Operators shall submit their requests through an FAA Principal Maintenance Inspector, who may concur or comment and then send it to the Manager, Regulations Group.

Note 2: Information concerning the existence of approved alternative methods of compliance with this AD, if any, may be obtained from the Regulations Group.

(d) Special flight permits may be issued in accordance with §§ 21.197 and 21.199 of the Federal Aviation Regulations (14 CFR 21.197 and 21.199) to operate the helicopter to a location where the requirements of this AD can be accomplished.

Note 3: The subject of this AD is addressed in Direction Generale De L'Aviation Civile (France) AD 98–510–055(A) for the Model AS 355 helicopters and AD 98–511–074(A) for the Model AS 350 helicopters. Both DGAC AD's are dated December 16, 1998.

Issued in Fort Worth, Texas, on February 11, 2000.

Eric Bries,

Acting Manager, Rotorcraft Directorate, Aircraft Certification Service.

[FR Doc. 00–4264 Filed 2–22–00; 8:45 am]

BILLING CODE 4910–13–U

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 71

[Airspace Docket No. 98–ANM–11]

RIN 2120–AA66

Proposed Alteration of Federal Airways; CO

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Proposed rule; withdrawal.

SUMMARY: This action withdraws the notice of proposed rulemaking (NPRM) published in the **Federal Register** on October 5, 1998. The FAA proposed to realign Federal airways in the State of Colorado. The FAA has determined that withdrawal of the proposed rule is warranted because the existing air traffic control (ATC) operational procedures are suitable.

DATES: The proposed rule is withdrawn on February 23, 2000.

FOR FURTHER INFORMATION CONTACT: Ken McElroy, Airspace and Rules Division, ATA–400, Office of Air Traffic Airspace Management, Federal Aviation Administration, 800 Independence Avenue, SW., Washington, DC 20591; telephone: (202) 267–8783.

SUPPLEMENTARY INFORMATION: On October 5, 1998, an NPRM was published in the **Federal Register** proposing to amend 14 CFR part 71 to modify Federal airways in Colorado (63 FR 53325). Interested parties were invited to participate in the rulemaking process by submitting written data, views, or arguments regarding the proposal. No comments were received on the proposal.

List of Subjects in 14 CFR part 71

Airspace, Incorporation by reference, Navigation (air).

The Withdrawal

In consideration of the foregoing, the Notice of Proposed Rulemaking, Airspace Docket No. 98–ANM–11, as published in the **Federal Register** on October 5, 1998 (63 FR 53325), is hereby withdrawn.

Authority: 49 U.S.C. 106(g), 40103, 40113, 40120; E.O. 10854; 24 FR 9565, 3 CFR, 1959–1963 Comp., p. 389.

Issued in Washington, DC, on February 16, 2000.

Reginald C. Matthews,

Manager, Airspace and Rules Division.

[FR Doc. 00–4225 Filed 2–22–00; 8:45 am]

BILLING CODE 4910–13–U

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 230 and 240

[Release Nos. 33–7801, 34–42430; International Series No. 1215; File No. S7–04–00]

[RIN: 3235–AH65]

International Accounting Standards

AGENCY: Securities and Exchange Commission.

ACTION: Concept release; request for comment.

SUMMARY: With the activities and interests of investors, lenders and companies becoming increasingly global, the Commission is increasing its involvement in a number of forums to develop a globally accepted, high quality financial reporting framework. Our efforts, at both a domestic and international level, consistently have been based on the view that the only way to achieve fair, liquid and efficient capital markets worldwide is by providing investors with information that is comparable, transparent and reliable. That is why we have pursued a dual objective of upholding the quality of financial reporting domestically, while encouraging convergence towards a high quality global financial reporting framework internationally. In this release, we are seeking comment on the necessary elements of such a framework, as well as on ways to achieve this objective. One aspect of this is seeking input to determine under what conditions we should accept financial statements of foreign private issuers that are prepared using the standards promulgated by the International Accounting Standards Committee.

DATES: Comments should be received on or before May 23, 2000.

ADDRESSES: Please send three copies of your comments to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549–0609. You also may submit your comments electronically at the following e-mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7–04–00; you should include this file number in the subject line if e-mail is used. Comment letters can be inspected and copied in our public reference room at 450 Fifth Street, N.W., Washington, D.C. 20549–0102. We will post electronically submitted comments on our Internet Web site at www.sec.gov.

FOR FURTHER INFORMATION CONTACT: Sandra Folsom Kinsey, Senior International Counsel, Division of Corporation Finance at (202) 942–2990, or D.J. Gannon, Professional Accounting Fellow, Office of the Chief Accountant at (202) 942 4400.

SUPPLEMENTARY INFORMATION:

I. Introduction and Purpose of This Release

Over the last two decades, the global financial landscape has undergone a significant transformation. These developments have been attributable, in part, to dramatic changes in the business and political climates, increasing global competition, the development of more market-based economies, and rapid technological improvements. At the same time, the world's financial centers have grown increasingly interconnected.

Corporations and borrowers look beyond their home country's borders for capital. An increasing number of foreign companies routinely raise or borrow capital in U.S. financial markets, and U.S. investors have shown great interest in investing in foreign enterprises. This globalization of the securities markets has challenged securities regulators around the world to adapt to meet the needs of market participants while maintaining the current high levels of investor protection and market integrity.

Our efforts to develop a global financial reporting framework have been

guided by the cornerstone principle underlying our system of regulation—pursuing our mandate of investor protection by promoting informed investment decisions through full and fair disclosure. Financial markets and investors, regardless of geographic location, depend on high quality information in order to function effectively. Markets allocate capital best and maintain the confidence of the providers of capital when the participants can make judgments about the merits of investments and comparable investments and have confidence in the reliability of the information provided.

Because of increasing cross-border capital flows, we and other securities regulators around the world have an interest in ensuring that high quality, comprehensive information is available to investors in all markets. We stated this view in 1988, when we issued a policy statement that noted that ''all securities regulators should work together diligently to create sound international regulatory frameworks that will enhance the vitality of capital markets.'' [1] We have applied this approach in a number of instances, including our recent adoption of the International Disclosure Standards developed by the International Organization of Securities Commissions (IOSCO) for non-financial statement information.[2] Our decision to adopt the International Disclosure Standards was based on our conclusion that the standards were of high quality and that their adoption would provide information comparable to the amount and quality of information that U.S. investors receive today.

Currently, issuers wishing to access capital markets in different jurisdictions must comply with the requirements of each jurisdiction, which differ in many respects. We recognize that different listing and reporting requirements may increase the costs of accessing multiple capital markets and create inefficiencies in cross-border capital flows. Therefore, we are working with other securities regulators around the world to reduce these differences. To encourage the development of accounting standards to be considered for use in cross-border filings, we have been working primarily through IOSCO, and focusing on the work of the International Accounting Standards Committee (IASC). Throughout this effort, we have been steadfast in advocating that capital markets operate most efficiently when investors have access to high quality financial information.

However, ensuring that high quality financial information is provided to capital markets does not depend solely on the body of accounting standards used. An effective financial reporting structure begins with a reporting company's management, which is responsible for implementing and properly applying generally accepted accounting standards. Auditors then have the responsibility to test and opine on whether the financial statements are fairly presented in accordance with those accounting standards. If these responsibilities are not met, accounting standards, regardless of their quality, may not be properly applied, resulting in a lack of transparent, comparable, consistent financial information.

Accordingly, while the accounting standards used must be high quality, they also must be supported by an infrastructure that ensures that the standards are rigorously interpreted and applied, and that issues and problematic practices are identified and resolved in a timely fashion. Elements of this infrastructure include:

- Effective, independent and high quality accounting and auditing standard setters;
- High quality auditing standards;
- Audit firms with effective quality controls worldwide;
- Profession-wide quality assurance; and
- Active regulatory oversight.

In this release, we discuss a number of issues related to the infrastructure for high quality financial reporting. We solicit views on the elements necessary for developing a high quality, global financial reporting framework for use in cross-border filings. We believe these issues should be considered in the development of any proposals to modify current requirements for enterprises that report using IASC standards because our decisions should be based on the way the standards actually are interpreted and applied in practice.

We recognize that each of the elements of the infrastructure may be at different stages of development and that decisions and progress on some of these infrastructure issues may be independent of the body of accounting standards used.

II. Elements of a High Quality Global Financial Reporting Structure

A. High Quality Accounting Standards

High quality accounting standards are critical to the development of a high quality global financial reporting structure. Different accounting traditions have developed around the world in response to varying needs of users for whom the financial information is prepared. In some countries, for example, accounting standards have been shaped primarily by the needs of private creditors, while in other countries the needs of tax authorities or central planners have been the predominant influence. In the United States, accounting standards have been developed to meet the needs of participants in the capital markets.

U.S. accounting standards provide a framework for reporting that seeks to deliver transparent, consistent, comparable, relevant and reliable financial information. Establishing and maintaining high quality accounting standards are critical to the U.S. approach to regulation of capital markets, which depends on providing high quality information to facilitate informed investment decisions.

High quality accounting standards consist of a comprehensive set of neutral principles that require consistent, comparable, relevant and reliable information that is useful for investors, lenders and creditors, and others who make capital allocation decisions. High quality accounting standards are essential to the efficient functioning of a market economy because decisions about the allocation of capital rely heavily on credible and understandable financial information.

When issuers prepare financial statements using more than one set of accounting standards, they may find it difficult to explain to investors the accuracy of both sets of financial statements if significantly different operating results, financial positions or cash flow classifications are reported under different standards for the same period. Questions about the credibility of an entity's financial reporting are likely where the differences highlight how one approach masks poor financial performance, lack of profitability, or deteriorating asset quality.

The efficiency of cross-border listings would be increased for issuers if preparation of multiple sets of financial information was not required. However, the efficiency of capital allocation by investors would be reduced without consistent, comparable, relevant and reliable information regarding the financial condition and operating performance of potential investments. Therefore, consistent with our investor protection mandate, we are trying to increase the efficiency of cross-border capital flows by seeking to have high

[1] Regulation of International Securities Markets, Securities Act Release No. 6807 (November 14, 1988) [53 FR 46963].

[2] International Disclosure Standards, Exchange Act Release No. 41936 (September 28, 1999) [64 FR 53900].

quality, reliable information provided to capital market participants.

B. High Quality Auditing Standards

The audit is an important element of the financial reporting structure because it subjects information in the financial statements to independent and objective scrutiny, increasing the reliability of those financial statements. Trustworthy and effective audits are essential to the efficient allocation of resources in a capital market environment, where investors are dependent on reliable information.

Quality audits begin with high quality auditing standards. Recent events in the United States have highlighted the importance of high quality auditing standards and, at the same time, have raised questions about the effectiveness of today's audits and the audit process.[3] We are concerned about whether the training, expertise and resources employed in today's audits are adequate.

Audit requirements may not be sufficiently developed in some countries to provide the level of enhanced reliability that investors in U.S. capital markets expect. Nonetheless, audit firms should have a responsibility to adhere to the highest quality auditing practices—on a world-wide basis—to ensure that they are performing effective audits of global companies participating in the international capital markets. To that end, we believe all member or affiliated firms performing audit work on a global audit client should follow the same body of high quality auditing practices even if adherence to these higher practices is not required by local laws.[4] Others have expressed similar concerns.[5]

C. Audit Firms With Effective Quality Controls

Accounting and auditing standards, while necessary, cannot by themselves ensure high quality financial reporting. Audit firms with effective quality controls are a critical piece of the financial reporting infrastructure. Independent auditors must earn and maintain the confidence of the investing public by strict adherence to high quality standards of professional conduct that assure the public that auditors are truly independent and perform their responsibilities with integrity and objectivity. As the U.S. Supreme Court has stated: ''It is not enough that financial statements be accurate; the public must also perceive them as being accurate. Public faith in the reliability of a corporation's financial statements depends upon the public perception of the outside auditor as an independent professional * * *''[6] In addition, audit firms must ensure that their personnel comply with all relevant professional standards.

The quality control policies and procedures applicable to a firm's accounting and auditing practice should include elements such as:[7]

- Independence, integrity and objectivity;
- Personnel management, including proper training and supervision;
- Acceptance and continuance of clients and engagements;
- Engagement performance; and
- Monitoring.

A firm's system of quality control should provide the firm and investors with reasonable assurance that the firm's partners and staff are complying with the applicable professional standards and the firm's standards of quality.

Historically, audit firms have developed internal quality control systems based on their domestic operations. However, as clients of audit firms have shifted their focus to global operations, audit firms have followed suit and now operate on a world-wide basis. Therefore, quality controls within audit firms that rely on separate national systems may not be effective in a global operating environment. We are concerned that audit firms may not have developed and maintained adequate internal quality control systems at a global level.[8]

D. Profession-Wide Quality Assurance

The accounting profession should have a system to ensure quality in the performance of auditing engagements by its members. Necessary elements of the system include:

- Providing continuing education and training on recent developments;
- Providing an effective monitoring system to ensure that:
  - —Firms comply with applicable professional standards;
  - —Firms have reasonable systems of quality control;
  - —There is an in-depth, substantive and timely study of firms' quality controls, including reviews of selected engagements;
  - —Deficiencies and/or opportunities for improvements in quality controls are identified; and
  - —Results of monitoring are communicated adequately to the appropriate parties.
- Providing an effective and timely disciplinary process when individuals or firms have not complied with applicable firm or professional standards.

In some jurisdictions the local accounting profession may have a system of quality assurance. However, structures focused on national organizations and geographic borders do not seem to be effective in an environment where firms are using a number of affiliates to audit enterprises in an increasingly integrated global environment.

E. Active Regulatory Oversight

The U.S. financial reporting structure has a number of separate but interdependent elements, including active regulatory oversight of many of these elements, such as registrants' financial reporting, private sector standard-setting processes and self-regulatory activities undertaken by the accounting profession. Each of these elements is essential to the success of a high quality financial reporting framework. This oversight reinforces the development of high quality accounting and auditing standards and focuses them on the needs of investors. It provides unbiased third party scrutiny of self-regulatory activities. Regulatory oversight also reinforces the application of accounting standards by registrants and their auditors in a rigorous and consistent manner and assists in ensuring a high quality audit function.

[3] We have asked the Public Oversight Board to study the effectiveness of audits. *See* ''The Numbers Game''—Remarks of Chairman Arthur Levitt at the N.Y.U. Center for Law and Business, New York, NY, September 28, 1998 and ''Remarks to the Panel on Audit Effectiveness of the Public Oversight Board'' by Chairman Arthur Levitt, New York, NY, October 7, 1999, both available on the SEC website at <www.sec.gov>.

[4] *See* ''Quality Information: The Lifedblood of Our Markets'' remarks of Chairman Arthur Levitt at the Economics Club of New York, New York, NY, October 18, 1999, available on the SEC web site at <www.sec.gov>.

[5] *See* ''World Bank Warns Big Give Over Global Audit Standards,'' *Financial Times*, October 19, 1998, page 1.

[6] *United States* v. *Arthur Young & Co.,* 465 U.S. 805, 819 (1984).

[7] *See* the discussion of the elements of quality control of an audit firm's practice in Statement of Quality Control standard section 20.07, published by the American Institute of Certified Public Accountants' (AICPA's) Auditing Standards Board.

