IFRS. The Commission has asked the Committee of European Securities Regulators (CESR) to assess the equivalence of U.S. GAAP to IFRS by June 2005, less than 10 months from now. If U.S. companies were forced to state their accounts abroad in accordance with IFRS, they would incur significant additional costs to issue their securities in Europe, impeding their ability to raise capital. There is substantial concern that the EU Commission may not find U.S. GAAP equivalent to IFRS.

One important reason for the concern arises from the fact that the SEC does not allow European companies issuing securities on U.S. public markets to state their accounts in accordance with IFRS. Instead, the SEC requires such issuers to use U.S. GAAP or to reconcile accounts issued under IFRS to U.S. GAAP. The major reason the SEC has refused to allow foreign companies to state their accounts in accordance with IFRS is that the SEC asserts that U.S. GAAP is a better accounting standard, but it has been unwilling to put this belief to a market test. EU investors have found IFRS acceptable; U.S. investors are likely to be similarly satisfied.

As a practical matter, it will be difficult for the EU to open its borders to U.S. GAAP when the U.S. is closing its borders to IFRS. Further, it may be difficult for the EU to say U.S. GAAP is equivalent to IFRS when the SEC insists that there are important differences that might misinform investors.

A real impasse is looming. While the EU-U.S. informal regulatory Dialogue has had this issue before it for some time, the Dialogue has until now failed to achieve a resolution. The failure to deal with this impasse will not only mean, as stated above, that U.S. companies issuing securities in the EU will face increased costs and a true transatlantic securities market will not develop, but more fundamentally, this failure may heighten political tensions across the Atlantic at a particularly inopportune time.

The Shadow Financial Regulatory Committee (SFRC) believes the EU should allow U.S. companies to issue securities in the EU under U.S. GAAP and that the SEC should permit foreign companies to issue securities in the United States under IFRS. Both should do so as soon as possible and be willing to cooperate to achieve this end. The rules of the game should be clear well before the end of 2006.

The SEC should drop its insistence on U.S. GAAP because: (1) There is no evidence that U.S. GAAP is a better accounting standard than IFRS; (2) IFRS and U.S. GAAP are not that far apart, and the Financial Accounting Standards Board (FASB)- IASB Convergence Project has reduced and will continue to reduce the differences; (3) maintaining the requirement for U.S. GAAP in the U.S. does not necessarily increase investor protection, since U.S. investors wishing to buy European securities not sold in the U.S. will be forced to buy these securities abroad, in less regulated markets; and (4) U.S. public trading venues will lose important sources of revenue because European issues will be traded only abroad; and (5) IFRS are by definition international, not just European, administered by an organization, the International Accounting Standards Board (IASB), that the U.S. took a significant role in creating and in which the U.S. fully participates.

The SFRC is aware that there is a substantial disagreement in the EU over the extent to which the fair value accounting rules for financial assets and liabilities embodied in IAS 39, dealing with hedge accounting, should be applied to European banks. It is indeed possible that the EU may exempt European banks from some portion of IAS 39. This prospect does not affect our recommendation. The portion of IAS 39 under dispute, while important, is a very small portion of the overall IFRS, and that portion affects only banks. The fact that IAS 39, as adopted in the EU, may deviate from IAS as recommended by IASB, is not a good reason for the SEC to reject IFRS in its entirety.

Indeed, the Committee recommends that, if the SEC were to determine, based on a detailed inquiry, that IFRS in general, or IFRS as implemented in the EU, were deficient in some material respect, the SEC should permit foreign issuers to use "IFRS Plus." IFRS Plus would be IFRS as supplemented by critical provisions of U.S. GAAP that the SEC believes are essential. We note that the Commission has followed a similar approach by permitting Canadian companies, under the Multijurisdictional Discloure Statement, to use Canadian financial disclosure rules in selling securities on the U.S. public market. Where the SEC found Canadian disclosure rules lacking in some material respect (e.g. their failure to require segment reporting as under U.S. rules), it required Canadian companies to use U.S. mandated segment reporting rules in addition to the disclosures required under Canadian law.

The Committee urges the SEC, and if necessary the U.S. Congress, to address this issue now before a financial reporting war breaks out between the United States and the European Union.