

COMMENTARY

**Response to the U.S. Securities and Exchange’s  
Proposed Rule: Roadmap for the Potential  
Use of Financial Statements Prepared  
in Accordance with International Financial  
Reporting Standards by U.S. Issuers  
(Release No. 33-8831; 34-56217; IC-27924; File No. S7-20-07)**

**Research Committee of the American Accounting Association’s  
International Accounting Section**

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**ABSTRACT:** This paper is a response to the U.S. Securities and Exchange Commission’s request for comments on its proposed rule concerning a “Roadmap” for the use of financial statements prepared in accordance with International Financial Reporting Standards (IFRS) by U.S. issuers. The paper addresses only a few of the 70 multipart questions contained in the Roadmap (refer to the Appendix for a list of all 70 questions). We find that while there are widely divergent opinions, little empirical evidence directly bears on the question of whether U.S. issuers should be required or permitted to adopt IFRS. We conclude that further analysis of the costs and benefits of a mandated transition to IFRS should be done. Notwithstanding the need for further analysis, we question whether it is justified to withhold from U.S. issuers the option to use IFRS for financial reports based on industry membership or size, when all non-U.S. issuers have the option to do so. While IFRS might marginally increase the concentration among audit firms, research suggests that concentration of audit services may be driven primarily by the litigious environment in the U.S. This suggests that concentration would be relatively unaffected by a change in accounting standards.

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## I. INTRODUCTION

In this paper, prepared at the request of the International Accounting Section of the American Accounting Association, we respond to the U.S. Securities and Exchange Commission's (SEC's) request for comments on its proposed rule concerning a "Roadmap" for the use of financial statements prepared in accordance with International Financial Reporting Standards (IFRS) by U.S. issuers.<sup>1,2</sup>

The Roadmap is a multiyear plan presenting milestones that, if achieved, could lead to the use of IFRS by all U.S. issuers beginning in 2014. Under the proposal, the SEC would decide in 2011 whether adoption of IFRS would benefit investors and be in the public interest.<sup>3</sup> The proposal includes 70 questions for comment, many of which relate to two alternative proposals under which U.S. issuers that elect to use IFRS would disclose supplemental U.S. GAAP-based information.<sup>4</sup>

Under a staged transition, large accelerated filers<sup>5</sup> would begin filing IFRS-based statements for fiscal years ending on or after December 15, 2014, with early adoption allowed for some companies. Other accelerated filers would begin IFRS-based filing for years ending on or after December 15, 2015. Nonaccelerated filers would begin one year later. The proposal's seven milestones are: (1) improved accounting standards, (2) accountability and funding for the International Accounting Standards Committee (IASC) Foundation, (3) improved ability to use interactive data for IFRS reporting, (4) education and training, (5) limited early use of IFRS where this would enhance comparability for U.S. investors, (6) anticipated timing of future rulemaking by the Commission, and (7) implementation of mandatory use of IFRS.

In this paper we focus on the potential contribution of empirical accounting research to the SEC's Roadmap questions. Empirical research potentially can provide descriptive evidence useful to the SEC in its deliberations. However, traditional research methods cannot resolve the issue of appropriate regulatory requirements because decisions on the appropriate trade-offs among conflicting interest groups and regulatory objectives are not empirical questions. Furthermore, accounting regulatory policy is strongly influenced by lobbying and other political influences.<sup>6</sup> We do not provide an exhaustive survey of the literature, nor an in-depth review of existing research. Instead, we use specific papers to illustrate broader points.

We address the following questions (cross-referenced to the Roadmap questions in sections below): First, would U.S. investors, U.S. issuers, and U.S. markets benefit from the development and use of a single set of globally accepted accounting standards? Second, if the SEC chooses to change to IFRS for U.S. issuers, how might the change be accomplished? Third, what are the auditing implications of a transition to IFRS by U.S. issuers?

Our main comments and conclusions are as follows. First, little existing research directly addresses whether U.S. investors, issuers, and markets would benefit from implementation of IFRS in the U.S. One reason is that comparative evidence on IFRS versus U.S. GAAP financial

<sup>1</sup> The SEC voted on August 27, 2008, to publish the proposed rule for comment (SEC 2008b). The proposal itself was released on November 14, 2008.

<sup>2</sup> The term "issuer" as used in this paper means any entity subject to the SEC's financial reporting requirements under the Securities Exchange Act of 1934 (15 U.S.C. sect. 78a).

<sup>3</sup> The SEC has also used "Roadmap" to refer to the steps leading to the elimination for the need for non-U.S. companies that prepare IFRS-based financial statements to reconcile to U.S. GAAP financial statements (SEC 2007e).

<sup>4</sup> The questions range from being broad and conceptual to narrow and procedural. Many of the questions consist of multiple parts.

<sup>5</sup> Refer to the Securities Exchange Act Rule 12b-2 (17 CFR 240.12b-2) for definitions of accelerated filer and large accelerated filer. Nonaccelerated filers are issuers that meet neither the accelerated nor large accelerated filer conditions.

<sup>6</sup> Watts and Zimmerman (1986), Ball (2008, 2006), and Zeff (2002) are among the many studies that discuss the influence of politics on financial reporting standard setting. See Watts (2006) for discussion of the influences of private market forces and political forces (the legal system, the political system, and regulation) on financial reporting. Refer to Barth (2008) for discussion of the extent to which academic research can contribute to standard-setting debates.

reporting by U.S. issuers is not available because U.S.-domiciled issuers have exclusively used U.S. GAAP in their financial reporting.<sup>7</sup> Also, because U.S. capital markets, financial reporting regulation, and many other environmental and issuer characteristics differ substantially from those in other parts of the world, conclusions from non-U.S.-based research are not necessarily valid in the U.S. context.

We therefore recommend that the SEC conduct a more thorough analysis of the costs to issuers, investors, and markets of a transition to IFRS—and perhaps more importantly, a thorough analysis of the potential *benefits* to issuers, investors, and markets.<sup>8</sup> While the SEC has estimated the transition costs to issuers, it is essential to address the overall costs as well as the potential benefits in order to evaluate the economic desirability of those costs. As part of this analysis, we suggest that the SEC more thoroughly review the many responses to its earlier related requests for comment. The November 2008 Roadmap document, for example, gives only passing reference to the many dozens of responses made to the SEC's 2007 concept release on allowing U.S. issuers to prepare financial statements in accordance with IFRS.<sup>9</sup>

In response to the second broad question of how a change to IFRS for U.S. issuers might be accomplished, we note that the SEC could either mandate the change or allow the change to occur more gradually. A gradual change could occur via the combined effects of (1) continued convergence of the two sets of standards, and (2) granting U.S. issuers an option to move to IFRS. Regarding an *optional* transition to IFRS, we recommend that the SEC further evaluate the justification for denying U.S. issuers an option that is currently available to all non-U.S. issuers—the option to report either under U.S. GAAP or under IFRS (with no reconciliation to U.S. GAAP). Specifically, we question whether the currently less-favorable treatment of U.S. issuers is consistent with the principle of equal treatment of foreign and domestic firms. As a part of this evaluation, the Commission may wish to consider that its allowing the current U.S. dual-standards reporting environment implicitly presumes that such an environment does not unduly jeopardize investor protection.

Regarding our third broad question of auditing implications, we observe that requiring U.S. issuers to use IFRS would create at least one potential challenge to maintaining high quality audits because IFRS permits wider use of fair value as a basis of measurement than does U.S. GAAP, and auditing fair value has presented challenges to auditors. With respect to concerns about concentration among audit firms, we note the following: provision of auditing services to U.S. public companies is already highly concentrated; concentration need not indicate a deterioration of audit quality; and concentration may be driven primarily by issuers' defensive responses to the litigious environment of the U.S., and thus would be relatively unaffected by a change in the set of accounting standards used in reporting.

To motivate our discussion of research, we first briefly discuss the goals of U.S. financial reporting and summarize recent SEC developments. We then discuss findings from academic research concerning whether U.S. issuers should use IFRS financial statements in their filings with the SEC. The purpose of this discussion is to highlight the differences of opinion (even when based on academic research) regarding the question of whether IFRS should be adopted in the U.S. We then comment on how a move to IFRS for U.S. issuers could be accomplished if the SEC

<sup>7</sup> This is in sharp contrast to questions related to IFRS adoption in other parts of the world, where at least some empirical evidence is available on non-U.S. companies that voluntarily adopt IFRS or are required to do so.