[8] *See* for example, 34–40945, AAER–1098 (PricewaterhouseCoopers) and letters from the SEC Chief Accountant to the AICPA SEC Practice Section dated November 30, 1998, and December 9, 1999 regarding the need for global quality internal controls over independence matters, available on the SEC website at <www.sec.gov>. We have asked the Public Oversight Board to sponsor reviews at other accounting firms and to oversee development of enhnacements to quality controls and other professional standards to address this concern.

III. Background on Efforts To Reduce Barriers to Cross-Border Capital Flows

A. Foreign Private Issuers—The Current Requirements

The Securities Act of 1933 [9] and the Securities Exchange Act of 1934 [10] establish the disclosure requirements for public companies in the United States. The form and content requirements for financial statements filed with the Commission are set forth in Regulation S–X. [11] This framework establishes the initial and continuing disclosures that companies must make if they wish to offer securities in the United States or have their securities traded publicly on an exchange or quoted on the Nasdaq stock market. [12]

Our current financial statement requirements for foreign private issuers parallel those for U.S. domestic issuers, except that foreign private issuers may prepare financial statements in accordance with either U.S. generally accepted accounting principles (U.S. GAAP) or with another comprehensive body of accounting standards (including IASC standards). A foreign private issuer using accounting standards other than U.S. GAAP must provide an audited reconciliation to U.S. GAAP.[13]

There are some exceptions to this reconciliation requirement. For example, we have amended our requirements for financial statements of foreign private issuers to permit use of certain IASC standards without reconciliation to U.S. GAAP. [14] These are:

- Use of International Accounting Standard (IAS) 7, *Cash Flow Statements* (as amended in 1992) for the preparation of a statement of cash flows;
- Acceptance of portions of IAS 22, *Business Combinations* (as amended in 1993), regarding the method of accounting for a business combination and the determination of the amortization period for goodwill and negative goodwill; and
- Acceptance of portions of IAS 21, *The Effects of Changes in Foreign Exchange Rates* (as amended in 1993), regarding translation of amounts stated in a currency of an entity in a hyperinflationary economy.

By requiring a U.S. GAAP reconciliation, with the exceptions noted above, we do not seek to establish a higher or lower disclosure standard for foreign companies than for domestic companies. Rather, the objective of this approach is to protect the interests of U.S. investors by requiring that all companies accessing U.S. public markets provide high quality financial reporting that satisfies the informational needs of investors, without requiring use of U.S. standards in the presentation of that information.[15]

The U.S. GAAP reconciliation requirement requires foreign issuers to supplement their home country financial statements. The total number of foreign reporting companies increased from 434 in 1990 to approximately 1,200 currently.

B. Towards Convergence of Accounting Standards in a Global Environment

In the past, different views of the role of financial reporting made it difficult to encourage convergence of accounting standards. Now, however, there appears to be a growing international consensus that financial reporting should provide high quality financial information that is comparable, consistent and transparent, in order to serve the needs of investors. Over the last few years, we have witnessed an increasing convergence of accounting practices around the world. A number of factors have contributed to this convergence. First, large multinational corporations have begun to apply their home country standards, which may permit more than one approach to an accounting issue, in a manner consistent with other bodies of standards such as IASC standards or U.S. GAAP. Second, the IASC has been encouraged to develop standards that provide transparent reporting and can be applied in a consistent and comparable fashion worldwide. Finally, securities regulators and national accounting standard-setters are increasingly seeking approaches in their standard-setting processes that are consistent with those of other standard-setters.[16] Some national standard-setters are participating in multinational projects, such as those on accounting for business combinations, in order to draw on a broader range of comment about an issue.

If convergence of disclosure and accounting standards contributes to an increase in the number of foreign companies that publicly offer or list securities in the U.S. capital markets, investors in the United States would benefit from increased investment opportunities and U.S. exchanges would benefit from attracting a greater number of foreign listings. Although the U.S. markets have benefited greatly from the high quality financial reporting that U.S. GAAP requires, current disparities in accounting practices may be a reason foreign companies do not list their securities on U.S. exchanges. As Congress has recognized,

> [E]stablishment of a high quality comprehensive set of generally accepted international accounting standards would greatly facilitate international financing activities and, most importantly, would

[9] 15 U.S.C. 77a *et seq.* (Securities Act).

[10] 15 U.S.C. 78a *et seq.* (Exchange Act).

[11] 17 CFR 210.1–01 *et seq.*

[12] In addition to exchange and Nasdaq traded securities, which are required to be registered, the securities of many unregistered foreign issuers trade in the over-the-counter markets in the United States. Unregistered companies are not required to file periodic reports with the Commission or reconcile their financial statements to U.S. generally accepted accounting principles.

[13] Items 17(c) and 18(c) of Form 20–F permit a foreign private issuer to provide financial statements prepared in accordance with another comprehensive basis of accounting, provided that the issuer also provides a reconciliation of net income and balance sheet items to U.S. GAAP. Domestic issuers are required to file financial statements prepared in accordance with U.S. GAAP. Rule 4–01(a)(2) of Regulation S–X, 17 CFR 210.4–01(a)(2). All financial statements must be audited in accordance with U.S. generally accepted auditing standards (Rule 2–02(b) of Regulation S–X, 17 CFR 210.2–02(b)) by an auditor satisfying the U.S.. independence requirements (Rule 2–01 of Regulation S–X, 17 CFR 210.2–01.

We are not considering modifying the requirement that financial statements filed with the Commission be audited in accordance with U.S generally accepted auditing standards. We note, however, that IOSCO currently is exploring furtehr work on improving auditing requirments. Current auditing practices in the United States are under review by the Panel on Audit Effectiveness, sponsored by the AICPA Public Oversight Board. We also are not considering modifying the requirement that auditors comply with U.S. independence requirments.

[14] *See* Items 17 and 18 of Form 20–F for a description of the relief from reconciliatin provided to financial statements prepared using IASC standards or standards that are consistent with IASC standards. 17 CFR 249.220f.

[15] *See* Grace Pownall and Katherine Shipper, ''Implications of Accounting Research for the SEC's Consideration of International Accounting Standards for U.S. Securities Offerings'' in *Accounting Horizons*, September 1999. Among other things, this paper describes selected academic research that addresses the unsefulness to U.S. investors of non-U.S. GAAP reports and U.S. GAAP reconciliations. Pownall and Schipper point to research that suggest that higher net income often is reported under the current IASC standards than under U.S. GAAP. This paper also cites research that suggests that financial statements prepared using IASC standards are not seen as substitutes for U.S. GAAP performance measures by U.S. investors.

[16] *See*, for example, the ''FASB's Plan for International Activities,'' February 1997, that includes ''Continu[ing] to consider foreign national and IASC standards in FASB project[s]'' and ''Cooperat[ing] directly with other standard-setting organizations to resolve specific issues and to work toward reducing differences in accounting standards between nations.'' Additionally, the FASB has undertaken joint projects with other standard setters, for example, on segments and earnings per share. Also, standard setters from the United States, Canada, Australia, New Zealand and the United Kingdom have worked with the IASC through the ''G–4+1'' group to debate current agenda items and coordinate standard setting efforts.

enhance the ability of foreign corporations to access and list in the United States markets.[17]

These concerns are offset by significant benefits realized by companies reporting under U.S. GAAP, as a result of improvements in the quality of information available to both management and shareholders as a result of reporting under U.S. GAAP.[18] It is important that convergence does not sacrifice key elements of high quality financial reporting that U.S. investors enjoy currently. Investors benefit when they have the ability to compare the performance of similar companies regardless of where those companies are domiciled or the country or region in which they operate.

Over the years, we have realized that foreign companies make their decisions about whether to offer or list securities in the United States for a variety of economic, financial, political, cultural and other reasons. Many of these reasons are unrelated to U.S. regulatory requirements.[19] However, some foreign companies cite, among other reasons, a reluctance to adopt U.S. accounting practices as a reason for not listing in the United States. These companies have indicated that they have forgone listing in the United States rather than follow accounting standards that they have not helped formulate. Therefore, accepting financial statements prepared using IASC standards without requiring a reconciliation to U.S. GAAP could be an inducement to cross-border offerings and listings in the United States.

On the other hand, other factors could continue to deter foreign access to the U.S. markets. For example, some foreign companies have expressed concern with the litigation exposure and certain public disclosure requirements that may accompany entrance into the U.S. markets.[20] Foreign companies also may be subject to domestic pressure to maintain primary listings on home country stock exchanges.

[17] National Securities Market Improvements Act of 1996.

[18] *See* Louis Lowenstein, ''Financial Transparency and Corporate Governance: You Manage What You Measure,'' *Columbia Law Review,* Volume 98, No. 5 (June 1996).

''* * * Senior officers of Ciba Geigy Limited and The Holderbank Group report a long list of managerial gains from improved financial disclosure [footnote omitted]. Divisions now report on a consistent basis, there is a more rational allocation of costs, and expenses are no longer charged to surplus. In short, they have found it easier to manage the company * * *'' (p. 1357).

[19] James A. Fanto and Roberta S. Karmel, ''A Report on the Attitudes of Foreign Companies Regarding a U.S. Listing,'' *Stanford Journal of Law, Business and Finance,* Summer 1997, Vol 3 No. 1 pg. 51–83.

[20] *See* Fanto and Karmel, *id.*

C. Development of the Core Standards Project

After studying issues relating to international equity flows, IOSCO noted that development of a single disclosure document for use in cross-border offerings and listings would be facilitated by the development of internationally accepted accounting standards. Rather than attempt to develop those standards itself, IOSCO focused on the efforts of the IASC. In 1993, IOSCO identified for the IASC what IOSCO believed to be the necessary components of a core set of standards that would comprise a comprehensive body of accounting principles for enterprises making cross-border securities offerings. IOSCO later identified a number of issues relating to the then-current IASC standards. The IASC then prepared a work plan designed to address the most significant issues identified by IOSCO—the ''core standards'' work program. In 1995, IOSCO and the IASC announced agreement on this work program, and IOSCO stated that if the resulting core standards were acceptable to IOSCO's Technical Committee, that group would recommend endorsement of the IASC standards. The focus of IOSCO's involvement in the core standards project is on use of IASC standards by large, multinational companies for cross-border capital-raising and listing.[21]

IV. Major Issues To Be Addressed in Our Assessment of the IASC Standards

A. Criteria for Assessment of the IASC Standards

In an April 1996 statement regarding the IASC core standards project, we indicated that, once the IASC completed its project, we would consider allowing use of the resulting standards in cross-border filings by foreign issuers offering securities in the United States.[22] The three criteria set forth in that statement remain the criteria that will guide our assessment of the IASC standards. We request your views on whether the IASC standards:

1. Constitute a comprehensive, generally accepted basis of accounting;
2. Are of high quality; and
3. Can be rigorously interpreted and applied.

In responding to the requests for comment set forth below, please be specific in your response, explaining in detail your experience, if any, in applying IASC standards, and the factors you considered in forming your opinion. Please consider both our mandate for investor protection and the expected effect on market liquidity, competition, efficiency and capital formation.

IASC standards are published and copyrighted by the IASC, and we can not reproduce those standards as part of this release. However, copies of the standards have been placed in our public reference rooms. The IASC also has summaries of each standard available on its website at <www.iasc.org.uk>. A listing of the IASC standards and their effective dates is included as Appendix B. For your convenience, a listing of questions 1–26 is included as Appendix A.

1. Are the Core Standards Sufficiently Comprehensive?

The goal of the core standards project was to address the necessary components of a reasonably complete set of accounting standards that would comprise a comprehensive body of principles for enterprises undertaking cross-border offerings and listings. In developing the work program for the core standards project, IOSCO specified the minimum components of a set of ''core standards'' and identified issues to be addressed by the IASC.[23] For topics outside the core standards, such as industry-specific accounting standards, it was agreed that IOSCO members either would accept ''home country'' treatment or require specific ''host country'' treatment or equivalent disclosure.

Q. 1 Do the core standards provide a sufficiently comprehensive accounting framework to provide a basis to address the fundamental accounting issues that are encountered in a broad range of industries and a variety of transactions without the need to look to other accounting regimes? Why or why not?

Q. 2 Should we require use of U.S. GAAP for specialized industry issues in the primary financial statements or permit use of home country standards with reconciliation to U.S. GAAP? Which approach would produce the most meaningful primary financial statements? Is the approach of having the host country specify treatment for topics not addressed by the core standards a workable approach? Is there a better approach?

Q. 3 Are there any additional topics that need to be addressed in order to

[21] *See* the discussion, ''Development of the Core Standards Project,'' in Appendix C.

[22] This statement is available in the appendix to the SEC's *Report to Congress on Promoting The Global Preeminence of American Securities Markets* (October 1997).

[23] *See* Appendix C for a discussion of the development of the core standards work program.

provide a comprehensive set of standards?

2. Are the IASC Standards of Sufficiently High Quality? Why or Why Not?

When we refer to the need for high quality accounting standards, we mean that the standards must result in relevant, reliable information that is useful for investors, lenders, creditors and others who make capital allocation decisions. To that end, the standards must (i) result in a consistent application that will allow investors to make a meaningful comparison of performance across time periods and among companies; (ii) provide for transparency, so that the nature and the accounting treatment of the underlying transactions are apparent to the user; and (iii) provide full disclosure, which includes information that supplements the basic financial statements, puts the presented information in context and facilitates an understanding of the accounting practices applied. Such standards should:

- Be consistent with an underlying accounting conceptual framework;
- Result in comparable accounting by registrants for similar transactions, by avoiding or minimizing alternative accounting treatments;
- Require consistent accounting policies from one period to the next; and
- Be clear and unambiguous.

In assessing the quality of the IASC standards, we are applying these criteria on a standard-by-standard basis, as well as to the IASC standards as a whole. In comment letters submitted to the IASC, the SEC staff has raised concerns including, but not limited to:

- The ability to override an IAS where application of the IAS would not result in a ''true and fair view'' (see IAS 1);
- The option to revalue property, plant and equipment to fair value (see IAS 16);
- Transition provisions that permit unrecognized minimum pension and employee benefit obligations (see IAS 19);
- The amortization of negative goodwill to offset restructuring costs (see IAS 22);
- Unlimited useful lives for goodwill and other intangibles (see IAS 22 and IAS 38);
- The capitalization of costs related to the development of internally generated intangible assets (see IAS 38);
- The remeasurement of impaired assets at an amount other than fair value (see IAS 36); and
- Principles for derecognition of financial assets, and a modified form of basis adjustment for cash flow hedges, including hedges of anticipated transactions and firm commitments (see IAS 39).

You may wish to review the SEC staff and IOSCO comment letters for a further discussion of these and other issues.[24] We, of course, welcome comments on other issues posed by specific approaches taken in the IASC standards, regardless of whether they were raised in IOSCO or SEC staff comment letters.

Indeed, we are seeking advice on any technical issues arising with respect to the IASC standards. In general, we are seeking to determine whether preparers, auditors and users of financial statements have identified particular issues based on their experience with the IASC standards and whether they have developed strategies for addressing those issues. We also would benefit from the public's views regarding whether any of the standards represent a significant improvement over U.S. accounting practices.[25]

A critical issue in assessing the quality of the IASC standards will be whether they would produce the same level of transparency and comparability that generally is provided to U.S. investors under U.S. GAAP. The focus of the staff's comments to the IASC has not been on the differences between the proposed standards and U.S. GAAP; rather, the staff focused on the quality of the proposed standards. An analysis of the differences, however, could serve as a useful tool for highlighting what differing information might be provided in financial statements prepared using IASC standards compared with U.S. GAAP financial statements.[26] If the differences between the IASC standards and U.S. GAAP are significant, the financial position and operating results reported under the IASC standards may be difficult to compare with results reported under U.S. GAAP. The ability to make such a comparison is important for an investor making capital allocation decisions between U.S. and non-U.S. enterprises, especially within the same industry.

