AIMR®

Association for
Investment Management
and Research®

Charlottesville • Hong Kong • London

560 Ray C. Hunt Drive • P.O. Box 3668
Charlottesville, VA 22903-0668 USA
Tel: 434-951-5499 • Fax: 434-951-5262
Email: info@aimr.org • Internet: www.aimr.org

22 April 2004

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File No. S7-15-04
RIN 3235-AI92
First Time Application of International Financial Reporting Standards

Mr. Katz:

The Financial Accounting Policy Committee (FAPC) and the Global Financial Reporting Advocacy Committee (GFRAC) of the Association for Investment Management and Research® (AIMR®)[1] is pleased to comment on the proposed rule, *First Time Application of International Financial Reporting Standards* (File No. S7-15-04). The FAPC and the GFRAC are standing committees of AIMR charged with representing the views of investors to and maintaining liaison with bodies that set financial reporting and disclosure standards and regulate financial statement disclosures. The FAPC responds to initiatives of standard-setters and regulators in the United States and Canada; and GFRAC responds to initiatives of the International Accounting Standards Board and standard-setters and regulators in jurisdictions outside North America. Both committees also maintain contact and dialogue with professional, academic, and other organizations interested in financial reporting.

General Comments

To be done comprehensively and effectively, financial analysis and investment decision-making require comparable and consistent financial reporting and disclosure information. Since forecasting of future performance and cash flows is a critical aspect of such analysis, investors need sufficient historical data to analyze past trends in income statement, balance sheet, and cash flow statement data and to permit reasonable forecasting of inputs to valuation models. Therefore, as a general rule, we are reluctant to agree to exempt a company from providing the number of years of data currently required in filings with the SEC.

[1] With headquarters in Charlottesville, VA, and regional offices in Hong Kong and London, the Association for Investment Management and Research® is a non-profit professional organization of 70,000 financial analysts, portfolio managers, and other investment professionals in 107 countries of which 57,000 are holders of the Chartered Financial Analyst® (CFA®) designation. AIMR's membership also includes 120 affiliated societies and chapters in 29 countries. AIMR is internationally renowned for its rigorous CFA curriculum and examination program and has more than 100,000 candidates from 143 nations enrolled.

Analyzing financial statements is not an easy task under the best of circumstances. It is particularly difficult when companies make fundamental changes in the principles applied, regardless of whether the choice is voluntary or mandated. While we are sympathetic when these changes will improve the relevance and usefulness of the financial statement information going forward, investors still need both adequate explanation about these changes to make good investment decisions and a sufficient bridge between the old and new to make the transition.

Permission to Omit Financial Statements for Third Financial Year

We support companies' adopting International Financial Reporting Standards (IFRS) as the basis on which they prepare their financial statements. We believe that IFRS are a high quality, comprehensive set of accounting principles and wish to encourage companies to move to IFRS from their domestic GAAP. Investors in the United States and globally will be better served when there are fewer GAAP regimes available for companies to use and when there is effective enforcement of the GAAPs that are used. Therefore, AIMR has publicly applauded the decision of the European Union to require its listed companies to adopt IFRS beginning 1 January 2005.

We do understand that conversion from one accounting regime to another is not a trivial task for companies under any circumstances. We also understand that preparers and auditors in the European Union are under considerable resource constraints and time pressure to have their accounting systems, internal and external controls in place for conversion to IFRS in 2005. We believe that it is critical for companies to direct their attention to ensuring that the financial statements that they will issue under IFRS are accurate and adequately audited for compliance. It will be critical for investors who must rely on those statements. Therefore, despite reservations, we are willing to support the Commission's proposal to provide relief from restatement of the third year of data. We agree, however, that this exemption should only apply to companies adopting IFRS, there should be a very short window of opportunity (until 1 January 2007) for such relief, and companies that have already published additional years of IFRS statements would not be eligible. Our reluctant support for the Commission's proposal is conditioned on the Commission's requiring additional data in prescribed formats, as described below, so that investors will have the ability to understand these fundamental changes and to update their analytical and valuation models.