<sup>8</sup> Assertions made by Wright et al. (2008) concerning the limitations of cost-benefit analyses in the standard-setting process are applicable to the SEC's IFRS-related regulatory choices. Note, however, that even a simple survey regarding costs and benefits might provide a useful addition to existing evidence. (See, for example, SEC 2008d.)

<sup>9</sup> See SEC 2007b and SEC 2008c for the concept release and comments on that release, respectively.

decides to mandate such a change, including responses to several specific Roadmap questions, and discuss its potential impact on auditing. The final section presents a summary and conclusions.

## II. BACKGROUND AND RECENT SEC DEVELOPMENTS

### Goals of Investor-Oriented Securities Regulation

The two main objectives of securities regulation in investor-oriented markets are to promote investor protection and market quality.<sup>10</sup> Investor protection includes (1) providing investors with material information (financial transparency), (2) monitoring and enforcing market rules, (3) inhibiting fraud in the offering, trading, voting and tendering of securities, and (4) seeking comparability of financial information.<sup>11</sup> Market quality includes (1) promoting equitable access to information and trading opportunities (market fairness), (2) enhancing liquidity and reducing transaction costs (market efficiency), (3) promoting freedom from abuse through monitoring and enforcement, (4) fostering investor confidence, (5) facilitating capital formation, and (6) seeking market orderliness.

The SEC's reporting requirements are generally consistent with both the investor protection and the market quality objectives.<sup>12</sup> Although many speak as if enhancing investor protection and increasing market quality are the same,<sup>13</sup> this is not the case. For example, highly stringent reporting requirements may satisfy the investor protection objective at the cost of market quality, either by reducing investors' investment opportunities or by imposing high transaction costs on taking advantage of available opportunities. In addition, opinions about the effects of accounting regulations vary depending on the individuals' economic incentives and subjective judgments. For example, former SEC chair Christopher Cox aggressively promoted a move to IFRS in the United States. In contrast, Mr. Cox's replacement, Mary Schapiro, has expressed concerns about the SEC's IFRS initiatives, stating "I would proceed with great caution so we don't have a race to the bottom."<sup>14</sup>

<sup>10</sup> The [International Organization of Securities Commissions \(2003\)](#) lists as a third goal the reduction of systemic risk (financial failure of market intermediaries) through capital and internal control requirements. See [Frost and Lang \(1996\)](#) for a framework that synthesizes views presented in [SEC \(1995, 1987\)](#), the U.K. [Securities and Investments Board \(1994\)](#), and related documents. See also [SEC 2009](#) for related discussion.

<sup>11</sup> Comparability refers to the extent to which investors can compare financial information between companies and across industries and domiciles.

<sup>12</sup> For example, substantial empirical evidence is consistent with the view that enhanced quality of financial reporting and disclosure is associated with capital markets benefits such as lower transaction costs. Refer to [Healy and Palepu \(2001\)](#) and [Wright et al. \(2008\)](#) for references and discussion.

<sup>13</sup> See, for example, [FAF \(2009, second paragraph\)](#).

<sup>14</sup> See, for example, [Roland \(2009\)](#).

### Recent U.S. Regulatory IFRS-Related Activities

The SEC and FASB have long supported the development of a “single set of high-quality globally accepted accounting standards.”<sup>15</sup> In 2002 the FASB and the IASB issued the “Norwalk Agreement,” in which they pledge to seek (1) to make their existing financial reporting standards fully compatible as soon as practicable, and (2) to coordinate their future work programs to ensure that once achieved, compatibility is maintained.<sup>16</sup> Barth (2008) notes that since the Norwalk Agreement, the IASB/FASB convergence relationship has developed and strengthened. Today, most major agenda projects are joint projects. The boards’ new business combinations standards, IFRS 3 (revised) and SFAS No. 141R (IASB 2007; FASB 2007) are the first jointly issued standards that are almost word-for-word the same. Moreover, the boards have an active agenda for joint projects continuing until the end of 2011.<sup>17</sup>

In December 2007, the SEC issued its final rule to eliminate the U.S. GAAP reconciliation requirement for foreign private issuers that file their financial statements with the SEC using IFRS as issued by the International Accounting Standards Board (IASB).<sup>18</sup> During 2007, the SEC also became more active in considering the use of IFRS by U.S. issuers. In August 2007, the Commission published a concept release asking for comments on 35 questions related to whether U.S. issuers should have the option of choosing, or be required, to prepare financial statements under IFRS as issued by the IASB.<sup>19</sup> That concept release’s first two questions are: (1) Do investors, U.S. issuers, and market participants believe that the Commission should allow U.S. issuers to prepare financial statements in accordance with IFRS as published by the IASB?, and (2) What would be the effects on the U.S. public capital market of some U.S. issuers reporting in accordance with IFRS and others in accordance with U.S. GAAP?<sup>20</sup>

The SEC received more than 100 comments on its August 2007 Concept Release, and held three roundtables, two in December 2007, and a third in August 2008.<sup>21</sup> Many roundtable participants and commenters supported allowing U.S. issuers to use IFRS. However, some commenters stated that U.S. issuers should continue to use U.S. GAAP and supported continuing convergence efforts.<sup>22</sup> A third group of commenters recommended that IFRS should be mandated for all U.S.

<sup>15</sup> Refer to SEC 2008a, Barth (2008), and Larson and Street (2006) for further background on accounting convergence and development of the SEC’s and FASB’s policies related to IFRS. The SEC’s November 2008 proposed rule and many other SEC and FASB documents refer repeatedly to “high-quality accounting standards,” and financial statement “compatibility” and “comparability.” However, precise definitions are not provided. The Financial Accounting Standards Advisory Council (FASAC 2005) defines convergence as follows: “[The IASB and FASB] rejected the dictionary definition of convergence, moving toward union or uniformity, as an end in itself, agreeing instead to focus on convergence as described in the 2002 Norwalk Agreement—the development of high-quality compatible accounting standards that could be used for both domestic and cross-border financial reporting. Under that view of convergence, a change to either IASB or FASB standards must both converge standards and improve financial reporting.” Ball (2006) states that high-quality financial statements provide useful information to many types of users, and that high quality requires: (1) accurate depiction of economic reality, (2) low capacity for managerial manipulation, (3) timeliness, and (4) timelier recognition of bad news, relative to good news. Ball (2006) questions the usefulness of the FASB’s Conceptual Framework accounting quality criteria of “relevance” and “reliability.”

<sup>16</sup> See FASB (2002a, 2002b).

<sup>17</sup> Refer to the Deloitte website (<http://www.iasplus.com>) for extensive information about IFRS and the IASB. The IAS Plus ongoing survey of the use of IFRS by jurisdiction reports that, as of January 5, 2009, 109 of the 162 jurisdictions surveyed now either require (85 jurisdictions) or permit (24 jurisdictions) IFRS for all domestic listed companies.

<sup>18</sup> Refer to SEC 2007 for the final rule, and to SEC 2007a for the proposed rule. Refer to Street (2008) for discussion of the debate on whether the reconciliation requirement should be dropped. Note that two groups of academic respondents, both drawing on research evidence to support their analyses, presented dramatically different conclusions about the advisability of eliminating the reconciliation requirements (Jamal et al. 2008; Hopkins et al. 2008).

<sup>19</sup> See SEC 2007c. Refer to SEC 2008b for comment letters on that release.

<sup>20</sup> Only the first part of question (2) is presented here. Refer to SEC 2007b for the complete question and the complete set of 35 questions.

<sup>21</sup> The SEC website provides information on the roundtables and other relevant items. See SEC (2009b, 2007d).