Q. 4 Are the IASC standards of sufficiently high quality to be used without reconciliation to U.S. GAAP in cross-border filings in the United States? Why or why not? Please provide us with your experience in using, auditing or analyzing the application of such standards. In addressing this issue, please analyze the quality of the standard(s) in terms of the criteria we established in the 1996 press release. If you considered additional criteria, please identify them.[27]

Q. 5 What are the important differences between U.S. GAAP and the IASC standards? We are particularly interested in investors' and analysts' experience with the IASC standards. Will any of these differences affect the usefulness of a foreign issuer's financial information reporting package? If so, which ones?

Q. 6 Would acceptance of some or all of the IASC standards without a requirement to reconcile to U.S. GAAP put U.S. companies required to apply U.S. GAAP at a competitive disadvantage to foreign companies with respect to recognition, measurement or disclosure requirements?

Q. 7 Based on your experience, are there specific aspects of any IASC standards that you believe result in better or poorer financial reporting (recognition, measurement or disclosure) than financial reporting prepared using U.S. GAAP? If so, what are the specific aspects and reason(s) for your conclusion?

3. Can the IASC Standards Be Rigorously Interpreted and Applied?

(a) *The experience to date.* High quality financial reporting cannot be guaranteed solely by developing accounting standards with the strongest theoretical bases; financial reporting may be weak if conceptually sound standards are not rigorously interpreted and applied. If accounting standards are

[24] Comment letters from the SEC staff and IOSCO's Working Party No. 1 are available in our public reference room. The staff of the Financial Accounting Standards Board (FASB), which also responded to many of the IASC's invitations to comment, has made its comment letters available on its website at <www.fasb.org>. Other U.S. organizations with an interest in standard setting, such as AICPA, the Financial Executives Institute's Committee on Corporate Reporting and the Institute of Management Accountants (IMA), also have commented on many of the core standards.

[25] The Chief Accountant of the Commission published a call for academic research on key international accounting and auditing issues in a letter to the American Accounting Association dated August 15, 1999. This letter is available on the SEC website at <www.sec.gov/news/extra/aaacall.htm>.

[26] In this respect, FASB has produced and periodically updated an analysis of the differences between FASB standards and those of the IASC. This comparison, which has been updated for all the components of the core standards project, is available from the FASB. See the FASB website at <www.fasb.org> for more information. The FASB's summary of this comparison is included as Appendix D to this document because the FASB's comparison study is not available on its website.

[27] For an additional discussion of the characteristics of high quality standards, see the FASB paper, *Quality of Accounting Standards*, in the appendices to the ''International Accounting Standard Setting: A Vision for the Future—Report of the FASB'' at <www.fasb.org>.

to satisfy the objective of having similar transactions and events accounted for in similar ways, preparers must recognize their responsibility to apply these standards in a way that is faithful to both the requirements and intent of the standards, and auditors and regulators around the world must insist on rigorous interpretation and application of those standards. Otherwise, the comparability and transparency that are the objectives of common standards will be eroded.

In this respect, it is difficult to evaluate the effectiveness of certain of the IASC standards at this stage. First, there is little direct use of IASC standards in developed capital markets. Second, even where IASC standards are used directly in those markets, a number of the new or revised standards may not have been implemented yet.[28] For that reason, financial statements currently prepared using IASC standards may not reflect the improvements achieved by the IASC in the core standards project. Therefore, preparers, users and regulators may not have significant implementation experience with respect to those standards to assist us in our evaluation of the quality of the standards as they are applied.

In order for any body of standards to be able to be rigorously interpreted and applied, there must be a sufficient level of implementation guidance. The IASC standards frequently provide less implementation guidance than U.S. GAAP. Instead, they concentrate on statements of principles, an approach that is similar to some national standards outside the United States. Also, the IASC has formatted its standards by using bold (''black'') lettering to emphasize basic requirements of the standards while placing explanatory text in normal (''gray'') lettering. We believe that the requirements of an IASC standard are not limited to the black lettered sections and that compliance with both black and gray letter sections of IASC standards should be regarded as necessary. Additionally, the IASC has published a basis for conclusions for only two of its standards. The basis for conclusion in U.S. standards often is useful in promoting consistent understanding of the standard setter's reasoning and conclusions.

Comparability may be achieved with respect to less detailed standards through common interpretation and practice by companies and auditors who are familiar with the standards. Earlier standard-setting organizations in the United States, such as the Accounting Principles Board, followed this approach and developed less detailed standards. Our experience with that approach was not favorable, however, and led to the current organization and approach to standard-setting under the FASB.[29]

Q. 8 Is the level of guidance provided in IASC standards sufficient to result in a rigorous and consistent application? Do the IASC standards provide sufficient guidance to ensure consistent, comparable and transparent reporting of similar transactions by different enterprises? Why or why not?

Q. 9 Are there mechanisms or structures in place that will promote consistent interpretations of the IASC standards where those standards do not provide explicit implementation guidance? Please provide *specific* examples.

Q. 10 In your experience with current IASC standards, what application and interpretation practice issues have you identified? Are these issues that have been addressed by new or revised standards issued in the core standards project?

Q. 11 Is there significant variation in the way enterprises apply the current IASC standards? If so, in what areas does this occur?

(b) *The need for a financial reporting infrastructure.* Effective financial reporting begins with management, which is responsible for implementing and applying properly a comprehensive body of accounting principles. Rigorous and consistent application of accounting standards also depends on implementation efforts of the standard-setter, auditors and regulators. There are concerns that current IASC standards may not be rigorously and consistently applied. For example, a recent study authored by the former IASC secretary-general identifies non-compliance with IASC standards by a number of the 125 companies surveyed. It also cites examples of auditors who failed to identify properly a lack of compliance with IASC requirements in their reports on an issuer's financial statements.[30]

In addition, the SEC staff has noted inconsistent applications of IAS 22, *Business Combinations.* The staff has received a number of requests to accept characterizations of business combinations as ''unitings of interests'' despite IAS 22's clear intention that uniting of interest accounting be used only in rare and limited circumstances. In addition, the SEC staff, based on its review of filings involving foreign private issuers using IASC standards, has identified a number of situations involving not only inconsistent application of the standards but also misapplication of the standards.[31] In these circumstances, the SEC staff has required adjustments to the financial statements in order to comply with IASC standards.

Q. 12 After considering the issues discussed in (i) through (iv) below, what do you believe are the essential elements of an effective financial reporting infrastructure? Do you believe that an effective infrastructure exists to ensure consistent application of the IASC standards? If so, why? If not, what key elements of that infrastructure are missing? Who should be responsible for development of those elements? What is your estimate of how long it may take to develop each element?

(i) *The interpretive role of the standard-setter.* In order for a set of accounting standards to be fully operational, the standard-setter must support reasonably consistent application of its standards. A standard-setter's responsibility for ensuring consistent application of its standards includes providing an effective mechanism for identifying and addressing interpretive questions in an expeditious fashion.

The IASC began addressing interpretive issues in 1997 with the creation of its Standing Interpretations Committee (SIC) to provide resolution of interpretive issues arising in the application of the IASC standards that are likely to receive divergent or unacceptable treatment in the absence of authoritative guidance.

Q. 13 What has your experience been with the effectiveness of the SIC in

[28] Fifteen of the 31 core standards are new or have been revised significantly as part of the core standards project, and most of these standards have required adoption dates in 1999, 2000 or 2001.

[29] *See* the report of the Wheat Commission, ''Establishing Financial Accounting Standards, a Report of the Study on Establishment of Accounting Principles,'' American Institute of Certified Public Accountants, p. 38 (March 1972).

[30] See ''The FT International Accounting Standards Survey 1999, an assessment of the use of IAS's by companies, national standard setting bodies, regulators and stock exchanges,'' by David Cairns, published by The Financial Times, London, 1999.

[31] *See* ''International Reporting Issues,'' Remarks by Donald J. Gannon at the 27th Annual National AICPA Conference on Current SEC Developments, December 8, 1999, and ''Financial Reporting Issues Critical to European SEC Registrants/Users of US GAAP,'' Remarks by Lynn E. Turner at the European FASB–SEC Financial Reporting Conference, Frankfurt, Germany, April 8, 1999 (available on the SEC website at <www.sec.gov>).

See also David Cairns, ''Exceptions to the Rule,'' *Accountancy International*, p. 84 (November 1999) and ''Compliance Must Be Enforced,'' *Accountancy International*, p. 64 (September 1998).

reducing inconsistent interpretations and applications of IASC standards? Has the SIC been effective at identifying areas where interpretive guidance is necessary? Has the SIC provided useful interpretations in a timely fashion? Are there any additional steps the IASC should take in this respect? If so, what are they?

(ii) *The restructuring of the IASC.* The IASC has published a restructuring plan which is expected to result in an independent Board whose members are selected based on technical expertise, with oversight provided by an independent set of Trustees. The restructuring also is expected to integrate the roles of the IASC and those of national standard-setters.[32]

At this time, we do not anticipate adopting a process-oriented approach (like our approach to the FASB[33]) to IASC standards. Instead, we expect to continue a product-oriented approach, assessing each IASC standard after its completion. Nonetheless, the quality of the standard-setter has relevance to our consideration of the IASC standards, particularly with respect to implementation and interpretation questions. Since many of the IASC standards are new or relatively new, application issues may arise that require the response of an effective and high quality standard setter. Additionally, the quality of the standard-setter has critical implications for the development and acceptance of future standards.[34]

An effective high quality standard-setter is characterized by:

- An independent decision-making body;
- An active advisory function;
- A sound due process;
- An effective interpretive function;
- Independent oversight representing the public interest; and
- Adequate funding and staffing.

Q. 14 Do you believe that we should condition acceptance of the IASC standards on the ability of the IASC to restructure itself successfully based on the above characteristics? Why or why not?

(iii) *The role of the auditor in the application of the standards.* High quality accounting standards and an effective interpretive process are not the only requirements for effective financial reporting. Without competent, independent audit firms and high quality auditing procedures to support the application of accounting standards, there is no assurance that the accounting standards will be applied appropriately and consistently. As discussed in the introduction to this release, increasing globalization of business and integration of capital markets raise challenging questions of how to provide oversight of audit professionals on a world-wide basis to ensure consistent high quality and ethical audit and accounting practices.

In the United States, implementation and application of U.S. GAAP are supported through professional quality control practices and professional and governmental (state and federal) oversight and enforcement activities. National technical offices of U.S. accounting firms serve an important role in ensuring an appropriate and consistent interpretation and application of U.S. GAAP and U.S. auditing standards.

Q. 15 What are the specific practice guidelines and quality control standards accounting firms use to ensure full compliance with non-U.S. accounting standards? Will those practice guidelines and quality control standards ensure application of the IASC standards in a consistent fashion worldwide? Do they include (a) internal working paper inspection programs and (b) external peer reviews for audit work? If not, are there other ways we can ensure the rigorous implementation of IASC standards for cross-border filings in the United States? If so, what are they?

Q. 16 Should acceptance of financial statements prepared using the IASC standards be conditioned on certification by the auditors that they are subject to quality control requirements comparable to those imposed on U.S. auditors by the AICPA SEC Practice Section, such as peer review and mandatory rotation of audit partners?[35] Why or why not? If not, should there be disclosure that the audit firm is not subject to such standards?

In many jurisdictions, including the United States, accountants and auditors are trained and tested in their domestic accounting standards, but do not receive training in IASC standards. For that reason, accountants and auditors around the world will need to develop expertise with IASC standards to support rigorous interpretation and application of these standards.

Q. 17 Is there, at this time, enough expertise globally with IASC standards to support rigorous interpretation and application of those standards? What training have audit firms conducted with respect to the IASC standards on a worldwide basis? What training with respect to the IASC standards is required of, or available to, preparers of financial statements or auditors certifying financial statements using those standards?

(iv) *The role of the regulator in the interpretation and enforcement of accounting standards.* While the Commission has the authority to establish accounting standards,[36] historically we have looked to the private sector for leadership in establishing and improving accounting standards to be used by public companies.[37] As a result, the Commission has recognized the FASB as the private sector body whose standards it considers to have substantial authoritative support. This partnership with the private sector facilitates input into the accounting standard-setting process from all stakeholders in U.S. capital markets, including financial statement preparers, auditors and users, as well as regulators. Our willingness to look to the private sector, however, has been with the understanding that we will, as necessary, supplement, override or otherwise amend private sector accounting standards.

The SEC staff is involved with the application of accounting standards on a daily basis through its review and comment process. This review process, administered by the Division of Corporation Finance, allows the staff to review and comment on a company's application of GAAP and related SEC disclosure requirements. The SEC staff would have the same significant

[32] *See* the report of the IASC's Strategy Working Party, ''Recommendations on Reshaping IASC for the Future,'' November 1999, available on the IASC website at <www.iasc.org.uk>.

[33] We have stated that ''* * * principles, standards and practices promulgated by the FASB * * * will be considered by the Commission as having substantial authoritative support. * * *'' *See* SEC Accounting Series Releases No. 4 and 150, codified in section 100 of the SEC's Financial Reporting Policies (FRR 101).

[34] *See* the comments of the SEC Chief Accountant regarding the IASC's restructuring plans, ''Statement of SEC Chief Accountant Lynn E. Turner on IASC Board Decision to Support Restructuring Plan,'' SEC Press release no. 99–152, dated November 17, 1999, available on the SEC website at <www.sec.gov>. You also may wish to read SEC staff comment letters dated May 14, 1999 and September 21, 1999 on Strategy Working Party proposals. All of the comments received by the IASC on its Strategy Working Party proposals are available on the IASC website at <www.iasc.org.uk>.

[35] *See* SECPS Section 1000.08 ''Organizational Structure and Function of the SEC Practice Section,'' ''Requirements of Members,'' American Institute of Certified Public Accountants.

[36] *See, e.g.,* Sections 7 and 19(a) and Schedule A of the Securities Act; Sections 3(b), 12(b) and 13(b) of the Exchange Act; and Sections 8, 30(e), 31 and 38(a) of the Investment Company Act of 1940.

[37] *See* Accounting Series Release (ASR) 4 (April 25, 1938) and ASR 150 (December 20, 1973).

interpretive and enforcement role in the application of the IASC standards when those standards are used to prepare financial statements included in SEC filings.[38] To perform that role, our staff would need to develop expertise regarding the IASC standards.[39]

However, other jurisdictions accepting IASC standards may develop conflicting interpretations or may accept applications of IASC standards that would not be acceptable in the United States and other jurisdictions, in part, because of lack of expertise, resources, or even the authority to question a company's application of accounting standards. We are seeking to identify ways to reduce the development of diverging interpretations of IASC standards.

Q. 18 Is there significant variation in the interpretation and application of IASC standards permitted or required by different regulators? How can the risk of any conflicting practices and interpretations in the application of the IASC standards and the resulting need for preparers and users to adjust for those differences be mitigated without affecting the rigorous implementation of the standards?

