U.S. Securities and Exchange Commission

Speech by SEC Staff: Remarks Before 2005 AICPA National Conference on Current SEC and PCAOB Developments

by

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Introduction

Good morning. I appreciate the opportunity to join with so many key participants in the financial reporting process who are here today. For those of you I don't know, I look forward to meeting many of you during the remainder of this conference. For those of you I do know, it's nice to see you again. And let me say that it is especially nice for me, personally, to see two of the people who preceded me on the podium; namely, Leslie Murphy and Ed Jenkins. Why, you ask? Well, two small world stories.

First, it was Leslie's husband, Terry, who—in his role as the HR partner in Arthur Andersen's Detroit office—started me out on my auditing career by offering me a job after I graduated from college. And yes, I accepted the offer.

Second, it was Ed Jenkins who, nine years later, offered me the opportunity to work for him in Andersen's national office in Chicago. Again, I accepted the offer. Working with Ed and his colleagues taught me a lot and opened up a new and very rewarding phase of my career. That, combined with some international exposure at the International Accounting Standards Board (IASB) and at Stanford University, led me here to the SEC, which in turn prompts me to state that the remarks I make today are my own, and do not necessarily represent the views of the Commission, the Commissioners or of other members of the Commission's staff.

I realize that the majority of the people participating in this conference are from the U.S. and thus perhaps don't spend a significant portion of their time on international matters. However, we also have some participants who flew many miles and time zones to get here and who work with international financial reporting matters every day. Hopefully, my remarks can offer something for each of you, either here or in today's later Q and A session. And, if not, feel free to approach me in the hall. There is also the opportunity for dialogue at more of the nuts and bolts level during the international break-out session on Wednesday.

Today's Remarks

Last year, in my inaugural speech in this position, I took our few minutes together to discuss one thing: namely, my aspirations for our respective work on the standard setting, education, application, interpretation and regulation aspects of international financial reporting matters. This year, I would also like to discuss one thing; namely, how it's all going. Discussing how it's all going gives me a choice as to whether to cover either what I *see*, or what I *sense*.

If I were to cover what I *see*—matters such as convergence of International Financial Reporting Standards (IFRS) and U.S. GAAP, adoption of IFRS by more and more countries, the International Auditing and Assurance Standards Board (IAASB) undertaking a large project to clarify international audit standards, and so forth—then I suspect I would be covering developments you yourselves have already observed or read about. If I instead were to cover what I *sense*, perhaps I can share with you something new. So that is what I will do. But before I begin, let me describe my vantage point.

My vantage point is from "out there", rather than "in D.C." Granted, while I am not down in the trenches performing the unsung tasks associated with converting general ledgers and audit work programs to accommodate IFRS, I do travel internationally approximately one week a month in several capacities. I am an Observer at meetings of both the IASB's Standards Advisory Council and its International Financial Reporting Interpretations Committee (IFRIC). I lead some of the efforts of the International Organization of Securities Commission's—that is, "IOSCO's"—Standing Committee on Multinational Accounting and Disclosure. I participated in the International Auditing and Assurance Standards Board's recent Global Forum on International Standards on Auditing. And, there are also IASB roundtables, and conferences.

If you think all this must take me literally around the world, you are right. I made such a trip a couple weeks ago, and at the SEC we mostly fly coach. So, that's enough about my vantage point. Now, on to what I sense.

What I Sense

I can sum up what I sense in one point. I sense the difficult, and many times frustrating work to replace the old financial reporting traditions with the new ones. And in the international context, to develop these new traditions means coordinating change among practitioners so diverse that the month of July means summer to some and winter to others.