<sup>22</sup> As used here, convergence refers to the narrowing of differences between IFRS and U.S. accounting standards.

issuers rather than being limited to a specific group of U.S. issuers.<sup>23</sup> The Financial Accounting Foundation (FAF) supported the view that all U.S. public companies should prepare their financial reports following “accounting standards promulgated by a single global standard setter,” and argued that “permitting extended periods of choice between U.S. GAAP and IFRS results in an unnecessarily complex two-GAAP system” (FAF 2009).<sup>24</sup>

### Evidence on Accounting Convergence and the IASB’s and FASB’s Joint Work Plan

In theory, both the costs to issuers and the potential benefits to investors of switching standards decline as the two sets of standards converge. Thus, evidence of convergence and expectations about eventual convergence are important in evaluating the desirability of moving the U.S. toward IFRS adoption.

Academic research provides mixed evidence of convergence, as reflected in results reported under U.S. GAAP and under IFRS. Henry et al. (2009) present evidence suggesting that the IASB’s and FASB’s convergence projects have increased the similarity, on average, of results reported by European companies under U.S. GAAP and under IFRS. They find that the average gap between U.S. GAAP and IFRS income and between U.S. GAAP and IFRS shareholders’ equity declined from 2004 to 2006. Similarly, Haverty (2006) shows evidence of convergence of results reported under the two sets of standards by a sample of Chinese companies during the 1996 to 2002 time period. In contrast, Gray et al. (2009) provide evidence of divergence between IFRS and U.S. GAAP for income determination for European companies adopting IFRS for the first time in 2005, and for shareholders’ equity for companies previously reporting under U.K. GAAP.

Any research on continuing convergence of financial results reported under IFRS and U.S. GAAP will be limited by the SEC’s recent decision to eliminate the reconciliation requirement for non-U.S. issuers. Evaluation of the progress of convergence will likely rely on qualitative assessments of differences in the standards themselves rather than on quantitative assessments of the differences in the results reported under the standards, unless the SEC imposes a reconciliation requirement on U.S. issuers adopting IFRS.

Going forward, additional research that monitors the fundamental accounting differences between U.S. GAAP and IFRS as the convergence projects progress could usefully inform policy choices regarding the relative costs and benefits of U.S. issuers adopting IFRS.

### III. SHOULD A SINGLE SET OF ACCOUNTING STANDARDS BE DEVELOPED AND USED?

The SEC’s first Roadmap question is:

Do commenters agree that U.S. investors, U.S. issuers, and U.S. markets would benefit from the development and use of a single set of globally accepted accounting standards? Why or why not? What are commenters’ views on the potential for IFRS as issued by the IASB as the single set of globally accepted accounting standards?

This question (or set of questions) is multidimensional and is not specific about what types of investors and issuers are being considered, what “global acceptance” entails, and—importantly—how a global transition to a single set of accounting standards might proceed. Indeed, it can be argued that these first Roadmap questions make little sense unless they are based implicitly on the question of whether IFRS should be mandated for U.S. issuers.

Many empirical research studies examine the economic consequences of IFRS adoption (man-

<sup>23</sup> See SEC 2008a.

<sup>24</sup> See FAF (2009) for the FAF’s and FASB’s more current thinking on this and related issues.

datory or voluntary) in other countries around the world.<sup>25</sup> However, those studies are not directly relevant to the question of whether U.S. issuers should use IFRS. U.S. GAAP financial reporting is widely regarded as high quality, and assertions that IFRS are “better” than U.S. accounting standards are difficult to defend. IFRS supporters argue that cross-country comparability of accounting numbers would improve if U.S. issuers were required to use IFRS. However, even this assumption is questioned by many who argue that differences in financial reporting quality cannot be eliminated through uniform accounting standards. Furthermore, considering earnings quality as a concept distinct from financial reporting quality, research suggests that earnings quality is significantly affected by investor protection and legal enforcement but not by accounting standards (Leuz et al. 2003).

Barth (2008) argues that global financial reporting (presumably, IFRS) provides better information to investors and other financial statement users, and thereby improves the functioning of global capital markets. Barth (2008) asserts that global financial reporting offers three benefits: (1) global firms avoid the costs related to the preparation and audit of financial statements using several sets of standards, (2) comparability of accounting information is improved, and (3) global firms' cost of capital is reduced. In her discussion of academic research, however, Barth (2008) refers to studies of IFRS adoption outside of the U.S., and does not discuss any direct evidence on effects of adopting IFRS in the U.S. With regard to U.S. companies, Barth (2008, 1160) states that: “if IFRS-based financial statements are adequate to protect U.S. investors in non-U.S. firms (listed in the U.S.), then why would they not be adequate to protect U.S. investors in U.S. firms?” Collectively, the reasoning in this body of research appears to be: (1) global financial reporting is desirable, (2) non-U.S. SEC registrants are permitted to use IFRS; therefore (3) U.S. registrants should also be permitted (or required?) to use IFRS.

Former Public Company Accounting Oversight Board (PCAOB) member Charles Niemeier presents a contrasting view. He argues that switching to IFRS would not enhance comparability of financial reports, and that IFRS would not improve investor protection.<sup>26</sup> Niemeier asserts that research consistently shows reconciliations provide value-relevant information, and that IFRS has not yet resulted in convergence with or comparability to U.S. GAAP.<sup>27</sup> Niemeier also refers to evidence, for example in studies such as Ball et al. (2003), supporting the view that the incentives of managers and auditors strongly influence financial reporting quality. Thus, high quality financial reporting standards will not assure high quality financial reports.<sup>28</sup>

Some commenters argue that U.S. GAAP and IFRS should be allowed to compete in the U.S., and that accounting uniformity reduces the usefulness of financial reporting. For example, Dye and Sunder (2001) argue that regulatory competition allows different standards to develop for different corporate clienteles, allows corporations to send more informative signals by their choice of accounting standards, and helps protect standard setters from excessive interest group pressures.<sup>29</sup> Ball (2006, 4) states that “there is little settled theory or evidence on which to build an assessment of the advantages and disadvantages of uniform accounting rules within a country, let alone internationally.”

In summary, many logical arguments have been offered both to support and to oppose the

<sup>25</sup> See Barth (2008) for references to key IFRS-related studies, including Barth, Landsman, Lang, and Williams (2008), Barth, Landsman, and Lang (2008), and Armstrong et al. (2009). Also see Daske (2006), and Daske et al. (2007). Refer to Hail et al. (2009) and Bothwell (2009) for analyses commissioned by the FAF/FASB.

<sup>26</sup> For further discussion of views expressed by Niemeier in late 2008, see Kranacher (2008), Leone (2008), and Chasan (2008). Refer to the PCAOB website ([www.pcaob.org](http://www.pcaob.org)) for the text of Niemeier's September 10, 2008, speech that included discussion of some of his concerns about adopting IFRS in the U.S.

<sup>27</sup> Refer to Niemeier (2008) for many detailed cites.

<sup>28</sup> Also see, for example, Ball (2006), Lang et al. (2006) and Bradshaw and Miller (2008).

<sup>29</sup> Also see Sunder (2007).

adoption of IFRS for U.S. issuers in the U.S. Little direct evidence has, however, accompanied those arguments. In the following section we turn to questions about how adoption of IFRS for U.S. issuers in the U.S. might occur.

#### IV. HOW MIGHT A MOVE TO IFRS BE ACCOMPLISHED?

If the SEC decides to allow or require the use of IFRS by U.S. issuers, the main implementation questions relate to timing. Specifically: should the timing of IFRS adoption (whether mandatory or optional) proceed in stages, depending on companies' size and/or industry, or be simultaneous for all listed companies (reference Roadmap question 4)?<sup>30</sup> Further, if IFRS adoption were to proceed in stages, depending both on firm size (e.g., based on existing definitions of "large accelerated filer") and industry, how should the selection be made for inclusion in various categories (reference Roadmap questions 19 and 20)? Finally, if companies had the option to file using IFRS, what would affect their willingness to do so (reference Roadmap questions 18 and 32)?