In considering changes in our current financial reporting requirements, we will consider the effects of possible changes on the ability of our enforcement program to provide an effective deterrent against financial reporting violations by foreign issuers, their corporate officials and their auditors.

Q. 19 Would further recognition of the IASC standards impair or enhance our ability to take effective enforcement action against financial reporting violations and fraud involving foreign companies and their auditors? If so, how?

To facilitate its investigations of possible securities law violations, the SEC staff may need to obtain access to a non-U.S. auditor's working papers, as well as testimony, in connection with audit work done outside the United States.[40] In some prior investigations, we have obtained access to information through the voluntary cooperation of the company or its foreign auditors. We also have the potential of using domestic compulsory mechanisms or enforcement tools such as memoranda of understanding and other arrangements with non-U.S. regulators. However, these approaches for obtaining information about an auditor's work can cause delays in investigations, and may still not permit obtaining access to working papers and testimony that are needed to assess information the issuer has provided to its auditors and to investigate the adequacy of the work supporting the auditor's report. The circumstances in which we need this information have grown, due to the expanded multinational activities of U.S. companies and the increasing number of foreign issuers that are listed on U.S. exchanges. Greater acceptance of the IASC standards may increase further the instances in which an issuer's auditor is not based in the United States.

Q. 20 We request comment with respect to ways to assure access to foreign working papers and testimony of auditors who are located outside the United States. For example, should we amend Regulation S–X to require a representation by the auditor that, to the extent it relied on auditors, working papers, or information from outside the United States, the auditor will make the working papers and testimony available through an agent appointed for service of process? If not, should we require that the lack of access to auditors' workpapers be disclosed to investors? Is there another mechanism for enhancing our access to audit working papers and witnesses outside the United States?

B. Possible Approaches to Recognition of the IASC Standards for Cross-Border Offerings and Listings

As discussed, IOSCO and Commission recognition of the IASC standards will depend on the outcome of the current assessment work. The assessment work has two aspects: (1) Considering the quality of each of the IASC standards individually; and (2) evaluating whether the body of standards operates effectively as a whole.

The goal of the core standards project has been to develop a high quality set of generally accepted international accounting standards that ultimately would reduce or eliminate the need for reconciliation to national standards. Any Commission action could take several forms, including, for example:

- Maintaining the current reconciliation requirements in all respects.
- Removing some of the current reconciliation requirements for selected IASC standards and extending that recognition to additional IASC standards as warranted based on future review of each standard. Under this approach, when alternative treatments are specified (such as benchmarks and allowed alternatives), we may specify one treatment as acceptable, while retaining the reconciliation requirement to those financial statements that employ the unacceptable treatment. For example, we might require reconciliation if a company applies the allowed alternative treatment of periodically writing-up long-lived assets to estimated fair value.[41] Other items for which reconciliation might be required include unrecorded pension liabilities and costs capitalized for internally generated intangible assets.
- Relying on the IASC standards for recognition and measurement principles, but requiring U.S. GAAP and SEC supplemental disclosure requirements for footnote disclosures and the level of detail for the line items in financial statements.
- Accepting financial statements prepared in accordance with the IASC standards without any requirement to reconcile to U.S. GAAP.

There may be other approaches, or combinations of approaches, that would be appropriate. In determining what approach to take we will consider outstanding substantive issues noted by IOSCO in its report, the underlying work assessing the IASC standards performed by the SEC staff and other members of IOSCO, as well as responses we receive to this release. In addition, the approach we adopt initially may change in light of future modifications of the IASC standards or further development of the related infrastructure elements.

Q. 21 What has been your experience with the quality and usefulness of the information included in U.S. GAAP reconciliations? Please explain, from your viewpoint as a preparer, user, or auditor of non-U.S. GAAP financial statements, whether the reconciliation process has enhanced the usefulness or reliability of the financial information and how you have used the information provided by the reconciliation. Please identify any consequences, including quantification of any decrease or increase in costs or benefits, that could result from reducing or eliminating the reconciliation requirement.

[38] We are not considering introducing mutual recognition of other jurisdictions' oversight of financial statements prepared in accordance with IASC standards.

[39] We already have begun a staff training program in anticipation of an increasing number of foreign registrants using the IASC standards in preparing their primary financial statements.

[40] For example, for non-U.S. work that supports a U.S. audit report or with respect to audit reports issued by non-U.S. audit firms for U.S. filings.

[41] IAS 16 (revised 1993) ¶¶ 36–51.

Q. 22 Should any requirements for reconciliation differ based on the type of transaction (*e.g.*, listing, debt or equity financing, rights offering, or acquisition) or the type of security (*e.g.*, ordinary shares, convertible securities, investment grade or high yield debt)? Are there any other appropriate bases for distinction?

Q. 23 If the current reconciliation requirements are reduced further, do you believe that reconciliation of a ''bottom line'' figure would still be relevant (e.g., presenting net income and total equity in accordance with U.S. GAAP)?

Q. 24 Should any continuing need for reconciliation be assessed periodically, based on an assessment of the quality of the IASC standards?

Q.25 The IASC standards finalized as part of the core standards project include prospective adoption dates. Most standards are not required to be applied until fiscal years beginning on or after January 1, 1998, at the earliest. Should we retain existing reconciliation requirements with respect to the reporting of any fiscal year results that were not prepared in accordance with the revised standards or simply require retroactive application of all revised standards regardless of their effective dates? If not, why not?

The current reconciliation requirements are designed to make financial statements prepared under non-U.S. GAAP more comparable to those prepared under U.S. GAAP. Additionally, there may be indirect benefits realized from those requirements. For example, some multinational accounting firms have stated that the reconciliation process has served as a quality control mechanism with respect to audit work performed by their local offices with respect to foreign companies. On the other hand, the SEC staff, based on its review of filings involving foreign private issuers using non-U.S. GAAP, has noted a number of situations involving the inclusion of reconciling items that appear to be the result of non-compliance with home country GAAP rather than a difference between the home country (or IASC) basis of accounting and U.S. GAAP. As such, there should not be a reconciling item. This may be indicative of not enough focus on the accuracy of the primary financial statements.

Q. 26 Does the existence of a reconciliation requirement change the way in which auditors approach financial statements of foreign private issuers? Also, will other procedures develop to ensure that auditors fully versed in U.S. auditing requirements, as well as the IASC standards, are provided an opportunity to review the financial reporting practices for consistency with those standards? If so, please describe these procedures. Alternatively, will the quality of the audit and the consistency of the application of the IASC standards depend on the skill and expertise of the local office of the affiliate of the accounting firm that conducts the audit?

V. Conclusion

Following receipt and review of comments, we will determine whether rulemaking or other further action is appropriate. In addition to responding to the specific questions we have presented in this release, we encourage commenters to provide any information to supplement the information and assumptions contained in this release regarding the role of accounting standards in the capital-raising process, the information needs of investors and capital markets, and the other matters discussed. We also invite commenters to provide views and data as to the costs and benefits associated with the possible changes discussed in this release in comparison to the costs and benefits of the existing regulatory framework. In order for us to assess the impact of changes that could affect capital formation, market efficiency and the protection of investors, we solicit comment from the point of view of a variety of groups, including, without limitation, foreign and domestic issuers, underwriters, broker-dealers, analysts, investors, accountants and attorneys involved in the registration process and other interested parties.

Dated: February 16, 2000.

By the Commission.

Jonathan G. Katz,

Secretary.

Appendix A.—Listing of Questions in the Concept Release

Criteria for Assessment of the IASC Standards

Are the Core Standards Sufficiently Comprehensive?

Q. 1 Do the core standards provide a sufficiently comprehensive accounting framework to provide a basis to address the fundamental accounting issues that are encountered in a broad range of industries and a variety of transactions without the need to look to other accounting regimes? Why or why not?

Q. 2 Should we require use of U.S. GAAP for specialized industry issues in the primary financial statements or permit use of home country standards with reconciliation to U.S. GAAP? Which approach would produce the most meaningful primary financial statements? Is the approach of having the host country specify treatment for topics not addressed by the core standards a workable approach? Is there a better approach?

Q. 3 Are there any additional topics that need to be addressed in order to provide a comprehensive set of standards?

Are the IASC Standards of Sufficiently High Quality? Why or Why Not?

Q. 4 Are the IASC standards of sufficiently high quality to be used without reconciliation to U.S. GAAP in cross-border filings in the United States? Why or why not? Please provide us with your experience in using, auditing or analyzing the application of such standards. In addressing this issue, please analyze the quality of the standard(s) in terms of the criteria we established in the 1996 press release. If you considered additional criteria, please identify them.

Q. 5 What are the important differences between U.S. GAAP and the IASC standards? We are particularly interested in investors' and analysts' experience with the IASC standards. Will any of these differences affect the usefulness of a foreign issuer's financial information reporting package? If so, which ones?

Q. 6 Would acceptance of some or all of the IASC standards without a requirement to reconcile to U.S. GAAP put U.S. companies required to apply U.S. GAAP at a competitive disadvantage to foreign companies with respect to recognition, measurement or disclosure requirements?

Q. 7 Based on your experience, are there specific aspects of any IASC standards that you believe result in better or poorer financial reporting (recognition, measurement or disclosure) than financial reporting prepared using U.S. GAAP? If so, what are the specific aspects and reason(s) for your conclusion?

Can the IASC Standards Be Rigorously Interpreted and Applied?

The Experience to Date

Q. 8 Is the level of guidance provided in IASC standards sufficient to result in a rigorous and consistent application? Do the IASC standards provide sufficient guidance to ensure consistent, comparable and transparent reporting of similar transactions by different enterprises? Why or why not?

Q. 9 Are there mechanisms or structures in place that will promote consistent interpretations of the IASC standards where those standards do not provide explicit implementation guidance? Please provide *specific* examples.

Q. 10 In your experience with current IASC standards, what application and interpretation practice issues have you identified? Are these issues that have been addressed by new or revised standards issued in the core standards project?

Q. 11 Is there significant variation in the way enterprises apply the current IASC standards? If so, in what areas does this occur?

The Need for a Financial Reporting Infrastructure

Q. 12 After considering the issues discussed in (i) through (iv) below, what do

you believe are the essential elements of an effective financial reporting infrastructure? Do you believe that an effective infrastructure exists to ensure consistent application of the IASC standards? If so, why? If not, what key elements of that infrastructure are missing? Who should be responsible for development of those elements? What is your estimate of how long it may take to develop each element?

The Interpretive Role of the Standard-Setter

Q. 13 What has your experience been with the effectiveness of the SIC in reducing inconsistent interpretations and applications of IASC standards? Has the SIC been effective at identifying areas where interpretive guidance is necessary? Has the SIC provided useful interpretations in a timely fashion? Are there any additional steps the IASC should take in this respect? If so, what are they?

Q. 14 Do you believe that we should condition acceptance of the IASC standards on the ability of the IASC to restructure itself successfully based on the above characteristics? Why or why not?

The Role of the Auditor in the Application of the Standards

Q. 15 What are the specific practice guidelines and quality control standards accounting firms use to ensure full compliance with non-U.S. accounting standards? Will those practice guidelines and quality control standards ensure application of the IASC standards in a consistent fashion worldwide? Do they include (a) internal working paper inspection programs and (b) external peer reviews for audit work? If not, are there other ways we can ensure the rigorous implementation of IASC standards for cross-border filings in the United States? If so, what are they?

Q. 16 Should acceptance of financial statements prepared using the IASC standards be conditioned on certification by the auditors that they are subject to quality control requirements comparable to those imposed on U.S. auditors by the AICPA SEC Practice Section, such as peer review and mandatory rotation of audit partners? Why or why not? Why or why not? If not, should there be disclosure that the audit firm is not subject to such standards?

Q. 17 Is there, at this time, enough expertise globally with IASC standards to support rigorous interpretation and application of those standards? What training have audit firms conducted with respect to the IASC standards on a worldwide basis? What training with respect to the IASC standards is required of, or available to, preparers of financial statements or auditors certifying financial statements using those standards?

The Role of the Regulator in the Interpretation and Enforcement of Accounting Standards

Q. 18 Is there significant variation in the interpretation and application of IASC standards permitted or required by different regulators? How can the risk of any conflicting practices and interpretations in the application of the IASC standards and the resulting need for preparers and users to adjust for those differences be mitigated without affecting the rigorous implementation of the standards?

Q. 19 Would further recognition of the IASC standards impair or enhance our ability to take effective enforcement action against financial reporting violations and fraud involving foreign companies and their auditors? If so, how?

Q. 20 We request comment with respect to ways to assure access to foreign working papers and testimony of auditors who are located outside the United States. For example, should we amend Regulation S–X to require a representation by the auditor that, to the extent it relied on auditors, working papers, or information from outside the United States, the auditor will make the working papers and testimony available through an agent appointed for service of process? If not, should we require that the lack of access to auditors' workpapers be disclosed to investors? Is there another mechanism for enhancing our access to audit working papers?

Possible Approaches to Recognition of the IASC Standards for Cross-Border Offerings and Listings

Q. 21 What has been your experience with the quality and usefulness of the information included in U.S. GAAP reconciliations? Please explain, from your viewpoint as a preparer, user, or auditor of non-U.S. GAAP financial statements, whether the reconciliation process has enhanced the usefulness or reliability of the financial information and how you have used the information provided by the reconciliation. Please identify any consequences, including quantification of any decrease or increase in costs or benefits, that could result from reducing or eliminating the reconciliation requirement.

Q. *22* Should any requirements for reconciliation differ based on the type of transaction (*e.g.*, listing, debt or equity financing, rights offering, or acquisition) or the type of security (*e.g.*, ordinary shares, convertible securities, investment grade or high yield debt)? Are there any other appropriate bases for distinction?

Q. *23* If the current reconciliation requirements are reduced further, do you believe that reconciliation of a ''bottom line'' figure would still be relevant (e.g., presenting net income and total equity in accordance with U.S. GAAP)?

Q. 24 Should any continuing need for reconciliation be assessed periodically, based on an assessment of the quality of the IASC standards?

Q. 25 The IASC standards finalized as part of the core standards project include prospective adoption dates. Most standards are not required to be applied until fiscal years beginning on or after January 1, 1998, at the earliest. Should we retain existing reconciliation requirements with respect to the reporting of any fiscal year results that were not prepared in accordance with the revised standards or simply require retroactive application of all revised standards regardless of their effective dates? If not, why not?

Q. 26 Does the existence of a reconciliation requirement change the way in which auditors approach financial statements of foreign private issuers? Also, will other procedures develop to ensure that auditors fully versed in U.S. auditing requirements, as well as the IASC standards, are provided an opportunity to review the financial reporting practices for consistency with those standards? If so, please describe these procedures. Alternatively, will the quality of the audit and the consistency of the application of the IASC standards depend on the skill and expertise of the local office of the affiliate of the accounting firm that conducts the audit?