Eligibility

We urge the Commission *not* to exempt companies who have purported or held themselves out as preparing IAS financial statements, whether or not the previous audit report referred to International Accounting Standards (IAS) or IFRS or made the statement that the financial statements were prepared under IAS or IFRS. Only those companies who are truly converting to IFRS should be eligible for this exemption.

Additional Data Requirements for Companies Omitting Third Year Financial Statements

First, in order to prepare 2004 financial statements, companies will need to have a January 1 opening balance sheet. In return for omitting the third year income statement, investors must be provided with this opening balance sheet. Since companies will have this information, it should be absolutely no hardship to provide it to investors. This will greatly assist investors in obtaining a better understanding of how the changes in the beginning and ending balance sheets over a two-year period translate into the reported earnings for those periods. Omitting the opening balance sheet significantly handicaps such an analysis.

Second, in doing their analysis, investors who will rely on the financial statements of those companies who omit the third year financial statements from Form 20-F will of necessity also rely on statements in previously filed Form 20-F prepared under the former GAAP. Therefore, reconciliation of the financial statements that are presented, together with additional narrative explanations, is critical. Because investors may have developed trends and forecasting models using the reporting GAAP, rather than US GAAP, in addition to any conventional reconciliation to US GAAP, there must be reconciliations and narratives that itemize the differences between the previous GAAP and the first-time application IFRS financial statements. These must be required for the (1) beginning equity balance, (2) income statement, (3) cash flow statement. This information is essential, not just “nice to have”, for investors to analyze and compare more accurately the performance and financial condition of a company, as well as between companies, for those periods reported under IFRS.

We believe that both numerical reconciliations and narrative explanations must be provided to make the transition more transparent between the financial statements prepared under the previous GAAP and those prepared under IFRS. Users of financial statements will need such disclosures to understand fully (1) the effects of the adoption of IFRS and (2) how to incorporate those effects into their financial analyses and the models they use to assess the performance and financial condition of a company. Therefore, it is imperative that reconciling amounts be shown gross rather than net of material items. Failure to provide gross amounts (which usually results in an amount that is labeled “other”) frustrates if not defies investors’ understanding. Users need to have disaggregated information, as well as narrative explanations, about items on the financial statements in order to predict trends and forecast cash flows.

Our request above for reconciliation of the old and new reporting GAAPs should not be considered a willingness on our part to relinquish the US GAAP reconciliation. As analysts, we use the US GAAP reconciliation (Items 17-18 of Form 20-F) to understand better the company and the financial reporting choices that it makes. We also believe that continuing to require the US GAAP reconciliation will encourage the FASB and IASB to work diligently to resolve the substantive convergence issues, as well as those convergence issues that may be accomplished more easily, and, therefore, lead to convergence more quickly.

Home Country Requirement for Third Year Financial Statements

Regardless of where in the world information may be required or provided, that information also should be required in Form 20-F. Therefore, it is essential that the Commission must require third year statements if they are required or provided by the issuer to anyone else or in any other jurisdiction.

Limitation on Time Frame for Eligibility

Regardless of the choice of date, some company may be disadvantaged. Since the primary responsibility of the Commission in regulating financial reporting and disclosure issues must be investor protection and since the real impetus for this exemption is the large number of preparers and auditors who are working on the adoption of IFRS in Europe, we do not believe that the Commission need be overly concerned in this regard. We believe that companies who are considering adopting IFRS have sufficient warning of the closing date for the exemption to take advantage of it if they wish.

The accommodation should definitely not be extended indefinitely. We find it hard to believe that a company would be encouraged or discouraged from the difficult and expensive task of changing its basis of accounting simply because it would be exempt in the United States from issuing three years of financial statements in the conversion year. That said, if a company would be encouraged by the presence of such a window, we are hopeful that the knowledge that the window will be shut will provide an inducement to change sooner.

References to Previous GAAP Statements and other Supplemental Disclosures

It is extremely helpful to investors when information is easy to find and comparable across companies. This is especially true for individual investors who may not have the time or other resources to sift and wade through disclosures for information critical to understanding the differences between what is provided now and what the company provided before. Therefore, we would strongly support the Commission requiring specific legends and language with respect to disclosures in the financial statements of first-time adopters of IFRS. A separate section that contains all relevant information about the change including the numerical reconciliations and narrative explanations of the changes from previous GAAP would seem to us to be a minimum requirement.