##### Timing: Staged Versus Simultaneous

Regulation requiring public companies to change accounting standards would increase the cost of being public, with the cost likely to disproportionately and adversely affect smaller firms. For example, academic research has examined the differential impact of costly regulation on small firms in the context of the Sarbanes-Oxley Act of 2002 (SOX).<sup>31</sup> The evidence gathered from that research suggests that SOX-related compliance costs weighed more heavily on smaller firms and contributed to the decision of some of those firms to delist (Engel et al. 2007). Smaller firms (but not larger ones) also exhibited a decreased preference for listing on U.S. exchanges versus U.K. exchanges following SOX (Piotroski and Srinivasan 2008). Similarly, Kamar et al. (2007) present evidence suggesting that an increase in the regulatory burden resulting from SOX induced small firms (but not large ones) to exit the U.S. public market, despite the exemption for small firms in annual evaluation of internal control effectiveness. To the extent that a staged implementation would mitigate the disproportionate impact on smaller firms, this research supports a staged rather than simultaneous implementation of a changeover from U.S. GAAP to IFRS.<sup>32</sup>

##### Implementation under a Staged Timing Scenario

The staged versus simultaneous timing decision links closely with the choice between optional and mandatory changeover. Within a staged timing scenario, the SEC proposes offering an early-use option of IFRS to those U.S. issuers that are among the largest companies in an industry where competitors largely use IFRS. The proposal questions whether offering the early-use option to certain companies is advisable and whether limiting the option to the largest 20 companies in industries meeting specific criteria is appropriate (reference Roadmap Questions 16, 17, and 19).

For many years, SEC financial reporting options for *all* non-U.S. registrants have included both IFRS (with a reconciliation to U.S. GAAP) and U.S. GAAP irrespective of the issuers' industry membership or size. Furthermore, since March 2008, non-U.S. issuers using IFRS are no longer required to provide a reconciliation to U.S. GAAP. Non-U.S. issuers that use IFRS in SEC filings vary widely in industry membership and size. For example, European non-U.S. issuers who

<sup>30</sup> Reference Roadmap question "x" refers to the questions as enumerated in the SEC's proposal.

<sup>31</sup> The Sarbanes-Oxley Act of 2002 is available at: <http://www.sec.gov/about/laws/soa2002.pdf>.

<sup>32</sup> The costs of initial adoption of IFRS by U.S. firms would probably include market-wide start-up costs such as training, while subsequent adoptions, for example by smaller firms, could potentially benefit from the general knowledge base that would be built by those initial adoptions. In addition, even if a staged implementation did not reduce the undiscounted compliance costs for small firms, deferring the implementation date for small firms would reduce the discounted value of those costs.



elected to use IFRS for financial reports filed with the SEC in 2006 operated in ten industries, as categorized by two-digit GICS<sup>33</sup> codes, and had market capitalization as small as \$243 million (Henry et al. 2009). As another example, a study of all non-U.S. issuers that elected to use IFRS for 2006 financial reports filed with the SEC contained a Russian company with a market capitalization of only \$55 million (Gordon et al. 2008).

These data beg the question of how the Commission can justify imposing more severe restrictions for using IFRS—such as industry and size requirements of any kind—on U.S. issuers than on non-U.S. issuers. In other words, if the option to report under either set of standards is a nonzero valued option, it is unclear on what basis the Commission could justify offering that option to non-U.S. issuers but not to U.S. issuers.

The SEC request for comments does include the following question about limiting the early-use option (reference Roadmap question 19): To the extent additional U.S. issuers are not permitted to report using IFRS even if such a minimum threshold is met, are such non-eligible U.S. issuers placed at a competitive disadvantage vis-à-vis U.S. issuers reporting in IFRS? Some academic research suggests that denial of permission to report in IFRS could place the issuers at a competitive disadvantage because IFRS and U.S. GAAP yield differences in reported Return on Equity (ROE).

ROE is an important measure that investors use to assess performance of companies (e.g., Soliman 2008), to screen for desirable investments,<sup>34</sup> and to develop estimates of the intrinsic value of a company's stock (Lee 1999). Therefore, in general, an issuer using accounting standards that result in a higher ROE might appear more attractive to an investor focusing on ROE. As of the end of 2006 (when reconciliations were still required), European non-U.S. issuers reconciling IFRS financial results to U.S. GAAP reported higher ROE under IFRS than under U.S. GAAP. The 2006 IFRS ROE was more than ten percentage points higher than U.S. GAAP ROE for 16.2 percent of the sample, but ten percentage points (or more) lower for only 2.7 percent of the sample (Henry et al. 2009). To the extent that reporting a higher ROE results in the appearance of better performance and potentially higher value, the data suggest that the option to report using IFRS rather than U.S. GAAP creates an economic advantage in the global competition for capital and that non-eligible U.S. issuers would be placed at a competitive disadvantage.

An important factor mitigating the apparent advantage to IFRS is that some reported differences arise from legacy divergence, i.e., differences across accounting standards that have subsequently converged. Continued convergence of the standards should thus reduce reported differences on a going-forward basis. As an example of legacy differences, ROE for Novartis A.G. in 2005 was 19.05 percent under IFRS and 13.65 percent under U.S. GAAP. A significant part of the difference between shareholders' equity under IFRS and under U.S. GAAP for Novartis in 2004 and 2005 resulted from divergence in the standards for reporting business combinations in existence at the time of the company's historical acquisitions (Henry and Yang 2007). Given the convergence of standards (e.g., for business combinations), similar differences would not be expected to arise in the future.

In general, on a going-forward basis, convergence between the two sets of standards could be expected to reduce any apparent advantage of IFRS. Consider, however, the current situation where IFRS offers greater flexibility than U.S. GAAP in certain types of transactions and thus the potential for better reported results. For example, in recognizing revenue on sales with multiple

<sup>33</sup> Global Industry Classification Standard.

<sup>34</sup> For example, Zacks, a well-known investment research firm, includes the following in its Screening Education: "Return on Equity (or ROE) is a commonly used measure of management efficiency. It's a favorite screening criteria of many money managers and investors because it tells them how successful a company is at using its shareholders' capital" (<http://www.zacks.com/research/screening/howto.php?id=2793>).

components (e.g., software sales bundled with a contract for future service and upgrades), U.S. GAAP is more restrictive than IFRS in how the fair values of individual components are established and in the timing of revenue recognition (Harris 2008).

Among the implementation details of a staged-implementation scenario, the SEC proposal would permit a variety of industry classification schemes in determining eligibility for the early-use option. This raises the question of whether using multiple industry classification schemes might confuse issuers attempting to determine whether they meet the eligibility criteria. Data suggest that correspondence across classification schemes varies. Specifically, academic research on three of the proposed schemes shows a high degree of correspondence between two of the proposed classification schemes, but much lower correspondence with the third proposed scheme.<sup>35</sup> If one industry classification scheme is to be selected, the GICS industry classification scheme might be preferred to the SIC and NAICS systems, since it more closely reflects the economic relatedness of companies.<sup>36</sup> The question of requiring the use of a single classification scheme is one of policy, whose answer depends on the Commission's priorities. If the Commission wishes to be as inclusive as possible, with the objective of providing the IFRS early-use option to as many U.S. issuers as possible, it should permit more choices among industry classification schemes, or indeed simply eliminate the industry membership criteria.

Underlying each implementation decision, including the decision about an early-use option for U.S. issuers meeting specific size and industry criteria, is an assumption of nonconvergence between IFRS and U.S. GAAP. If complete convergence were achieved in all material respects (that is, if the two sets of standards became essentially identical), then a choice between IFRS and U.S. GAAP would be moot. As presented, Roadmap questions about issuer choice imply the replacement of U.S. GAAP by IFRS, with some interim period during which U.S. GAAP would continue to exist but with planned obsolescence. This approach raises questions about how standard setters would operate during the transitional period. The approach used by the Canadian Accounting Standards Board (AcSB) for managing the five-year transition period preceding that country's adoption of IFRS for public companies might provide useful ideas for the U.S. The AcSB adopted any converged standards resulting from joint projects, and avoided revising domestic GAAP in ways that would impose costly system changes that would become obsolete at the time of IFRS adoption.<sup>37</sup>

### **IFRS Option: Accounting Choice**

What considerations might influence a U.S. issuer's decision concerning the optional use of IFRS if an implementation scenario were to create such an option (whether during a transitional period or as a more permanent choice, such as that currently available for non-U.S. issuers in the U.S. [reference Roadmap questions 18 and 32])? One obvious factor is the incremental costs of implementing IFRS. Such incremental costs include training personnel in international standards, revising affected contractual obligations based on reported financial information, and altering internal systems to accommodate the new standards.