Appendix B.—List of Core Standards and Each Standard's Effective Date

IAS and title	Effective date
1 Presentation of Financial Statements (revised).	1 Jan 99
2 Inventories	1 Jan 95
4 Depreciation Accounting	[1]1 Jan 77
7 Cash Flow Statements	1 Jan 94
8 Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies.	1 Jan 95
10 Events After the Balance Sheet Date (revised).	1 Jan 00
11 Construction Contracts	1 Jan 95
12 Income Taxes (revised)	1 Jan 98
14 Segment Reporting (revised).	1 Jul 98
16 Property, Plant and Equipment (revised).	1 Jul 99
17 Leases (revised)	1 Jan 99
18 Revenue	1 Jan 95
19 Employee Benefits (revised)	1 Jan 99
20 Accounting for Government Grants and Disclosure of Government Assistance.	1 Jan 84
21 The Effects of Changes in Foreign Exchange Rates.	1 Jan 95
22 Business Combinations (revised).	1 Jul 99
23 Borrowing Costs	1 Jan 95
24 Related Party Disclosures	1 Jan 86
25 Investment Properties[2]	1 Jan 87
27 Consolidated Financial Statements and Accounting for Investments in Subsidiaries.	1 Jan 90
28 Accounting for Investments in Associates.	1 Jan 90
29 Financial Reporting in Hyperinflationary Economies.	1 Jan 90
31 Financial Reporting of Interests in Joint Ventures.	1 Jan 92
32 Financial Instruments: Disclosure and Presentation.	1 Jan 96
33 Earnings Per Share	1 Jan 99
34 Interim Financial Reporting	1 Jan 99
35 Discontinuing Operations	1 Jan 99
36 Impairment of Assets	1 Jul 99
37 Provisions, Contingent Liabilities and Contingent Assets.	1 Jul 99
38 Intangible Assets	1 Jul 99
39 Financial Instruments: Recognition and Measurement.	1 Jan 01

[1] Will be withdrawn once IAS 38 becomes effective.

[2] Revisions to this standard are being debated currently. E64, *Investment Properties*, has been issued for comment. The IASC expects to finalize this standard in March 2000.

Appendix C.—The Core Standards Project

A. The IASC and IOSCO

The International Accounting Standards Committee (IASC) is a private sector body whose membership includes all the professional accountancy bodies that are members of the International Federation of Accountants (IFAC). IFAC has more than 140 members from over 100 countries. The IASC has the dual objectives of (i) formulating international accounting standards and promoting their acceptance and observance; and (ii) working generally for improvement and harmonization of accounting standards.

Currently,[42] the business of the IASC is conducted by a Board with 16 voting delegations [43] and five non-voting observer delegations with the privilege of the floor.[44] Each delegation includes up to three members who share a single vote. Delegation members normally are drawn from the accountancy profession and preparer community; representatives of national standard-setters may be included in a delegation, often as the technical advisor. The Board currently meets approximately four times a year for about a week to receive reports from its staff and steering committees and to discuss and approve exposure drafts and final standards for publication.

Board delegates serve on a part-time, volunteer basis. The IASC has a small full-time staff based in London. This staff provides a manager for most IASC projects; project staffing, in the form of Steering Committees, is provided by volunteers who represent a mix of Board member and non-Board member IFAC organizations. IOSCO (the International Organization of Securities Commissions) and the European Commission are non-voting observers for most Steering Committees.[45]

IOSCO is an association of securities regulatory organizations. It has approximately 135 ordinary, associate and affiliate members, including twelve based in the United States. Two key IOSCO committees following this project are the Technical Committee and its Working Party No. 1 on Multinational Disclosure and Accounting. The Technical Committee is composed of 16 regulatory agencies [46] that regulate some of the world's largest, more developed and internationalized markets. Its objective is to review major regulatory issues related to international securities and futures transactions and to coordinate practical responses to these concerns. Both the Commission and the Commodity Futures Trading Commission are members of this committee. We are represented by a member of the Commission.

Working Party No. 1 is one of several working groups that report to the Technical Committee. It has members from sixteen jurisdictions and is chaired by a Commission staff member. Commission staff members from the Division of Corporation Finance and the Office of the Chief Accountant are members of the Working Party.[47]

As a member of IOSCO, the Commission has been a significant participant in efforts to harmonize regulatory requirements for cross-border offerings and listings. Most recently, IOSCO approved and recommended that its members adopt a set of non-financial statement disclosure standards for the purposes of cross-border offerings and listings.[48] We have amended our foreign private issuer disclosure requirements to implement these IOSCO disclosure standards.[49]

B. Development of the Core Standards Project [50]

In 1989, IOSCO prepared a report entitled, ''International Equity Offers.'' [51] That report noted that cross-border offerings would be greatly facilitated by the development of internationally accepted accounting standards. Rather than attempt to develop those standards itself, IOSCO focused on the efforts of the IASC.

In 1993, IOSCO wrote to the IASC detailing the necessary components of a reasonably complete set of standards to create a comprehensive body of principles for enterprises undertaking cross-border securities offerings. In 1993, the IASC completed a project to improve the comparability and usefulness of financial statements prepared in accordance with its standards. Prior to this project, a number of IASC standards codified existing practice in multiple jurisdictions, permitting several alternative (and at times inconsistent) treatments for a single type of transaction. As a result of this improvement project, many alternatives were eliminated, although, in a few areas, the IASC standard retained multiple approaches, with one designated as a ''benchmark'' treatment and the other as an ''allowed alternative.''

In 1994, IOSCO completed a review of the revised IASC standards and identified a number of issues that would have to be addressed, as well as standards that the IASC would have to improve, before IOSCO could consider recommending IASC standards for use in cross-border listings and offerings. IOSCO divided the issues into three categories:

1. Issues that required a solution prior to consideration by IOSCO of an endorsement of the IASC standards;
2. Issues that would not require resolution before IOSCO could consider endorsement, although individual jurisdictions might specify treatments that they would require if those issues were not addressed satisfactorily; and
3. Areas where improvements could be made, but that the IASC did not need to address prior to consideration of the IASC standards by IOSCO.

In July 1995, IOSCO and the IASC agreed that the proposed ''core standards work program'' would, if completed successfully, address all the issues that required a resolution before IOSCO would consider endorsement.[52] IOSCO stated that, if the resulting IASC standards are acceptable to its Technical Committee, that group would recommend endorsement of those standards for cross-border capital raising and listing purposes.

C. Overview of the Work Program

The IASC's work program identified 12 areas that required new or substantially revised standards. As of January 2000, the IASC had published seven new standards and ten revised standards addressing those areas. One standard remains under consideration.[53] Since the IASC standards are copyrighted, we have not reproduced them as part of this release. However, summaries of the IASC standards, as well as information about obtaining the full text of these standards, are available from the IASC website at www.iasc.org.uk. Additionally,

[42] The IASC's Board has approved a plan for restructuring, subject to ratification by its membership. *See* the report of the IASC Strategy Working Party, ''Recommendations on Reshaping IASC for the Future,'' November 1999, available at the IASC website iasc.org.uk.

[43] The 16 voting delegations are: Australia, Canada, France, Germany, India (shares with Sri Lanka), Japan, Malaysia, Mexico, Netherlands, Nordic Federation of Public Accountants (the delegation to the IASC Board includes representatives from Denmark, Norway and Sweden; Finland and Iceland also are member countries), South Africa (shares with Zimbabwe), the United Kingdom, and the United States, the International Coordinating Committee of Financial Analysts' Association, the International Association of Financial Executives Institute, and the Federation of Swiss Holding Companies.

[44] The European Commission, the International Organization of Securities' Commission, the U.S. Financial Accounting Standards Board, the Chinese Institute of Certified Public Accountants, and the IFAC Public Sector Committee.

[45] For more information, see the IASC website at www.iasc.org.uk.

[46] The jurisdictions on the Technical Committee are: Australia, Belgium, the Canadian provinces of Ontario and Quebec, France, Germany, Hong Kong, Italy, Japan, Mexico, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States.

[47] For more information, see the IOSCO website at www.iosco.org.

[48] Final Communique of the 23rd Annual Conference of the International Organization of Securities Commissions (September 18, 1998).

[49] International Disclosure Standards, Exchange Act Release No. 41936 (September 28, 1999). [64 FR 53900].

[50] For a more detailed discussion of the background of the core standards project, see the *Report to Congress on Promoting Global Preeminence of American Securities Markets*, prepared by the SEC pursuant to Section 509 of the National Securities Improvements Act of 1996 (October 1997) (Report to Congress). The Report to Congress is available through the Commission's website at www.sec.gov.

[51] A summary of this report may be obtained from IOSCO. *See* the IOSCO website at www.iosco.org.

[52] The core standards work program exclude specialized industry standards, such as the banking, insurance, or motion picture industries. Specialized industry accounting issues are expected to be treated as suspense issues.

[53] The IASC still has under consideration one topic that is part of the core standards—investment properties. The IASC expects to complete this project in March 2000. The Working Party determined that although this element of the core standards project remains uncompleted, IOSCO's assessment process could begin, with a view to updating its analysis once the final standard on this topic is issued.

copies of the IASC standards have been placed in our public reference room in the public file for this release.

IOSCO, through Working Party No. 1, is a non-voting observer at meetings of the IASC Board, its Steering Committees, and its Standing Interpretations Committee. The Working Party has attempted to reply to each document the IASC published for comment. The Working Party comment letters alerted the IASC to concerns of the Working Party or its members while the issues were under discussion.

Some members of the Working Party also commented individually on proposed standards. In addition to contributing to Working Party comment letters, the Commission staff issued comment letters that provided detailed technical comments on substantially all of the IASC's published documents.[54] In developing comment letters, the staff focused on the type of information that would be provided to investors. The letters sought to identify areas where comparability and transparency might be compromised, and where other significant investor protection issues existed. The staff did not focus its analysis on eliminating differences from U.S. GAAP. In fact, in several instances the staff encouraged the IASC to benefit from U.S. experience with a particular component of U.S. GAAP and adopt a different and improved approach.

D. The Assessment Process

The pace of the IASC work program has required that, immediately following the adoption of a final standard, the Working Party and Commission staff shift their attention to other pending standards. As a result, the Working Party and Commission staff did not stop to evaluate each completed standard and assess the extent to which it addressed the concerns raised in the comment letters. This approach also was consistent with the understanding between the IASC and IOSCO that the Working Party would assess the completed standards, individually and as a group, once the IASC completed all of the core standards. That assessment of the core standards is now underway, and is focusing not only on the extent to which the completed standards address the IOSCO concerns, but also on whether the IASC's standards work together to form an operational basis of accounting.

Following its review and assessment of the core standards, the Working Party will make a report to IOSCO's Technical Committee that will describe outstanding substantive issues with the IASC standards and suggest ways to address these issues. The Technical Committee then is expected to develop and circulate to IOSCO's membership a resolution regarding the IASC standards.

Resolutions of both the Technical Committee and IOSCO as a whole are non-binding on its member organizations. Accordingly, were the Technical Committee to recommend to IOSCO's members that they accept financial statements prepared using IASC standards, each member would have to determine whether and how to implement that recommendation at a domestic level.

If, as a result of its assessment of the completed core standards, we conclude that changes to our current requirements for foreign private issuers are appropriate, we will issue a rule proposal for public comment. This may include modifications of the financial statement requirements for registration and reporting forms utilized by foreign private issuers, such as Forms F–1 and 20–F.

Appendix D.—Summary of the FASB's IASC/US GAAP Comparison Project

This document is an excerpt from the FASB's ''*The IASC-U.S. Comparison Project: A Report on the Similarities and Differences between IASC Standards and U.S. GAAP,*'' copyrighted by the Financial Accounting Standards Board, Norwalk, Connecticut, USA, 1999.

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CHAPTER 2—SUMMARY OF OBSERVATIONS

Introduction

In keeping with the objectives of the project, the comparative analyses presented in Chapters 3–30 of this report provide an information base to facilitate decision making about IASC standards by investors, analysts, standard setters, regulators, and others. Each comparative analysis was undertaken independently. However, based on the types of differences identified by the individual authors, there are some general observations that can be made about the potential comparability of information reported in financial statements between an enterprise using IASC standards and one using U.S. GAAP. Those observations are the subject of this chapter.

The discussion of observations that follows generally centers on the extent to which the similarities and differences identified by the authors of the comparative analyses could affect the comparability of actual reported financial information. That is, the discussion focuses on those similarities and differences deemed most likely to be significant to financial statement users comparing the financial statements of enterprises following IASC standards and those following U.S. GAAP. There are some limitations to that approach. Primarily, the basis for the project was limited to the comparison of accounting standards; it did not seek to observe the actual application and enforcement of those standards. How standards are interpreted and applied and the extent to which they are enforced can have a significant impact on reported financial information. Evaluating the effects of actual application and enforcement of accounting standards was beyond the scope of the project. It is not yet possible to observe those effects because many of the IASC standards and some U.S. standards that are the subject of the chapters that follow have yet to be used in preparing financial statements.

This chapter is presented in three sections. The first provides some background for understanding how differences in accounting standards can be important for assessing financial statement comparability. The second section provides some general observations about the most significant types of differences observed by the authors of the comparative analysis chapters and provides examples to illustrate those types of differences. The last section summarizes the key points of this chapter.

A Word About Differences

The IASC-U.S. comparison project set out to identify similarities and differences between IASC standards and U.S. GAAP (primarily FASB standards) predisposed to the view that the shortest route to understanding comparability would be to zero in on differences. Therefore, this report, by its very nature, focuses on differences as a basis for comparison. Similarities tend to be identified and described in a general manner, while differences are discussed in more detail.

IASC standards are different from FASB standards. That conclusion is not new, nor is it unique to this report. It is neither the objective nor the intent of the IASC to develop standards identical to FASB standards. IASC standards and FASB standards seek to serve different environments (international versus national), respond to different mandates, have different technical support levels, and result from different standard-setting structures and processes.[55] Differences between those two sets of standards, therefore, are inevitable and not necessarily inappropriate. However, if financial statements based on IASC standards are to be considered appropriate for cross-border access to the world's capital markets (including those in the United States), it is essential that IASC standards meet the demands of those capital markets for high-quality financial information.

In undertaking the project, the FASB staff sought to obtain greater understanding of the specific nature of IASC standards. At the time that the project began (in 1995), detailed information about the level of comparability of reported financial results between financial statements prepared based on IASC standards and those prepared based on U.S. GAAP was available to relatively few individuals. In large part due to increased awareness resulting from publicity surrounding the IASC's core standards project, research on the issues related to international comparability has increased. However, conclusions about the acceptability of IASC standards for cross-border securities listings and other purposes are mixed and often are supported by fragmentary evidence.

[54] Comment letters of the SEC staff and IOSCO Working Party No. 1 are available for inspection and copying in our public reference room.

[55] As noted in Chapter 1 of this report [*The IASC-U.S. Comparison Project: A Report on the Similarities and Differences between IASC Standards and U.S. GAAP*], the IASC published a discussion paper, *Shaping IASC for the Future,* in December, 1998. That discussion paper proposes changes to the IASC's objectives, standard-setting structure, and due process.

Some studies that compare IASC standards with U.S. GAAP have asserted that the two sets of standards are broadly similar or that use of IASC standards can lead to results similar to those that would have been obtained had U.S. GAAP been used. As some of the comparative analyses in this report show, some of the IASC standards and their U.S. GAAP counterparts do have a similar underlying approach to accounting in certain areas and it may be possible to arrive at similar results under both standards. However, the existence of alternatives, even within standards that are very similar, can create the potential for very different reported results. The comparative analysis of IAS 23, *Borrowing Costs*, provides an example. The allowed alternative treatment in IAS 23 requires capitalization of borrowing costs incurred in the acquisition, construction, or production of certain assets. That is very similar to the U.S. GAAP requirement. However, IAS 23's benchmark treatment requires that borrowing costs be expensed. That is very different from the allowed alternative treatment (and, consequently, from U.S. GAAP). The existence of both a benchmark and allowed alternative treatment has the potential to result in noncomparability both between IASC-based and U.S. GAAP-based financial statements and among financial statements prepared under IASC standards.