Financial Data to Be Disclosed

As we have said previously in this letter, sufficient historical data is critical to analysis. Therefore, in addition to other information that we have mentioned above, investors also need a reconciliation of shareowners' equity. This statement is critical to our constructing and understanding comprehensive income, especially in light of the sanctioned ability to defer certain gains and losses.

We also believe that investors' use of selected financial information would be facilitated if that information was presented together in the same section of the financial statements. Therefore, if we consider the current year to be Year 3, we would prefer to see the Commission require the following information and format:

(1) Primary Financial Statements under IFRS
    a. Balance sheets for the Year 2 and 3 as well as the opening balance sheet for Year 2
    b. Income statements for Year 2 and 3
    c. Cash flow statements for Year 2 and 3
    d. Complete footnote disclosures including a reconciliation of shareowners' equity for Year 2 and 3.
(2) Financial Statements under previous GAAP
    a. Balance Sheets for Year 1 and 2
    b. Income Statements for Year 1 and 2
    c. Cash Flow Statements for Year 1 and 2
    d. Footnote disclosures for all years presented including a reconciliation of shareowners' equity for Years 1 and 2.
(3) In the reconciliation footnote, we have no objection to providing side-by-side reconciliations.

With respect to selected financial data, we believe a minimum of 5 years must be required. This could easily be accomplished with three (3) tables provided on one page. The top table would contain information under IFRS, the next table would contain information for the years of previous GAAP, and US GAAP information for all years would be provided in the bottom table. We believe that if the tables are clearly labeled, investors will have no difficulty finding, using, and comparing this information, leading to better understanding of the financial statements as a whole.

Operating and Financial Review Prospects and Other Disclosures

As we discussed above, narrative and qualitative explanations of the information provided in the financial statements is important to ensure clarity and investor understanding of the implications of the current data from that which investors are accustomed to seeing and using. Therefore, we do not think it is sufficient for the Commission to require only explanations of the differences between IFRS and US GAAP. Many investors rely on the data reported in the primary financial statements for their analysis and to develop their forecasts of earnings and cash flows. These are the numbers that they forecast, not US GAAP information. In addition, investors will be relying on previously filed Form 20-F for their third year of financial statements. Therefore, contrary to the Commission's proposal, we recommend that issuers be required to include a section that explains the differences between IFRS and previous reporting GAAP. We do not believe that this is an undue burden on issuers. Rather we believe that this is issuers' responsibility to their current shareowners and to investors who are considering investing in their securities. Since companies have spent considerable time converting from a previous GAAP to IFRS, we would expect them to have a clearer and more in-depth understanding of the effects of this change.

This rationale applies to all supplemental disclosures provided by the company or required by Form 20-F. It is absolutely critical for investors to understand how the primary financial statements and other disclosures have changed because of the switch to IFRS from a previous GAAP. Yes, information about US GAAP is important. But we do not believe that investors can truly understand the differences between IFRS statements and US GAAP if they do not first understand the differences in the primary financial statements and other familiar disclosures caused by the adoption of IFRS in lieu of the previous GAAP.

Interim Reporting

Timely filing of interim reports is essential to investors. We are disappointed that the Commission did not take this opportunity to require this of IFRS reporting entities. We would urge the Commission to do so in the final rule.

With respect to the information contained in interim reports, we believe that investors are unlikely to be confused as long as companies present information in an appropriate format, adequately labeled. We have every confidence that investors who are familiar with analyzing and using financial statements in their investment decision-making process and who are prominently alerted to important changes in that information will know what to do. Although we remain "confused" about the degree of investor confusion, we believe that companies who truly want to communicate with investors will provide prominent, clear, attention-grabbing disclosures that will minimize or eliminate the potential for confusion.

We favor including both previous GAAP and IFRS information in interim reports. The more information that investors have about the differences they can expect between the numbers they are familiar with and the numbers they will see going forward, the better for everyone, investors and the companies alike. Therefore, if companies have IFRS and previous GAAP statements they should be required to provide them to investors.