A company's willingness to use IFRS might also be influenced by the effect of IFRS adoption

<sup>35</sup> Specifically, researchers show an 80 percent correspondence between firms' classifications as grouped by two-digit SIC codes and by their equivalent NAICS codes, but only a 56 percent correspondence between firms' classifications as grouped by two-digit SIC codes and by GICS groupings (Bhojraj et al. 2003).

<sup>36</sup> In this context, proxies for economic relatedness are (1) contemporaneous correlation of stock returns, (2) similarity of valuation multiples to key accounting measures, (3) similarity across financial ratios, and (4) similarity of expected growth (Bhojraj et al. 2003). Bhojraj et al. (2003) also find that the superiority of the GICS scheme is more pronounced for relatively large firms.

<sup>37</sup> Refer to the AcSB website for detailed discussion. Available at <http://www.cica.ca>.

on that company's eligibility for inclusion in market indices. The eligibility criteria of some market indices include the use of U.S. GAAP,<sup>38</sup> and the ability to be included in an index has economic consequences. A substantial amount of academic research provides evidence that the addition of a company to the S&P 500 index increases a company's stock price because inclusion in the index provides positive information about the firm (Dhillon and Johnson 1991), increases demand for the stock from index-tracking portfolio managers (Jain 1987), potentially increases the ability of companies to attract new capital and to broaden the stock's ownership (Chen et al. 2004), and/or increases the stock's liquidity (Hegde and McDermott 2003). The loss of eligibility for inclusion in an index would represent an economic cost to a company not currently in the index and would—depending on any offsetting benefits of adoption—be expected to make the company less willing to adopt the standards. Evidence is mixed, however, on the market impact of removal of a firm from a stock index, with some research showing that removal causes only a temporary decline in a firm's stock price (Chen et al. 2004). The loss of eligibility for inclusion in an index would thus also represent an economic cost, though perhaps a smaller cost, to a company already included in an index.

Offsetting the potential costs of voluntary early adoption of IFRS are, however, potential benefits that firms may realize. Research on the market reaction to IFRS adoption in the EU suggests that European investors viewed the benefits of EU-wide adoption as outweighing the costs (Armstrong et al. 2009). That research, however, suggested that one of the benefits of EU-wide adoption was the expectation that IFRS would yield higher quality financial information than did the then-existing domestic standards.<sup>39</sup> In contrast with the issue addressed here, it is *not* expected that superior quality of financial reporting information would result from replacing U.S. GAAP with IFRS (Barth, Landsman, Lang, and Williams 2008; Gordon et al. 2008).

Daske et al. (2008) show capital markets benefits such as lower cost of equity and greater market liquidity accruing to non-U.S. firms voluntarily moving from domestic GAAP to IFRS, but note that many countries adopted international accounting standards concurrently with improving enforcement and governance. These findings are not, therefore, directly applicable to the U.S. setting. Overall, if an implementation scenario were to create an option for a U.S. issuer to use IFRS or U.S. GAAP, accounting research does not indicate whether expected market benefits would drive the decision to exercise that option.

## V. IMPLICATIONS FOR AUDITING

We address two related questions concerning the auditing implications of adoption of IFRS by U.S. issuers (reference Roadmap question 8). First, would a requirement that U.S. issuers use IFRS have an effect on audit quality, and second, would such a requirement have an effect on concentration of market share among audit firms?

A requirement that U.S. issuers file financial statements prepared in accordance with IFRS would create at least one potential challenge to maintaining high quality audits: IFRS permits wider use of fair value as a basis of measurement than does U.S. GAAP, and auditing fair value

<sup>38</sup> Note, however, that if the SEC allows or requires U.S. issuers to adopt IFRS, market indices' eligibility criteria might change accordingly.

<sup>39</sup> One study of German firms using international standards (then IAS) and U.S. GAAP supports an expectation of minimal market benefits (e.g., cost of capital or liquidity) for a firm switching from U.S. GAAP to IFRS (Leuz 2003). However, those findings should be interpreted with caution, since the study used a sample from the German Neuer Market. The Neuer Market was closed in 2003 after having been "plagued by incidents of accounting legerdemain" throughout its history (Landler 2002). The Neuer Market's reputation was also damaged by numerous bankruptcies and shareholder lawsuits. By 2002, when the decision to close the market was announced, the value of the companies listed on that exchange had dropped 96 percent from the peak in 2000.

estimates has presented challenges to auditors. One example of IFRS's wider use of fair value is that IFRS provides entities with two alternatives for reporting property, plant, and equipment. One alternative is to use a cost model similar to U.S. GAAP, under which assets are carried at historical cost less accumulated depreciation and less any accumulated impairment losses. A second alternative, however, is to use a revaluation model, under which the basis of measurement is the asset's fair value.<sup>40</sup>

The use of fair value to measure property, plant, and equipment is not permitted under U.S. GAAP.<sup>41</sup> Fair value is, however, the U.S. GAAP basis for measuring many financial instruments, and auditing fair value in these instances has presented challenges for auditors. In a briefing paper to the Standing Advisory Group, the staff of the PCAOB noted that an increase in the use of estimates, such as those involved in fair values, increases the risks of material misstatements (PCAOB 2007). Some specific challenges that have confronted auditors in their audits of fair values include: (1) historically, a lack of auditor training in valuation techniques, (2) potential biases in fair value assessments, and (3) differences in internal controls required for fair value measurements (Martin et al. 2006; Olson 2007). In its 2008 summary of its previous four years of inspections, the PCAOB identifies fair value as a "critical and high-risk part" of audits in which "inspectors continue to find deficiencies" (PCAOB 2008, 2).

A requirement that U.S. issuers file financial statements prepared in accordance with IFRS also could potentially increase the degree of concentration in audit firms, because the large international firms likely have more ready access to employees trained in auditing IFRS and more established international capabilities. However, it should be noted that—even in the absence of IFRS—auditing services for U.S. public companies are already concentrated, with the four largest firms serving as auditor for companies representing approximately 98 percent of the total market capitalization of U.S. issuers (PCAOB 2008).<sup>42</sup>

The suggested causes of auditor concentration include economies of scale, the ability of larger firms to offer a relatively broad array of specialized expertise, and financial statement users' perceptions that larger audit firms offer higher quality audits than do other audit firms. References to academic research in which these causes have been suggested are provided in DeAngelo (1981).

The existence of fewer and larger audit firms need not, however, indicate a deterioration of audit quality. Indeed, a large body of academic research has presented evidence that larger audit firms may provide higher quality audit services.<sup>43</sup> DeAngelo (1981, 186), who defined the quality of audit services as "the market-assessed joint probability that a given auditor will *both* (1) discover a breach in the client's accounting system, and (2) report the breach," argued that larger audit firms have greater economic incentives to provide higher quality audits. Palmrose (1988, 56), who defined audit quality in terms of assurances such that higher quality audit services correspond to a higher "probability [that] financial statements contain no material omissions or misstatements," used audit-related litigation activity as a measure of audit quality. She finds that Big-X

<sup>40</sup> Specifically, under the revaluation model, an item of property, plant, and equipment is "carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period." (IAS 16; *Property, Plant, and Equipment* ¶31.)

<sup>41</sup> It could be argued that auditing estimates of fair value in the area of property, plant, and equipment is not that difficult since appraisals are commonly used; however, given the challenges that have arisen in the existing context of auditing fair value accounting, this difference between IFRS and U.S. GAAP merits consideration.

<sup>42</sup> Concentration of auditing services for U.S. companies has existed for a number of years (Palmrose 1988; Lim and Tan 2008).

<sup>43</sup> See Watkins et al. (2004) for a review of the academic literature on audit quality.

auditors<sup>44</sup> have lower litigation activity than non-Big-X auditors. DeFond and Jiambalvo (1991) find that statements audited by Big-X auditors have a lower incidence of accounting errors than financial statements audited by smaller firms, and Becker et al. (1998) find a relation between higher earnings quality, measured by discretionary accruals, and Big-X auditors. Behn et al. (2008) find that investor decisions, as proxied by analysts' forecast accuracy, are better for Big-X client firms.