Other studies have concluded that IASC standards are too broad and general to ensure that similar accounting methods are applied in similar circumstances or that similar results are consistently achieved. While the guidance provided by IASC standards often is more general than that found in U.S. GAAP, IASC standards may be more rigorous than the national standards of some countries and, in some circumstances, may be equally or more effective than U.S. GAAP. For example, both IAS 2, *Inventories*, and U.S. GAAP provide broad, general guidance on cost-flow assumptions in estimating inventory cost. However, IAS 2 provides more-extensive guidance than does U.S. GAAP on the topic of accounting for inventories of service providers.

On the other hand, an absence of implementation guidance can lead to differences in applying standards that are broadly similar. For example, IAS 33, *Earnings per Share*, and its U.S. GAAP counterpart, FASB Statement No. 128, *Earnings per Share*, resulted from a cooperative standard-setting effort between the IASC and the FASB. The two standards are very similar. However, Statement 128 provides more-specific implementation guidance for some of the calculations required for determining earnings per share, for example, for determining the impact of different types of contingencies related to contingently issuable shares. There may be differences in earnings-per-share calculations between enterprises following IAS 33 and those following Statement 128 because, in the absence of implementation guidance, enterprises following IAS 33 are not required to determine the impact of contingently issued shares on the same basis as that described in Statement 128 and would not be prohibited from using alternative bases for making that determination.

Finally, not all questions about comparability relate to the comparability of financial statements prepared using different sets of accounting standards. Few studies have focused on comparability among the financial statements of enterprises following IASC standards. For example, there is little (if any) research that provides evidence of whether the IASC-based financial statements provided by an enterprise from France are comparable to the financial statements provided by a similar enterprise from Japan that also is following IASC standards. That type of comparison was beyond the scope of this report. Notwithstanding similarities with or differences from U.S. GAAP, because IASC standards will be applied in different national environments—each with its own set of national accounting standards or conceptual framework—IASC standards must be capable of being consistently interpreted and applied in order to meet the objective of international comparability among those enterprises that use IASC standards.

Thus, it would be misleading to make sweeping generalizations or blanket assertions about the relative quality of IASC standards based solely on the similarities and differences between two sets of accounting standards. The mere existence of differences between accounting standards is not a sufficient measure of the quality or merit of any particular accounting standard relative to the other. The true test of an accounting standard is whether it satisfies the demand for information in the environment in which it is intended to be used. What is required, therefore, is a fuller understanding of the nature of similarities and differences in the information provided in the financial statements as a result of applying the two sets of accounting principles. The FASB staff believes that the comparative analyses in this report will provide useful information to help interested parties evaluate the current state of IASC–U.S. GAAP comparability and draw their own conclusions.

Types of Differences

The comparative analyses in the following chapters identify a wide range of differences between IASC standards and U.S. GAAP and attempt to assess the impact of those differences on the comparability of the respective financial statements prepared using each set of standards. Not all differences between standards will be meaningful to financial statement users trying to compare investment opportunities. Some believe that differences in methodologies for deriving financial information and where in the financial statements it is presented (which are important considerations for standard setters in developing accounting requirements) are less important than whether the resulting financial information provided is essentially the same. For example, two standard setters may have different underlying conceptual bases for concluding on a particular recognition or measurement requirement, but the financial information that results from applying either standard could be the same. Financial statement users may not find the difference in concepts troublesome in that case.

From the perspective of financial statement users, other types of differences may be seen as more problematic because they are likely to result in differences between the information reported for a given reporting period in financial statements of enterprises following IASC standards and the information reported by those following U.S. GAAP that would be difficult to compensate for in making comparisons. For example, the types of differences of greatest significance in comparing financial statements are likely to fall within the following categories: [56]

1. *Recognition differences.* Differences in recognition criteria and guidance for initial or subsequent recognition of the same financial statement item can lead to differences in:

- Whether that particular item is recognized at all.
- How recognition of that item affects the financial statements (for example, capitalization of an item on the balance sheet versus expensing that item as incurred in the income statement).
- When (that is, in what reporting period) the item is initially recognized.

2. *Measurement differences.* Different approaches to initial or subsequent measurement can lead to differences in the amounts recognized for the same item in financial statements. For example, one standard might require that an item be subsequently measured at amortized cost, while its counterpart might require the same type of item to be revalued to current cost or fair value in each reporting period.

3. *Alternatives.* Differences can arise when one standard permits a choice between two or more alternative methods of accounting for a similar transaction, but its counterpart requires use of a single method. For example, one standard might permit an item to be either capitalized or expensed as incurred, but its counterpart might require the same item to be expensed as incurred. When alternatives are permitted, that can also lead to differences between the financial statements of two enterprises following the same set of standards.

4. *Lack of requirements or guidance.* Differences also can arise when one standard does not provide requirements or guidance for a particular topic or class of transactions within an accounting area covered by its counterpart. For example, one standard might provide specific guidance for recognition and measurement of government grants, while its counterpart might lack guidance covering that area.

5. *Other differences.* There are some other specific differences between IASC standards and U.S. GAAP that affect the basis for presentation of information contained in the financial statements. Examples of areas in which those differences occur are the

[56] There also are less-significant differences between IASC standards and U.S. GAAP that contribute to noncomparability, for example, differences in definitions of line items and in presentation requirements. While those differences are identified in the chapters that follow, the discussion in this chapter is limited to examples in the categories of differences identified because they are likely to be the most significant from a financial statement user's perspective.

presentation of financial statements, segment reporting, business combinations, consolidation policy, and certain transition provisions.

The significance of the types of differences in the categories described above in any particular case would depend on a number of factors. For example, even if the recognition and measurement requirements of two standards that cover the same item are very different, those differences might not be significant to a financial statement user if the enterprises being compared rarely, if ever, engage in transactions giving rise to that item. To illustrate, for purposes of comparing IASC-based and U.S. GAAP-based financial statements, a financial statement user likely would be more concerned about differences in the recognition and measurement of construction contracts when comparing the financial statements of two shipbuilding enterprises, one based on IASC standards and one based on U.S. GAAP, than when comparing the financial statements of two financial institutions, one based on IASC standards and one based on U.S. GAAP.

On the other hand, differences in recognition and measurement requirements related to transactions or events that are common to most enterprises could create pervasive differences in the line items and amounts reported by enterprises following IASC standards and those following U.S. GAAP for one or more reporting periods. For example, differences in revenue recognition or income tax accounting are likely to impact comparisons of the financial statements of the vast majority of enterprises. Unless additional information is provided elsewhere in the financial statements to enhance comparability, differences generally contribute to increased uncertainty for financial statement users in assessing and making investment decisions.

Comparisons may be affected for a single reporting period or over a number of reporting periods. With the exception of the few instances in which an item may be required to be recognized under one set of standards but never recognized under the other, the effects of many of the differences described above and illustrated in the next section will eventually vanish. That is, if, for example, one standard requires a cost to be expensed whereas the other requires the same cost to be amortized over a specified period, comparability in the reporting periods in which the cost is initially recognized and subsequently amortized will be hindered. However, once the cost is fully amortized, the effect on the financial statements of the difference in accounting for that cost will disappear. As a result, a particular difference in requirements might create more than one type of difference in reported results. For example, different recognition criteria might not only result in differences in how an item is recognized (for example, whether as an expense or an asset), but also might impact the period or periods in which that item is recognized. For that reason, actual differences identified in the comparative analysis may overlap in the five categories of differences described above. The next section of this chapter highlights some examples of the more significant differences in those five categories from the perspective of assessing comparability of financial information that would be provided under IASC-based and U.S. GAAP-based financial statements that cover the same reporting period.

1. Recognition Differences

As noted above, different recognition requirements between an IASC standard and its U.S. GAAP counterpart can create differences in whether, how, and when an item is reported in financial statements. The following examples illustrate those differences.

Recognized or Unrecognized

Some types of recognition differences would require an item to be recognized under one standard, but the same item would be required to go unrecognized under its counterpart standard. One example of that type of difference between IASC standards and U.S. GAAP is the recognition requirements for leases. In the United States, the issue of whether to recognize a leased item as an asset of the lessee or keep it off-balance-sheet with periodic rental charges flowing through the income statement has been fiercely debated and generally centers on different perceptions of the substance of the lease transaction, that is, when to conclude that the lessor transfers the risks and rewards of ownership of the leased asset to the lessee as a result of the lease agreement. Because of the controversy over that issue and partly because there is a propensity in the United States to structure lease transactions so as to avoid capitalization, U.S. GAAP provides a great deal of detailed guidance for accounting for lease transactions.

In comparing IAS 17, *Leases,* and FASB Statement No. 13, *Accounting for Leases,* many similarities can be identified. Both standards define leases similarly, and both require that a leased item be recognized as an asset on the lessee's balance sheet for leases under which substantially all the risks and rewards incident to ownership of the leased asset are transferred to the lessee (that is, for leases classified as capital leases (Statement 13) or finance leases (IAS 17)). No asset is recognized by the lessee if the lease is classified as an operating lease. However, IAS 17's implementation guidance for determining lease classification is less detailed than the corresponding Statement 13 guidance. For example, Statement 13 provides specific quantitative criteria to be met in determining whether a leased item should be capitalized. IAS 17 relies instead on management's assessment of the ''substance'' of the lease transaction.

It is difficult to predict how often leased items that would be capitalized under Statement 13 would also be capitalized under IAS 17. Statement 13's ''bright line'' approach removes some of the judgment that otherwise would be necessary to determine the substance of the lease transaction (that is, whether it is a capital lease or an operating lease). However, it also permits lease transactions to be structured to meet (or to avoid meeting) the specified criteria. IAS 17's approach provides more room for judgment in determining the substance of the lease transaction, and it is difficult to know if all enterprises applying IAS 17 would interpret ''substance'' similarly. However, the IAS 17 approach may result in balance sheet recognition of a lease that is in substance a capital lease but that does not meet the criteria in Statement 13. Whether or not the same item is recognized or unrecognized can create obvious comparability problems for financial statement users, especially when trying to evaluate an enterprise's capital structure, determine financial ratios, and measure its performance.

In the comparative analyses that follow, there are relatively few areas in which the same item would be required to be recognized under one standard but would be required to be unrecognized under its counterpart. However, the following are some examples.

Income taxes. Differences between IAS 12, *Income Taxes,* and FASB Statement No. 109, *Accounting for Income Taxes,* can lead to an item being recognized under one standard but not the other. For example:

- Statement 109 prohibits and IAS 12 requires recognition of deferred taxes for temporary differences related to (a) foreign currency nonmonetary assets when the reporting currency is the functional currency and (b) intercompany transfers of inventory or other assets remaining within the consolidated group.

Employee benefits. Differences between IAS 19, *Employee Benefits,* and related U.S. GAAP can lead to an item being recognized under one set of standards but not the other. For example:

- Expense for equity compensation benefits (such as employee stock options) is not recognized under IAS 19. U.S. GAAP requires recognition of an expense for certain types of equity compensation benefits.

Same Item, Different Accounting Treatment

A more common type of difference identified in the comparative analyses is that in which the two standards specifically require the same item to be treated differently. The following example illustrates that type of difference.

Under U.S. GAAP, all internally generated research and development costs are required to be expensed as incurred. Under IAS 38, *Intangible Assets,* all costs identified as research costs are to be expensed; however, costs identified as development costs are to be capitalized if they meet specified criteria. Thus, the financial statements of an enterprise with development costs following IASC standards would not be comparable to those of an identical enterprise following U.S. GAAP. Using IASC standards, the enterprise would report higher income in the year that development costs are incurred and lower income in subsequent years than it would if it accounted for the same costs under U.S. GAAP. Comparability of cash flows also would be permanently impacted because cash flows related to development costs under U.S. GAAP generally would be reported as operating cash flows, whereas under IASC standards those cash flows would be reported as cash flows related to investing activities. IASC-based financial statements would be comparable to U.S. GAAP-based financial statements only if all

costs for those expenditures are identified as research costs or if no development costs qualify for capitalization.

All other things being equal, capitalizing an item rather than expensing it as incurred can have a long-term impact on financial statement comparison and analysis of both the balance sheet and income statement. Financial results for identical enterprises will differ each year until a capitalized item is completely amortized. Further, the resulting differences in classification of reported cash flows will never reverse. Unless adequate information is provided to equate two otherwise identical enterprises or to track expensed items over time, it may be difficult to adjust for those differences.

Examples of areas in which there is a possibility of encountering different recognition treatments of the same item depending on whether IASC standards or U.S. GAAP is applied include the following areas identified in the comparative analyses.

Depreciation or amortization. IASC standards and U.S. GAAP differ in the treatment of adjustments to depreciation and amortization amounts that result from a change in depreciation or amortization method:

• Under IASC standards, the impact of a change in depreciation or amortization method is recognized as an adjustment to depreciation or amortization expense in current and prospective periods affected by the change. U.S. GAAP generally requires recognition in the current period of the cumulative effect of that type of change.

Construction contracts. Differences between IAS 11, *Construction Contracts,* and U.S. GAAP can result in different financial statement recognition for similar items:

• Differences in requirements to combine or segregate construction contracts can lead to differences in profit recognition for construction contracts depending on whether IAS 11 or U.S. GAAP is followed.

• IAS 11 requires the use of the percentage-of-completion method to recognize contract revenue and expenses if the outcome can be estimated reliably; otherwise, IAS 11 requires the use of the zero-profit method. U.S. GAAP requires, in certain situations, the use of the completed-contract method of accounting for contracts.

Leases. Recognition of profit or loss on certain sale-leaseback transactions can differ depending on whether IASC standards or U.S. GAAP is followed:

• Statement 13 generally requires profit or loss deferral on a sale-leaseback transaction that is classified as an operating lease. IAS 17, on the other hand, requires immediate profit or loss recognition for a sale-leaseback transaction classified as an operating lease if the sale transaction is established at fair value.

Employee benefits. Recognition differences can lead to noncomparability for certain types of employee benefits:

• IAS 19 requires prior service cost related to retirees and active vested employees to be expensed, whereas U.S. GAAP requires that prior service cost be amortized over the expected service life of existing employees.

• Under IAS 19, a liability for a benefit obligation would be recognized for certain multiemployer plans that would not qualify for similar recognition under U.S. GAAP. Rather, the employer's contribution to those multiemployer plans would be recognized under U.S. GAAP as an expense in the period that the related employee services are rendered.

Business combinations. Treatment of certain items acquired in a business combination accounted for as a purchase can have a significant impact on the comparability of IASC-based and U.S. GAAP-based financial statements:

• In-process research and development acquired in a business combination is capitalized under IAS 22, *Business Combinations,* (either separately or as part of goodwill). Under U.S. GAAP, the amount of the purchase price allocated to in-process research and development acquired in a business combination is expensed.