In addition, we urge the Commission to be stringent about timely filing of interim reports. The utility of interim information in the analyses of periods within a year significantly diminishes when it is not timely. In addition, untimely filing of interim information undermines the complete understanding and analysis of the annual information when it is provided.

Timely Filing of Annual Financial Statements

Timely filing of annual financial statements is essential to investors. We are disappointed that the Commission did not take this opportunity to accelerate the filing of annual results for all 20F and 40F reporting entities. We urge the Commission to do so in the final rule.

Comprehensive Adoption of IFRS

Compliance with all IFRS must be required. It will set a terrible precedent if the Commission should allow companies that claim to report under IFRS yet do not fully comply with either an IFRS in its entirety or a particular provision of an IFRS. Qualified audit reports in this regard should not be permitted. IFRS has undergone the same due process procedures as US GAAP. Regulators should fully support this process and the requirements that issue from it. If any regulator, the Commission included, permits exemptions from IFRS requirements in their jurisdiction, we strongly believe such actions would undermine the IASB's independent standard-setting process.

Exceptions to IFRS

We did not support the elective and mandatory exemptions in IFRS 1. Because companies will take advantage of these exemptions, we believe adequate explanations of the extent and the effect of these exemptions on the financial statements is a critical piece of information for investors.

We agree that issuers should identify the items or class of items to which the exception was applied and they should provide a description of the accounting principle used and how it was applied. In addition, we support requiring an explanation, if not a numerical estimate or range, of the significance of each exception to the financial condition and results of operations. Information about the line item in which these measurements appear is also important.

Especially in the case where companies elect an exception, we believe they fully understand the quantitative and qualitative impact of this election on the financial statements and should disclose it. Else, we wonder about, and would like disclosed, the basis on which the company decided to make the election.

With respect to specificity about the disclosure, we prefer that the Commission provide companies with more rather than less information about what investors should expect to see. We are concerned that in the absence of specific requirements, companies will resort to boilerplate and cursory explanations that will meet the letter but not the spirit of the requirement.

Reconciliation to Previous GAAP

We have many times in this letter emphasized the importance of investors' understanding the change from previous GAAP to IFRS so that they can make the appropriate and correct changes to their analysis and valuation models. We cannot stress this too much. Therefore, we would like to reiterate that the Commission must require reconciliations to both previous GAAP and US GAAP if investors are to adjust to the change in reporting regime quickly and effectively.

We agree that companies should be required to provide the information and form required by IG63 of the Implementation Guidance to IFRS 1. This must be mandatory. We agree that requiring the same content and format would permit comparability with companies using IFRS but not listing in the US. We believe this efficiency would benefit investors.

With respect to the burden on issuers, we would also reiterate that, although IFRS financial statements should provide higher quality information to investors in the long term, in the short term investors will be challenged to understand and adequately adjust for the differences in the financial statements. Issuers must be required to provide as much information as possible— especially in this area where issuers would be expected to have a depth of understanding— so that investors can make the transition to IFRS statements efficiently and with minimum pain.

We believe this information is especially critical for individual investors who will not have the resources available to them that investment professionals do. If the Commission wants to minimize or forestall exploitable information inefficiencies that will work to the detriment of the average investor, we urge it to require more rather than less substantive information in this area. We also urge that the information be required to be provided in clear, useful formats with adequate narrative explanations of the numbers presented.

Again, the US GAAP reconciliation will provide an important and familiar link for investors between previous GAAP and IFRS. It is critical that this reconciliation be maintained.

Concluding Remarks

The members of the Financial Accounting Policy Committee and the Global Financial Reporting Advocacy Committee appreciate the opportunity to express their views on the Proposed Rule: First-time Application of International Financial Reporting Standards (File No. S7-15-04). If the Commission or its staff have any questions or would like further clarification of our views, please contact Patricia Doran Walters, CFA, at 1 434 951 5315 or patricia.walters@aimr.org. We would be pleased to provide any additional information you might request.

Respectfully yours,

/s/ Jane Adams, CPA
Chair, Financial Accounting Policy Committee

/s/Patricia McConnell, CPA
Chair, Global Financial Reporting Advocacy Committee

/s/Patricia Doran Walters, CFA
Senior Vice President, Professional Standards & Advocacy, AIMR