Capital markets research suggests that audit firm size is positively associated with users' perceptions of financial reporting reliability (Teoh and Wong 1993; Krishnan 2003). The perception of higher quality audits by Big-X auditors apparently exists, however, only in the litigious environment of the U.S. and not in other countries (Khurana and Raman 2004). If users' perceptions of higher quality reports have contributed to auditor concentration, then the research suggests that it is the U.S. legal environment that has exhibited the greatest influence on audit industry concentration. To the extent that the U.S. legal environment is the primary driver of concentration of audit firms, it is not likely that such concentration would be affected by a change in the set of accounting standards.

Overall, concentration of audit firms—which need not indicate deterioration of audit quality—has already occurred in the absence of any requirement that U.S. issuers use IFRS and therefore does not appear to be a key consideration that should be addressed in the SEC's current policy decisions.

## VI. SUMMARY AND CONCLUSIONS

In this paper, we respond to the SEC's request for comments on its November 2008 proposed rule concerning use of financial statements prepared in accordance with IFRS by U.S. issuers. Our findings and recommendations are summarized as follows.

We find that little empirical evidence is directly relevant for the policy question of whether U.S. issuers should be required or permitted to adopt IFRS, although there are widely divergent opinions regarding this question. We recommend further analysis of the costs and benefits of a mandated transition to IFRS for U.S. issuers, investors, and markets. Notwithstanding the need for further analysis, we question the basis on which the Commission can justify withholding from U.S. issuers the option to use IFRS for financial reports based on the issuer's industry membership or size, when all non-U.S. issuers are provided the option to do so.

With regard to the impact on auditing, IFRS adoption could marginally increase the degree of concentration among audit firms because the large international firms may have more ready access to employees trained in auditing IFRS. The provision of audit services to U.S. issuers is, however, already highly concentrated, and a large body of academic research has presented evidence that concentration need not impact the quality of audit services. Finally, research suggests that concentration of audit services may be driven primarily by the litigious environment in the U.S., suggesting that concentration would be relatively unaffected by a change in accounting standards used by publicly listed companies.

<sup>44</sup> The composition of the group of largest audit firms has varied over time because of mergers and other corporate events, and academic research uses a size cutoff reflecting the industry concentration relevant at the time of the analysis. We use the term "Big-X" to refer to the largest firms in each academic study.

## APPENDIX

**SEC ROADMAP QUESTIONS FROM THE SEC'S PROPOSED RULE:  
ROADMAP FOR THE POTENTIAL USE OF FINANCIAL STATEMENTS PREPARED  
IN ACCORDANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS  
BY U.S. ISSUERS**

1. Do commenters agree that U.S. investors, U.S. issuers, and U.S. markets would benefit from the development and use of a single set of globally accepted accounting standards? Why or why not? What are commenters' views on the potential for IFRS as issued by the IASB as the single set of globally accepted accounting standards?
2. Do commenters agree that the milestones and considerations described in Section III.A. of this release ("Milestones to be Achieved Leading to the Use of IFRS by U.S. Issuers") comprise a framework through which the Commission can effectively evaluate whether IFRS financial statements should be used by U.S. issuers in their filings with the Commission? Are any of the proposed milestones not relevant to the Commission's evaluation? Are there any other milestones that the Commission should consider?
3. Do commenters agree with the timing presented by the milestones? Why or why not? In particular, do commenters agree that the Commission should make a determination in 2011 whether to require use of IFRS by U.S. issuers? Should the Commission make a determination earlier or later than 2011? Are there any other timing considerations that the Commission should take into account?
4. What are commenters' views on the mandated use of IFRS by U.S. issuers beginning in 2014, on an either staged-transition or non-staged transition basis? Should the date for mandated use be earlier or later? If the Commission requires the use of IFRS, should it do so on a staged or sequenced basis? If a staged or sequenced basis would be appropriate, what are commenters' views on the types of U.S. issuers that should first be subject to a requirement to file IFRS financial statements and those that should come later in time? Should any sequenced transition be based on the existing definitions of large accelerated filer and accelerated filer? Should the time period between stages be longer than one year, such as two or three years?
5. What do commenters believe would be the effect on convergence if the Commission were to follow the proposed Roadmap or allow certain U.S. issuers to use IFRS as proposed?
6. Is it appropriate to exclude investment companies and other regulated entities filing or furnishing reports with the Commission from the scope of this Roadmap? Should any Roadmap to move to IFRS include these entities within its scope? Should these considerations be a part of the Roadmap? Are there other classes of issuers that should be excluded from present consideration and be addressed separately?
7. Do commenters agree that these matters would affect market participants in the United States as described above? What other matters may affect market participants? Are there other market participants that would be affected by the use by U.S. issuers of IFRS in their Commission filings? If so, who are they and how would they be affected?
8. Would a requirement that U.S. issuers file financial statements prepared in accordance with IFRS have any effect on audit quality, the availability of audit services, or concentration of market share among certain audit firms (such as firms with existing international networks)? Would such a requirement affect the competitive position of some audit firms? If the competitiveness of some firms would be adversely affected, would these effects be disproportionately felt by firms other than the largest firms?

9. What are commenters' views on the IASB's and FASB's joint work plan? Does the work plan serve to promote a single set of high-quality globally accepted accounting standards? Why or why not?
10. How will the Commission's expectation of progress on the IASB's and FASB's joint work plan impact U.S. investors, U.S. issuers, and U.S. markets? What steps should be taken to promote further progress by the two standard setters?
11. The current phase of the IASB's and FASB's joint work plan is scheduled to end in 2011. How should the Commission measure the IASB's and FASB's progress on a going-forward basis? What factors should the Commission evaluate in assessing the IASB's and FASB's work under the joint work plan?
12. What are investors', U.S. issuers', and other market participants' views on the resolution of the IASB governance and funding issues identified in this release?
13. What steps should the Commission and others take in order to determine whether U.S. investors, U.S. issuers, and other market participants are ready to transition to IFRS? How should the Commission measure the progress of U.S. investors, U.S. issuers, and other market participants in this area? What specific factors should the Commission consider?
14. Are there any other significant issues the Commission should evaluate in assessing whether IFRS is sufficiently comprehensive?
15. Where a standard is absent under IFRS and management must develop and apply an accounting policy (such as described in IAS 8, for example), should the Commission require issuers to provide supplemental disclosures of the accounting policies they have elected and applied, to the extent such disclosures have not been included in the financial statements?
16. Do commenters agree that certain U.S. issuers should have the alternative to report using IFRS prior to 2011? What circumstances should the Commission evaluate in order to assess the effects of early adoption on comparability of industry financial reporting to investors?
17. Do commenters agree with the proposed criteria by which the comparability of an industry's financial reporting would be assessed? If not, what should the criteria be?
18. Which eligible U.S. issuers have the incentive to avail themselves of the proposed amendments, if adopted? Are there reasons for which an issuer that is in a position to file IFRS financial statements under the proposed amendments would elect not to do so? If so, what are they?
19. Is limiting the proposal to the largest 20 competitors by market capitalization an appropriate criterion? Should it be higher or lower? Should additional U.S. issuers be eligible to report in IFRS if some minimum threshold of U.S. issuers (based on the actual number or market capitalization of U.S. issuers choosing to report in IFRS) elects to report in IFRS under the eligibility requirements proposed? To the extent additional U.S. issuers are not permitted to report in IFRS even if such a minimum threshold is met, are such non-eligible U.S. issuers placed at a competitive disadvantage vis-à-vis U.S. issuers reporting in IFRS?
20. Would the use of different industry classification schemes as proposed be unclear or create confusion in determining whether an issuer is IFRS eligible? Should we require that all issuers use a single industry classification scheme? Why or why not?
21. What impact will the Commission's determination to allow an industry to qualify as an "IFRS industry" without majority IFRS use have on the Commission's objective of pro-