Borrowing costs. Although an alternative similar to U.S. GAAP is available under IAS 23, the effects of applying the benchmark treatment for accounting for borrowing costs would be quite different from the effects of applying U.S. GAAP:

• Enterprises following the benchmark treatment under IAS 23 would expense borrowing costs incurred related to the acquisition, construction, or production of an asset. Under U.S. GAAP, capitalization of those costs is required for qualifying assets.

Financial instruments. Differences between IAS standards and related U.S. GAAP can lead to different accounting treatments for the same financial instruments:

• IAS 32, *Financial Instruments: Disclosure and Presentation,* requires that mandatorily redeemable preferred stock be classified as a liability with its dividends recognized as expenses in the income statement. Under U.S. GAAP, mandatorily redeemable preferred stock is classified as neither a liability nor equity, and dividends are deducted from net income in arriving at income available to common stockholders.

• IAS 32 requires that the issuer of a financial instrument that contains both a liability and an equity element (such as convertible debt) classify the instrument's component parts separately. U.S. GAAP prohibits separate presentation of the liability and equity components of convertible debt unless warrants are detachable.

• The U.S. GAAP distinction between sales and secured borrowings is different from that in IAS 39. As a result, more asset transfers would qualify for sale accounting treatment under IAS 39 than would qualify for sale accounting treatment under U.S. GAAP.

Timing Differences

Even if two standards require the same item to be recognized and the same accounting treatment, different recognition criteria can result in recognition of the same item in a different reporting period. For example, IAS 12 requires recognition of the effects of a change in tax laws or rates when the change is ''substantively enacted.'' Thus, recognition may precede actual enactment by a period of several months. Statement 109 requires recognition upon actual enactment, which, in the United States, is the date that the president signs the tax law.

Timing of recognition may differ between IASC standards and U.S. GAAP for other items as well. Some examples follow.

Business combinations. There are differences between IASC standards and U.S. GAAP for negative goodwill, goodwill, and acquired intangible assets that will affect the timing of recognition:

• The timing of income statement recognition of negative goodwill may differ as a result of different methods for amortizing negative goodwill specified in IAS 22 and APB Opinion No. 16, *Business Combinations.*

• The periods over which amortization expense related to goodwill and intangible assets is recognized may differ between IASC standards and U.S. GAAP.

Discontinuing operations. Presentation and recognition and measurement requirements differ between IAS 35, *Discontinuing Operations,* and related U.S. GAAP:

• Timing of segregation of discontinuing operations from continuing operations may differ depending on whether IAS 35 or U.S. GAAP is followed.

• Timing of recognition of gain or loss on discontinuance and income or loss from activities of the discontinuing operation may differ depending on whether IAS 35 or U.S. GAAP is followed.

Provisions and contingencies. Recognition requirements under IAS 37, *Provisions, Contingent Liabilities and Contingent Assets,* differ from requirements in U.S. GAAP:

• Timing of recognition of provisions under IAS 37 may differ from the timing of recognition of liabilities and contingent losses under FASB Statement No. 5, *Accounting for Contingencies.*

• The timing of recognition of liabilities associated with a restructuring may differ due to different recognition thresholds.

Impairment. Differences in approach between IAS 36, *Impairment of Assets,* and FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of,* can lead to differences in timing of recognition for impairment losses:

• Timing of recognition of impairment losses may differ due to different recognition thresholds.

Interim financial reporting. Because of different approaches to preparing interim financial information, certain items may be recognized in different periods and at different amounts depending on whether IAS 34, *Interim Financial Reporting,* or U.S. GAAP is followed:

• The U.S. GAAP requirements related to timing of recognition of certain accruals made for interim reporting purposes differ from the requirements of IAS 34, including requirements related to purchase price variances and volume or corporate cost variances expected to be absorbed by year-end and accrual or deferral of costs clearly expected to benefit two or more periods.

2. Measurement Differences

Differences in whether and when an item is recognized in the financial statements are not the only differences that can raise comparability issues. How items are valued, especially subsequent to initial recognition, can impede straightforward comparison.

Subsequent Measurement

One example of a measurement difference relates to the requirements for subsequent measurement of impaired assets. IAS 36 and Statement 121 take significantly different approaches to reversals of impairment losses. IAS 36 requires impairment losses to be reversed on assets (excluding goodwill) when certain impairment indicators reverse, provided that the estimates used to determine those assets' net selling prices and values in use have changed. IAS 36 requires impairment losses on goodwill to be reversed if certain other conditions are met. In contrast, Statement 121 prohibits reversal of impairment losses in all circumstances for assets held and used. Thus, the carrying amounts of certain assets may differ depending on whether IASC standards or U.S. GAAP is followed.

Other examples of possible differences in measurement between IASC standards and U.S. GAAP are identified below.

Leases. Different measurement guidance in IAS 17 and U.S. GAAP can lead to different amounts reported for lease transactions:

• There are differences between IAS 17 and U.S. GAAP related to the calculation of minimum lease payments and the rate used to discount minimum lease payments.

Employee benefits. Although similar in many ways, some aspects of measurement of employee benefits differ between IAS 19 and U.S. GAAP:

• In measuring the employer's benefit obligation, IAS 19 permits an enterprise to anticipate changes in future postemployment benefits based on its expectations of changes in the law that would impact variables such as state medical or social security benefits. U.S. GAAP expressly prohibits anticipating changes in the law that would affect those variables.

• U.S. GAAP requires recognition of a minimum liability on the balance sheet equal to at least the unfunded accumulated pension benefit obligation. IAS 19 does not.

Provisions. Comparability of amounts recognized for certain types of liabilities can be impacted by differences between IASC standards and U.S. GAAP:

• IAS 37 provides a variety of recognition criteria for different items that may enter into the measurement of a provision. Consequently, the amounts of provisions may vary among enterprises that apply IAS 37 and between those enterprises and those that apply U.S. GAAP.

Discontinuing operations. A fundamentally different approach to measurement of discontinuing operations can make comparisons of IASC-based and U.S. GAAP-based financial statements difficult:

• Under IAS 35, the *actual* operating results of a discontinuing operation are reported as part of discontinuing operations when incurred. Under APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions,* the *estimated* operating results of a discontinuing operation are included in the measurement for the expected gain or loss on disposal.

Impairment. Judgment is required in applying both the U.S. standard and IASC standard on impairment. However, specific measurement differences will contribute to the potential for noncomparability:

• IAS 36 requires an impairment loss to be measured as the amount by which an asset's carrying amount exceeds its impairment recognition trigger (the higher of net selling price or value-in-use), whereas Statement 121 requires an impairment loss to be measured as the amount by which an asset's carrying amount exceeds its fair value.

Borrowing costs. Measurement differences can affect the comparability of items even when similar recognition principles apply:

• Enterprises choosing to capitalize borrowing costs under the allowed alternative in IAS 23 (which is similar to the requirement to capitalize those costs under U.S. GAAP) might measure those costs differently than enterprises following U.S. GAAP if they include foreign currency exchange gains and losses related to those costs.

Interim financial reporting. Different measurement principles for inventories can affect amounts reported in interim periods:

• U.S. GAAP does not require recognition in interim periods of inventory losses from market declines that reasonably can be expected to be restored in the fiscal year. IAS 34 does.

Financial instruments. There are differences in the measurement requirements between IAS 39, *Financial Instruments: Recognition and Measurement,* and related U.S. GAAP for the same financial instruments:

• IASC standards provide for classification as trading, available-for-sale, or held-to-maturity for all types of financial assets. U.S. GAAP applies those classifications only to securities. As a result, measurement of some financial assets would differ depending on whether IASC standards or U.S. GAAP was followed.

• IAS 39 requires that hedging gains and losses from cash flow hedges of firm commitments and of forecasted transactions be included as part of the initial measurement of the cost basis of the related hedged item (basis adjustment). U.S. GAAP does not permit basis adjustment for cash flow hedges. Instead, it requires that hedging gains and losses on cash flow hedges be recorded in other comprehensive income when they occur and reclassified into earnings over the period that the hedged item affects earnings.

• Certain commodity contracts for which an enterprise normally takes delivery would be initially and subsequently measured at historical cost under IAS 39, with any gain or loss recognized as part of the cost of the goods acquired when the contract is settled. Under U.S. GAAP, those contracts would be measured at fair value unless no market mechanism exists to net settle the contract.

3. Alternatives

Comparability between IASC-based and U.S. GAAP-based financial statements may be hindered if one standard explicitly permits a choice among alternative approaches for a particular topic and the other (1) requires a single approach that is somewhat like one of the alternatives or (2) also permits a similar choice of approaches. Such alternatives may relate to recognition, measurement, display, or disclosure requirements. Free choice alternatives not only create problems in comparing financial statements based on different standards, but also in comparing financial statements based on the same set of standards.

In some cases, the IASC standard permits a choice and U.S. GAAP does not. For example, under IAS 16, *Property, Plant and Equipment,* an enterprise can choose to measure its property, plant, and equipment following either the benchmark treatment, that is, to carry those assets at cost (less accumulated depreciation and accumulated impairment losses), or the allowed alternative treatment, that is, to periodically revalue its property, plant, and equipment to fair value (less subsequent accumulated depreciation and subsequent accumulated impairment losses). Revaluation increases under the allowed alternative treatment are credited directly to equity as revaluation surpluses unless they reverse a revaluation decrease that was previously recognized as an expense, in which case they are credited to income. Revaluation decreases are first charged against any surpluses for the same asset, then they are recognized as expenses. Upon disposal of a revalued asset, the amount recognized in the income statement under IAS 16 as gain or loss on disposal differs from that which would be recognized for a similar asset that was accounted for at historical cost. IAS 16 also permits a choice for presentation of revalued assets: gross assets and accumulated depreciation can be proportionately restated to equal the revalued amount or the gross assets and accumulated depreciation accounts can be eliminated and the net revalued amount presented.

U.S. GAAP requires accounting similar to IAS 16's benchmark treatment and does not permit revaluation accounting for fixed assets. The financial statements of an enterprise choosing to revalue its assets under the IASC standard would not be readily comparable to those of an enterprise following U.S. GAAP, nor would they be comparable to the financial statements of an enterprise following IASC standards that chose not to revalue its assets. The impact of revaluation on the financial statements may not be obvious or easy to trace, depending on how often assets are revalued, how they are grouped for revaluation, and what choices are made for their presentation in the balance sheet. Nor can financial statements prepared under U.S. GAAP be easily adjusted to compare with revalued amounts for property, plant, or equipment in IASC-based financial statements. For financial statement users making comparisons, there may be uncertainty related to the determination of revalued amounts, the validity of certain asset ratios, and the ability to evaluate performance.

In other cases, U.S. GAAP permits a choice of alternative approaches and the IASC standard does not. For example, IAS 11 and AICPA Statement of Position 81–1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts,* both address the topic of how a construction contractor calculates the components of

income earned. SOP 81–1 explicitly permits a choice between two approaches: a revenue-cost approach and a gross-profit approach. IAS 11 requires the revenue-cost approach.

Sometimes both sets of standards permit a similar range of alternatives on a particular topic. For example, IAS 2 and ARB No. 43, Chapter 4, ''Inventory Pricing,'' permit a similar range of accounting choices in measuring the cost of inventory. Those choices include the use of the retail or standard cost method in estimating the cost of inventory and the use of specific identification; first-in, first-out; average cost; or last-in, first-out in reporting the flow of cost. Identical accounting among enterprises applying the IASC standard or among enterprises applying U.S. GAAP or between those applying the IASC standard and those applying U.S. GAAP will be achieved only by coincidence.

Examples of other areas identified in the comparative analyses that illustrate the provision of alternatives within IASC standards, U.S. GAAP, or both include the examples identified below.

Cash flow statements. Although the two standards are mostly similar, there are some areas in which the requirements of IAS 7, *Cash Flow Statements,* and those of FASB Statement No. 95, *Statement of Cash Flows,* differ:

• IAS 7 permits a choice of classifying (1) dividends and interest paid or received as operating cash flows or (2) interest or dividends paid as financing cash flows and interest or dividends received as investing cash flows. Statement 95 requires that the interest paid and dividends received be classified as operating cash flows and that dividends paid be classified as financing cash flows.

Correction of an error and accounting changes. Differences in the permitted alternatives to accounting for error corrections and accounting changes can impact the comparability of IASC-based and U.S. GAAP-based financial statements:

• In accounting for a fundamental error, an enterprise following the benchmark treatment in IAS 8, *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies,* would correct the error by an adjustment to the opening balance of retained earnings for the earliest period presented. However, under IAS 8's allowed alternative, fundamental errors are corrected by inclusion in net income and by supplemental disclosure. U.S. GAAP requirements for correction of an error are identical to IAS 8's benchmark treatment.

• The IAS 8 benchmark treatment for accounting changes requires restatement of prior periods. However, IAS 8 also permits the application of either the cumulative-effect method or the prospective method if the amounts needed to restate prior periods are not ''reasonably determinable.'' [57] Under U.S. GAAP, the general rule is to use the cumulative-effect method for changes in accounting principle, although restatement of prior periods is required for certain changes. In specific circumstances, U.S. GAAP allows changes in accounting principle to be handled prospectively. Given those differences, comparability of net income and retained earnings amounts could differ significantly between financial statements prepared under IAS 8 and those prepared under U.S. GAAP.

Foreign currency translation. Alternatives provided under IAS 21, *The Effects of Changes in Foreign Exchange Rates,* differ from the requirements in FASB Statement No. 52, *Foreign Currency Translation:*

• IAS 21 permits two methods of accounting for exchange losses on a liability for the recent acquisition of an asset invoiced in a foreign currency: (1) charge those exchange losses to expense or (2) add the exchange losses to the cost of the asset when the related liability cannot be settled and there is no practical means of hedging. Statement 52 requires that those exchange losses be expensed in all cases.

• IAS 21 also permits alternatives in translating goodwill and fair value adjustments to assets and liabilities that arise from purchase accounting for the acquisition of a foreign entity for which the foreign currency is the functional currency. Under IAS 21, use of either the current exchange rate or the historical exchange rate is permitted. When the foreign currency is the functional currency, Statement 52 requires use of the current exchange rate to translate all balance sheet items, including goodwill and fair value adjustments.

Borrowing costs. Depending on the alternative accounting treatment chosen under IAS 23, the accounting for those costs under IASC standards can differ significantly from their accounting under U.S. GAAP:

• IAS 23 allows enterprises to choose between two methods of accounting for borrowing costs. The benchmark treatment requires that enterprises expense all borrowing costs in the period in which they are incurred. The allowed alternative treatment requires capitalization of borrowing costs as part of the cost of an asset to the extent the borrowing costs are attributable to the acquisition, construction, or production of a qualifying asset. FASB Statement No. 34, *Capitalization of Interest Cost,* requires an approach similar to IAS 23's allowed alternative.

Investments in associates. In the financial statements of an enterprise without subsidiaries, accounting for an investment that gives the investor significant influence can differ between IASC-based financial statements and U.S. GAAP-based financial statements:

• IAS 28, *Accounting for Investments in Associates*, permits investments in associates to be measured using the equity method, cost, or fair value in the financial statements of entities without subsidiaries and requires disclosure of what would have been the effect had the equity method been applied. APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, requires the use of the equity method regardless of whether an entity has subsidiaries.