- moting comparability for U.S. investors? How will this impact U.S. investors, U.S. issuers, and U.S. markets? Is the use of IFRS more than any other set of financial reporting standards the right criterion? Should it be higher or lower?
22. Should the Commission permit additional industries to qualify as IFRS industries, and thus additional U.S. issuers to become early adopters, as more countries outside the U.S. adopt IFRS? Alternatively, should the group of potential industries and early adopters be limited to those that qualify at the time the Commission determines to permit early adoption?
  23. Do commenters have any suggestions about the procedural aspects of the proposed eligibility requirements, e.g., the procedure for obtaining a letter of no objection from the Commission staff or the minimum contents of the required submission? Is such a procedure necessary? Do commenters agree that such a procedure would assist both issuers and investors? Should the procedural aspects of the proposed eligibility requirements be less formal? Should the procedure be similar to that in the no-action letter process regarding shareholder proposals under Rule 14a-8 of the Exchange Act? Should the letter of no objection be advisory only? Should obtaining a letter of no objection be optional? Is the method for calculating eligibility clear and appropriate or are there alternative suggestions that should be considered? Should the Commission publish standards or criteria to guide the staff's determination? What do commenters believe the respective role of the Commission and its staff should be in making these eligibility determinations? Should the Commission post on its website all submissions and responses, including those for which the staff does not issue a no-objection letter?
  24. Currently, some public companies in the U.S. public capital market report in accordance with IFRS and others in accordance with U.S. GAAP. Today, however, this ability to report using IFRS exists only for foreign companies. What consequences, opportunities, or challenges would be created, and for whom, of extending the option to use IFRS to a limited number of U.S. companies based on the criterion of improving the comparability of financial reporting for investors?
  25. Do commenters agree that the criterion of enhanced comparability is the correct one? Are there other criteria that should be used? For example, should issuers be eligible based on their size or their global activities? If a size criterion were used to include the largest U.S. issuers, what should the cutoff be? Should there be a criterion based on the absence of past violations of the federal securities laws<sup>45</sup> or based on shareholder approval?
  26. Do commenters agree that the proposed required disclosures are appropriate? If not, what disclosures should be provided?
  27. What are commenters' views on the accounting principles that should be used by those U.S. issuers that elect to file IFRS financial statements if the Commission decides not to mandate or permit other U.S. issuers to file IFRS financial statements in 2011? Should the Commission require these issuers to revert back to U.S. GAAP in that situation?
  28. Is it appropriate to exclude investment companies, employee stock purchase, savings, and similar plans, and smaller reporting companies? Are there other classes of issuers or certain industries that should be excluded?
  29. Should we limit the first filing available to an annual report on Form 10-K, as proposed?

<sup>45</sup> An example of such a criterion is found under clauses (vi), (vii), and (viii) under the definition of "ineligible issuer" under Rule 405 under the Securities Act [17 CFS 230.405].



- If not, why not? Is the proposed transition date of fiscal years ending on or after December 15, 2009, appropriate? Should it be earlier or later, and why? What factors should be considered in setting the date?
30. Are there any considerations that may make it difficult for an eligible U.S. issuer to file IFRS financial statements? Are there considerations about filing IFRS financial statements that would weigh differently for an eligible U.S. issuer than they would for a foreign private issuer that files IFRS financial statements?
  31. What difficulties, if any, do U.S. issuers anticipate in applying the requirements of IFRS No. 1 on first-time adoption of IFRS, including the requirements for restatement of and reconciliation from previous years' U.S. GAAP financial statements?
  32. What would affect a company's willingness to use IFRS if it were eligible to do so? For example, some market indices, such as the S&P 500, currently only include issuers that report in U.S. GAAP. Are there other investment instruments or indices that would affect companies that would be eligible to use IFRS under the proposed criteria? Would the ability to be included in the S&P 500, or other instrument or index, affect whether an eligible U.S. issuer decides to use IFRS? Would these indices be prepared to accept IFRS, and if so, how long would it take for them to change their criteria? Would more issuers be likely to use IFRS after they do? Should these considerations influence our decision on whether or when to permit or require U.S. issuers to use IFRS in their Commission filings?
  33. To facilitate the transition to IFRS, should we add an instruction to Form 10-K and Form 10-Q under which an issuer could file two years, rather than three years, of IFRS financial statements in its first annual report containing IFRS financial statements as long as it also filed in that annual report three years of U.S. GAAP financial statements? Under such an approach, an issuer could, during its third year after beginning its IFRS accounting, choose to file a Form 10-K/A with IFRS financial statements covering the previous two fiscal years.<sup>46</sup> For the current (third) fiscal year, the issuer could then file quarterly reports on Form 10-Q using IFRS financial statements.<sup>47</sup> For example, a calendar-year issuer that began its IFRS accounting for the 2010 fiscal year would use U.S. GAAP to prepare its Forms 10-Q and Forms 10-K for the 2010 and 2011 fiscal years. In 2012, that issuer would have the option of filing a Form 10-K or a form 10-K/A with IFRS financial statements for 2010 and 2011, which would allow it to use IFRS in its quarterly reports during 2012, or continuing to use U.S. GAAP. In either case, the Form 10-K covering the 2012 fiscal year would include three years of IFRS financial statements.
  34. What are commenters' views on Proposals A and B relating to U.S. GAAP reconciling information? Which Proposal would be most useful for investors? Is there a need for the supplemental information provided by Proposal B? Would the requirement under Proposal B have an effect on whether eligible U.S. companies elect to file IFRS financial statements? To what extent might market discipline (i.e., investor demand for reconciliation information) encourage early adopters to reconcile to U.S. GAAP even in the absence of a reconciliation requirement?

<sup>46</sup> The IFRS financial statements covering the two prior years could be included in the Form 10-K if the issuer were prepared to do so as of the due date. In that case, the Form 10-K would also contain three years of U.S. GAAP financial statements. Compliance with Exchange Act Rule 13a-14 [240.13a-14] would be required for both a Form 10-K and a Form 10-K/A that contained IFRS financial statements.

<sup>47</sup> An issuer that did not choose to file two years of IFRS financial statements would file its quarterly reports for the third year using U.S. GAAP.

35. What role does keeping a set of books in accordance with U.S. GAAP play in the transition of U.S. issuers to IFRS? What impact will keeping U.S. GAAP books have on U.S. investors, U.S. issuers, and market participants?
36. How valuable is reconciliation to U.S. investors, U.S. issuers, and market participants? How valuable is reconciliation to global market participants? Are there some financial statements (such as the statement of comprehensive income) which should not be required to be reconciled to U.S. GAAP?
37. Under either Proposal, would investors find the U.S. GAAP information helpful in their education about IFRS or in being able to continue to make financial statement comparisons with U.S. (and non-U.S.) issuers that continue to prepare U.S. GAAP financial statements? Would one alternative be more helpful to U.S. investors, regulators, or others in understanding information prepared under IFRS or to continue to make comparisons with issuers who prepare U.S. GAAP financial statements?
38. Should we be concerned about the ability of U.S. issuers that elect the early use of IFRS to revert to U.S. GAAP? Would either Proposal be preferred to facilitate such a reversion, should that be appropriate or required as described above?
39. Under Proposal B, should the proposed U.S. GAAP financial information be audited? Is the proposed role of the auditor appropriate? Should the proposed U.S. GAAP financial information be filed as an exhibit to the Form 10-K annual report, instead of as part of the body of the report? Is the proposed treatment of the information appropriate? For example, should the information be deemed “furnished” and not “filed” for purposes of Section 18 of the Exchange Act? Should we require that the supplemental U.S. GAAP information be contained in the annual report that is prepared pursuant to Exchange Act Rule 14a-3(b)?<sup>48</sup> Should the supplemental U.S. GAAP information appear as a note to the financial statements? Is the proposed role of the auditor appropriate?
40. Under either Proposal, should we provide more guidance as to the form and content of the information called for? Under either Proposal, should we require that additional information be provided, such as a “full reconciliation” as is required under Item 18 of Form 20-F?<sup>49</sup> Is there an intermediate position between the reconciliation under Proposal B and the reconciliation under Item 18 of Form 20-F?
41. Under either Proposal, should we require that the issuer’s “Management’s Discussion and Analysis of Financial Condition and Results of Operations” prepared under Item 303 of Regulation S-X contain a discussion of the reconciliation and the differences between IFRS as issued by the IASB and U.S. GAAP?<sup>50</sup>
42. Should we require supplemental U.S. GAAP information, such as that in Proposal B, for all quarterly periods covered by IFRS financial statements?
43. Should the option to report under IFRS, whether under Proposal A or Proposal B, automatically terminate as of a certain date? If so, should that date be a set period of time? For example, should it be three years following the effective date of an adopting release? Should it be a longer or shorter time period? Should it be measured from another date (e.g., the first permissible compliance date or the date of the first letter of no objection issued)? What considerations should be part of our decision as to the date or duration?
44. Under Proposal B, does providing U.S. GAAP information require issuers electing to file

<sup>48</sup> 17 CFR 240.14a-3(b).