Joint ventures. An enterprise following IASC standards has a choice in accounting for investments in joint ventures, whereas U.S. GAAP specifies a single method:

• IAS 31, *Financial Reporting of Interests in Joint Ventures*, permits use of either the equity method or proportionate consolidation method of accounting for interests in corporate joint ventures. Opinion 18 generally requires the use of the equity method.

Intangible assets. Like the choice for subsequent measurement for property, plant, and equipment under IAS 16, enterprises following IAS 38 can choose to revalue certain intangible assets:

• IAS 38 provides two methods for subsequent measurement of an intangible asset. The first requires that an acquired or internally generated intangible asset be carried at amortized cost less any accumulated impairment loss. That method is similar to accounting required by U.S. GAAP. The second method allows an intangible asset that has an active market to be revalued at regular intervals. U.S. GAAP does not permit revaluation accounting for intangible assets.

4. Lack of Requirements or Guidance

Comparability also is impacted when either the IASC standard or the closely related U.S. GAAP addresses an accounting area or class of transactions not explicitly addressed by the other. For example, U.S. GAAP provides guidance for a number of specialized industries and specialized transactions that are not specifically addressed in IASC standards. IASC standards currently lack guidance for the unique aspects of insurance and rate-regulated enterprises; not-for-profit entities; the extractive (for example, oil and gas), health care, and entertainment industries; agricultural and forest products; and employee stock-compensation plans.[58]

Although U.S. GAAP in total addresses more topics than IASC standards do, several IASC standards address topics that are not covered by U.S. GAAP. Many of those are topics in which IASC standards provide definitions of terms that are not explicitly defined in U.S. GAAP or that relate to display or disclosure requirements not specified in U.S. GAAP.[59] There are some topics identified in IASC standards that provide recognition or measurement guidance not found in U.S. GAAP. For example, IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, provides accounting standards for government grants and other forms of government assistance to business enterprises in a single standard. No U.S. standard comprehensively addresses that topic.

Other examples of areas in which one standard provides guidance but the other does not follow.

[57] In the absence of specified transition provisions, an enterprise following IASC standards must follow the guidance in IAS 8. For first-time application of IASC standards, an enterprise would also look to the guidance provided in SIC Interpretation 8, *First-Time Application of IASs* as the Primary Basis of Accounting.

[58] The IASC currently has projects on its agenda to address accounting issues related to insurance enterprises and agriculture.

[59] While those items may not be addressed explicitly in U.S. GAAP, in some cases the IASC guidance is similar to established practice in the United States.

Inventories. IASC standards provide guidance in the areas of disclosure and accounting for the inventories of service providers. U.S. GAAP does not. U.S. GAAP provides specialized guidance on inventories related to the motion picture, software, and agricultural industries. IASC standards do not.

Accounting changes. IASC standards do not provide recognition guidance for changes in reporting entities. U.S. GAAP does.

Income taxes. U.S. GAAP provides guidance for aspects of income tax accounting related to (1) measurement of income taxes when there are different tax rates for distributed and undistributed income, (2) measurement of deferred income taxes in tax jurisdictions that have alternative minimum tax systems, and (3) accounting and disclosure of income taxes in the separately issued financial statements of an entity that is a member of a group that files a consolidated tax return. Those areas are not specifically addressed in IASC standards.

5. Other Differences

Some other specific differences between IASC standards and U.S. GAAP affect the basis for presentation of information contained in the financial statements. Those differences occur in the areas of business combinations, consolidation policy, presentation of financial statements, segment reporting, and certain transition provisions. Each of those is an area in which a different approach to preparing financial information is possible, and that has implications for the recognition, measurement, display, or disclosure of an entire class of transactions or events, rather than a single line item. The differences between IASC and U.S. accounting standards in those areas can result in pervasive differences in the information contained in the financial statements that generally are difficult, sometimes impossible, to compensate for with other information. Those examples are discussed below.

Business combinations. A business combination that is accounted for as a pooling of interests is reflected in subsequent financial statements by combining the financial statement items (including asset, liability, and equity items) of each enterprise, for the most part, at their existing carrying amounts. Under both IAS 22 and Opinion 16, if a business combination does not qualify as a pooling of interests, it must be accounted for under the purchase method. Under the purchase method, the subsequent financial statements of the acquirer will reflect the allocation of the purchase price (cost of acquisition) to the identifiable assets and liabilities acquired and any resulting goodwill (or negative goodwill) that arises from an excess of the cost of acquisition over the acquirer's interest in the fair value of the identifiable assets and liabilities acquired (or any excess of the acquirer's interest in the fair value of the identifiable assets and liabilities acquired over the cost of acquisition).

Under IAS 22, inability to identify the acquirer in a business combination is the overriding condition that must be met to use the pooling-of-interests method. In contrast, U.S. GAAP requirements specify 12 conditions that must be met in order for an enterprise to use the pooling-of-interests method to account for a business combination. If the 12 conditions are met, the pooling-of-interests method is required. It is likely that fewer business combinations would qualify to use the pooling-of-interests method under IAS 22 because an acquirer can be identified in most combinations. As a result, most business combinations would be accounted for by the purchase method under IAS 22.

The effects of using the purchase method under IAS 22 for a business combination that would qualify for the pooling-of-interests method under Opinion 16 would prove extremely difficult, if not impossible, to identify from financial statements. Further, many of the differences in application of the two standards would have lasting effects, that is, comparability (of what are otherwise similar transactions) could be impaired for long periods of time as a result of the long-term or even permanent nature of many of the differences. (The same can be said for any comparison of financial statements in which one enterprise uses the purchase method of accounting and the other uses the pooling-of-interests method, whether IASC standards or U.S. GAAP is used.) The issue is compounded by the fact that much of the information that might be useful for assessing similarities and differences (for example, footnote disclosures containing purchase price information) would no longer be presented after a limited number of years. [60]

Consolidation policy. In general, consolidated financial statements combine, line item by line item, the assets, liabilities, equity, income, and expenses of a parent company and its subsidiaries with adjustments for certain items that relate to transactions and balances between component companies of the consolidated group. Under both IASC standards and U.S. GAAP, the basis for determining whether to include an entity as a subsidiary in the consolidated financial statements is control. However, whereas IAS 27, *Consolidated Financial Statements and Accounting for Investments in Subsidiaries*, defines control, U.S. pronouncements have focused on ownership of a majority voting interest. Thus, in the United States, preparation of consolidated financial statements primarily has been based on an ownership criterion—majority of the voting interest—rather than on some other criterion to assess the presence of control. It is likely that more entities would qualify for consolidation under IAS 27 because of the IASC's emphasis on control rather than on ownership of a majority voting interest. [61] The presentation and content of informatin provided in the consolidated financial statements related to entities in which the parent company has an interest will differ significantly from that which would have been presented if the entities had not been consolidated.

Presentation of financial statements. IAS 1, *Presentation of Financial Statements*, provides guidance for determining whether it is necessary for an enterprise to depart from applying IASC standards in order to achieve fair presentation. If an enterprise determines that compliance with one or more IASC standards would result in the selection and application of an accounting policy that would result in misleading financial statements, it must depart from the IASC standard (or standards) and select an alternative accounting policy. Similar guidance is found in U.S. auditing standards. However, while the requirements for departure from standards may appear similar between the IASC approach and U.S. approach to achieving fair presentation, the application may differ due to conceptual differences between the two approaches.

Under the IASC approach, fair presentation may be interpreted as a concept that overrides IASC standards because, in some circumstances, fair presentation can only be achieved by departure from IASC standards. The concept of fair presentation, therefore, is not confined by reference to a particular accounting standards framework. Those enterprises following IASC standards that determine that a departure from IASC standards is necessary may instead use a different standard, for example, a standard that is part of the set of national standards of its own country, if it is consistent with the IASC Framework for the Preparation and Presentation of Financial Statements. Under the U.S. approach, the notion of fair presentation exists only by reference to U.S. GAAP and is achieved by adhering to U.S. accounting standards and practices. As a result, in the United States, the departure itself is presumed misleading and inaccurate. That presumption must be overcome by demonstrating and disclosing the need for a departure. In practice, departures from U.S. GAAP are almost nonexistent. In other countries, departures from domestic GAAP requirements have been much more common. Thus, there is the possibility that the interpretation of fair presentation in the context of IASC standards versus fair presentation in the context of U.S. auditing standards would differ. The impact of that difference likely would vary on a case-by-case basis.

Segment reporting. A significant difference between IAS 14, *Segment Reporting*, and FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, relates to the process the standards prescribe for identifying reportable segments. Under IAS 14, specific requirements governing the format and content of a reportable segment provide the basis upon which all reportable segments are identified. An enterprise must comply with

[60] The FASB has a project on its agenda to reconsider the existing standards on accounting for business combinations. Changes to the existing requirements that will reduce differences between IASC standards and U.S. GAAP in the accounting for business combinations are likely to result from that project. For example, the FASB has reached a tentative conclusion to require use of the purchase method for all business combinations.

[61] The FASB has a project on its agenda to reconsider the existing standards on accounting for consolidations. The February 1999 FASB Exposure Draft, *Consolidated Financial Statements: Purpose and Policy*, proposes a definition of control similar to that in IAS 27 as the basis for consolidation.

those requirements regardless of the form and content of information provided by an enterprise's internal financial reporting system (although IAS 14 presumes that the enterprise's internal reporting system ''normally'' would provide the information necessary to comply with IAS 14's requirements). In contrast, Statement 131 adopts a management approach that relies on the form and content of information provided by an enterprise's internal reporting system for identifying reportable segments. The management approach requires an enterprise to report those segments whose operating results are regularly reviewed by the enterprise's chief operating decision maker. Segments reported under IAS 14 and Statement 131 would be comparable if an enterprise chose to construct its internal information systems so as to comply with both standards. Otherwise, significant noncomparability can result between the primary segments identified under IAS 14 and the operating segments identified under Statement 131.

Beyond identification of reportable segments, fundamental differences between the IAS 14 approach and the Statement 131 approach have implications for the measurement of reported segment information, even if the segments identified under IAS 14 and Statement 131 are comparable. For example, IAS 14 requires that an enterprise report ''a measure of segment result'' for each segment using the same basis of measurement (that is, accounting policies) used in the consolidated financial statements. Statement 131 requires disclosure of ''a measure of profit or loss.'' The measure of segment profit or loss disclosed in the financial statements is the measure reported to the chief operating decision maker, even if that measure is on a basis that differs from the basis used in the consolidated statements. As a result, it is unlikely that the measure of profit or loss disclosed for a particular segment by an enterprise following Statement 131 would be the same as the measure of segment result that would have been disclosed had the same enterprise followed IAS 14. As with identification of reportable segments, unless internal information systems are designed to comply with both standards, segment disclosures of enterprises following U.S. GAAP would differ significantly from those of enterprises following IASC standards. Further, more diversity also is likely among enterprises following Statement 131 than among those following IAS 14 because of the differences in approach.

Transition provisions. Although not always likely to create permanent differences, transition provisions are one area that may cause some comparability difficulties when comparing financial statements both among enterprises following IASC standards and between those following IASC standards and those following U.S. GAAP. That is particularly true for the transition provisions that relate to the IASC standards that were revised as part of the core standards project because a number of them are not yet effective and the effects of transition have not yet been reported in financial statements. The effects of transition are to be expected for those enterprises applying an IASC standard for the first time; however, transition issues can also arise for those enterprises that followed IASC standards issued prior to the core standards project when they adopt the revised standards that cover the same area.

For example, the transition provisions in IAS 22 (1998) require that IAS 22's new requirements be applied retrospectively. However, that requirement is more limited than it appears. That is because when IAS 22 was first revised in 1993, its transition provisions encouraged, but did not require, retrospective application (restatement). If not applied retrospectively, the balance of any preexisting goodwill was required to be accounted for in accordance with the revised standard from the date it was first effective. As a result of the transition provisions in the 1993 version of IAS 22, goodwill that arose on a business combination consummated prior to January 1, 1995, and that was written off against equity (as permitted by the original IAS 22 (1983)) would never be reinstated.

There are other areas, such as leases and employee retirement benefits, in which transition provisions can have various effects on comparability. The problem is compounded by certain U.S. standards that also provide for long periods of transition accounting (for example, FASB Statement No. 87, *Employers' Accounting for Pensions*). The effect of different transition requirements can vary from one standard to another and may relate to timing, recognition, measurement, and disclosure. Thus, financial statement users should be aware of the potential for comparability issues related to transition and should refer to individual standards to gain a better understanding of specific differences.

Summary

There are differences between the accounting requirements of IASC standards and those of U.S. GAAP. The examples provided above illustrate several differences in five broad categories: recognition, measurement, alternatives, lack of requirements or guidance, and other differences. The resulting differences in reported financial information can be very significant from both a conceptual standpoint and a practical standpoint. Issues related to whether to recognize and how to measure items in the financial statements are among the most fiercely debated by standard setters. For financial statement users, compensating for the types of differences illustrated above is likely to be difficult because the information necessary to reconcile them may not be available. Some of those differences may be temporary—for example, differences in the timing of recognition may be short-term—while others may be permanent—for example, differences in accounting for a business combination can have indefinite effects on financial statement comparability.

There are less-significant types of differences between IASC standards and U.S. GAAP that are not discussed above that can make financial statement analysis and comparison complicated. For example, differences in presentation and display of similar items may require additional effort by financial statement users in making comparisons, and differences in definitions can lead to reported items that appear to be similar but may, in fact, be different. Those types of differences also are identified in the comparative analyses that follow.

Identifying all of the reasons why IASC standards and U.S. GAAP differ would be impossible. However, some of the reasons for the differences can be traced to the characteristics of the standard setters themselves. Although both the IASC and the FASB are concerned with improving the quality of financial reporting and increasing international comparability, they focus on different financial reporting environments. With FASB's primarily domestic focus, FASB standards overall tend to be fairly detailed, responding to the complexities of the U.S. economic environment and a demand from sophisticated financial-statement users for reliable, high-quality financial information. IASC standards, on the other hand, respond to a variety of national perspectives about what financial information is the most relevant and reliable for a particular topic.[62] Consequently, the IASC develops standards without focusing on any particular economic environment, which may contribute to the tendency of IASC standards to be more general. That generality may be an inevitable characteristic of international standards, and additional guidance at the national level may continue to be necessary even in those nations that use IASC standards as national standards.

The existence of differences between accounting standards and resulting reported financial information is less important than the extent to which the reported financial information meets the demands of its consumers, that is, the financial statement users, in the market in which the information is provided. That should be the basis for assessing the acceptability of IASC standards for use in cross-border securities listings in the United States. Nonetheless, the observations about differences between IASC standards and U.S. GAAP in this and the chapters that follow provide a starting point for making that assessment by comparing IASC standards to those that have been developed with the objective of meeting U.S. capital market needs.

After a discussion of the methodology and significant considerations used in undertaking the project, the remaining chapters in this report provide comparative analyses of specific IASC standards and their related U.S. GAAP counterparts.

[FR Doc. 00–4217 Filed 2–22–00; 8:45 am]

BILLING CODE 8010–01–P

[62] Because the development of IASC standards and U.S. GAAP results from different objectives and processes, a qualitative assessment of the positive or negative impact of differences depends on the context in which the standards are intended to be applied. For purposes of the project, the U.S. capital market was chosen as the appropriate context for assessing the differences between IASC standards and U.S. GAAP. A similar project undertaken in a different country likely would make its comparison in the context of that country's capital market.