<sup>49</sup> Item 18 of Form 20-F requires that a foreign private issuer provide as part of the U.S. GAAP reconciliation “all other information required by U.S. generally accepted accounting principles and Regulation S-X.”

<sup>50</sup> Foreign private issuers that provide a U.S. GAAP reconciliation are required to provide such disclosure. See Instruction 2 to Item 5 of Form 20-F.

- IFRS financial statements to maintain sufficient information, records, and controls in order to revert back to U.S. GAAP? If not, what additional information, records, or controls must be maintained?
45. Under Proposal A, what additional information, records, or controls would be necessary for U.S. issuers electing to file IFRS financial statements to maintain so that they could revert back to U.S. GAAP?
  46. Are the criteria for issuers eligible to file financial statements in accordance with IFRS as issued by the IASB clear from the proposed definition of "IFRS issuer"? If not, in what way is the definition unclear, and what revisions would be necessary to eliminate any lack of clarity?
  47. Is there any ambiguity in the proposed amendments regarding the reasons for the distinction between "IFRS issuer" and foreign private issuer, and the application of the rules to each? If so, what is the nature of the ambiguity and what would be necessary to provide clarity?
  48. Is the application of Regulation S-X and Regulation S-K to financial statements prepared in accordance with IFRS as issued by the IASB clear from the proposed amendments, or are there other items within those regulations that should be specifically amended to permit the filing of financial statements prepared in accordance with IFRS as issued by the IASB? If so, how would the application of Regulation S-X and Regulation S-K be unclear if there were no changes to those other than those proposed? What changes would be suggested in order to make them clear?
  49. Is there any reason why an issuer would be unable to assert compliance with IFRS as issued by the IASB and obtain the necessary opinion from its independent auditor?
  50. Is the application of Articles 1 through 12 of Regulation S-X to IFRS financial statements clear from the proposed Rule 13-02? If not, what further clarification is necessary? Are there other rules contained in Articles 1 through 12 that do not, or may not, apply to financial statements prepared in accordance with IFRS as issued by the IASB and that are not addressed in proposed Rule 13-02? If so, what are they and how should they be addressed?
  51. A U.S. issuer engaged in oil and gas producing activities that has followed the successful efforts method and carries forward that practice under IFRS will have consistent reserves disclosure under FAS No. 19, FAS No. 69, and Industry Guide 2. If that issuer were to apply another method of accounting permitted under IFRS, it may lead to inconsistencies between Industry Guide disclosure, FAS No. 69 disclosure, and the financial statements. Would such potential inconsistencies create ambiguity for users of that information or otherwise be a cause for concern? If so, what would be an appropriate means of addressing the inconsistencies?
  52. With regard to specific references to U.S. GAAP in our regulations, should we amend the references to U.S. GAAP pronouncements to also reference appropriate IFRS guidance, and if so, what should the references refer to? Would issuers be able to apply the proposed broad approach to U.S. GAAP pronouncements and would this approach elicit appropriate information for investors? Should we retain the U.S. GAAP references for definitional purposes?
  53. With regard to general references to U.S. GAAP, is our proposed approach appropriate and sufficiently clear? If not, how should these matters be addressed differently and why?
  54. Is our proposed approach sufficiently clear on how to address general caption data, segment data, and schedule information outside the financial statements? If not, what changes should we make? Are there other places in our regulations that need to be addressed?

55. Will three years of selected financial data based on IFRS be sufficient for investors, or should IFRS issuers be required to disclose in their selected financial data previously published information based on U.S. GAAP with respect to previous financial years or interim periods?
56. Should the Commission address the implications of forward-looking disclosure contained in a footnote to the financial statements in accordance with IFRS No. 7? For example, would some kind of safe harbor provision or other relief or statement be appropriate?
57. Is the proposed disclosure in Form 10-K sufficient in prominence and content to indicate to investors that the issuer has changed its basis of financial reporting from that used in previous filings? If not, what further disclosure should be provided, and where? Should we require that an issuer disclose the criteria under which it is eligible to file IFRS financial statements? Should issuers be required to reference the letter of no objection in their first IFRS filing?
58. Should we amend Form 8-K to require “forward-looking” disclosure relating to an issuer’s consideration of whether it will file IFRS financial statements in the future? If so, what type of information should be disclosed, and at what point in time prior to the issuer actually filing IFRS financial statements? Would a requirement to make such forward-looking disclosure have any impact on an issuer’s decision to adopt IFRS? If so, what would the effect be?
59. Are there issues on which further guidance for IFRS issuers would be necessary and appropriate?
60. Is the application of the proposed rules to the preparation of financial statements and financial information described in Sections V.D and V.E above sufficiently clear? If not, what areas need to be clarified? Are any further changes needed for issuers that prepare their financial statements using IFRS as issued by the IASB?
61. Under the proposed rules, an IFRS issuer or foreign private issuer may file financial statements of an entity under Rule 3-05, 3-09, or 3-14 prepared in accordance with IFRS as issued by the IASB even though the entity does not meet the definition of “IFRS issuer.” Should we also accept financial statements required under Rule 3-05, 3-09, or 3-14 prepared in accordance with IFRS as issued by the IASB without regard to the status of the issuer as an IFRS issuer or foreign private issuer? Should our acceptance depend on characteristics of the entity whose financial statements are being provided, such as that the entity already prepares IFRS financial statements or the entity principally operates outside the United States?
62. Are there other rules in Regulation S-X that should be specifically amended to accommodate our proposal? If so, how would the application of those rules be unclear if there were no changes to those rules, and what changes would be suggested in order to make them clear?
63. Should an IFRS issuer be required to continue to comply with the disclosure requirements of FAS No. 69? What alternatives may be available to elicit the same or substantially the same disclosure? Proposed Rule 13-03(d) of Regulation S-X is modeled on an instruction relating to FAS No. 69 in Item 18 of Form 20-F. Does this proposed rule need to be modified in any way to more clearly require filers to provide information required by FAS No. 69?
64. Is the guidance in this proposal sufficient to avoid any ambiguity about the use of IFRS financial statements in exempt offerings? If not, what additional clarification is needed? Is any revision to forms or rules necessary?
65. Are there other rules or forms under the Securities Act or the Exchange Act that should be specifically amended to permit the filing of financial statements prepared in accor-

- dance with IFRS as issued by the IASB? If so, how would the rules or forms be unclear if there were no changes to those forms, and what changes would be suggested in order to make them clear?
66. Are there other considerations in addition to those discussed in this release that the Commission should consider as part of the proposed amendments to permit the limited use of IFRS or its future decision regarding the use of IFRS by U.S. issuers?
  67. Do you agree with our assessment of the costs and benefits as discussed in this section? Are there costs or benefits that we have not considered? Are you aware of data and/or estimation techniques for attempting to quantify these costs and/or benefits? If so, what are they and how might the information be obtained?
  68. We solicit comment on whether the proposed rules would impose a burden on competition or whether they would promote efficiency, competition, and capital formation. For example, would the proposals have an adverse effect on competition that is neither necessary nor appropriate in furtherance of the purposes of the Exchange Act?
  69. Would the proposals create an adverse competitive effect on U.S. issuers that are not in a position to rely on the alternative or on foreign private issuers that do not report in IFRS?
  70. Would the proposed amendments, if adopted, promote efficiency, competition, and capital formation?

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