To perhaps better explain, let me put this same "replacing traditions" point a little more lightly. I sense members of our profession may be feeling a bit like the character Tevye in the play entitled, "Fiddler on the Roof". If you recall, Tevye experiences changes to the trappings of his traditional life in the Russian city of Anatevka as his daughters grow up and as Russia heads toward revolution. The first "tradition" to go is that of the local matchmaker selecting a daughters' husband. This melts away when Tevye's oldest daughter, Zeitel, seeks, and succeeds in selecting, her own marriage partner—the tailor—in place of the man whom the matchmaker had selected—the butcher. Two of Tevye's other daughters then proceed to do the same.

In our national financial reporting jurisdictions we have our traditions as well, and like Tevye we see those traditions changing. For example, on the standard setting front:

- Moving from many sets of national financial reporting standards to a single set of global standards;
- Moving from an existing set of international standards on auditing to a rewritten and clarified set; and
- Moving to a revised international *Code of Ethics for Professional Accountants* that establishes a conceptual framework based upon five fundamental principles.

On the education front, we move from hiring young people who are solely steeped in national traditions to hiring those who have studied global financial reporting standards in school. On the application and interpretation front, we have national accounting standard setters in IFRS jurisdictions engaging in some movement from their traditional role—as in essence the local "pope" on accounting matters—to global role in which they engage in dialogues from which they can identify interpretation matters that the IASB or IFRIC may consider addressing. So if previously these standard setters were in essence the local "pope", they now can fulfill a role of global "cardinal", if you will. On the regulation front, we move from no vehicle for sharing IFRS application decisions among national securities regulators to the gear up of such a vehicle via IOSCO.

Because financial reporting encompasses both math and logic, one might think that changes in traditions would nonetheless lead everyone to the same new spot. But my sense is that financial reporting also contains a very human element. I sense the difficulty and sometimes frustration that those who are involved experience in fostering these changes in traditions. To that end, I have heard points made that the main argument for a particular accounting approach under IFRS is that it was the approach previously used under local accounting standards, despite tacit acknowledgment that the local approach conflicts with IFRS. It also seems to be human nature to read the provisions of IFRS through ones national eyeglasses. In this case if varying approaches are acceptable under IFRS in accounting for a particular item, the dominant approach used in one jurisdiction may be in the vast minority in another. With time and effort I suspect these things will move to change as some coalescence occurs and investors and practitioners establish a sense of balance under the new traditions.

The SEC's "Traditions"

Let me now move closer to home. All my comments about changes in financial reporting traditions beg the inevitable question as to what those developments on the international front mean for the "traditions" in the U.S. capital markets? First, I would say that the SEC is not adverse to change; far from it. When an opportunity to improve investor protection and capital market efficiency presents itself, the SEC can move with relative speed. That said; let me cover three of our "traditions.

Audit and Professional Standards in the U.S. Capital Markets

Let me begin with audit and professional standards. We have the PCAOB to set those standards for the U.S. capital markets. While the PCAOB is still relatively new in this role, it is nonetheless well-established. The SEC staff has no intentions to change the SEC's "tradition" with respect to the PCAOB's role and the role of their standards in our markets. That being said, I am supportive of the efforts the PCAOB and IAASB have made to stay abreast of each other's work.

Accounting Standards in the U.S. Capital Markets

Now let me move to the potential role of IFRS in the U.S. capital markets. This matter is addressed in an April 2005 article authored by the former Chief Accountant that is commonly referred to as the "roadmap". Perhaps many of you have read it, but nonetheless let me cover a few points from it.

The roadmap puts forth the prospect of a decision regarding IFRS co-existing with U.S. GAAP in the U.S. capital markets by 2009, and possibly sooner. This co-existence would occur if the SEC were to conclude that it was no longer necessary for its foreign registrants to reconcile financial statements prepared under IFRS to U.S. GAAP. In this case these foreign registrants would provide investors in the U.S. capital markets with IFRS-based financial statements while domestic registrants would continue to provide financial statements prepared under U.S. GAAP. Other foreign registrants would continue to either prepare, or reconcile, their home country financial statements to U.S. GAAP.

To support such a recommendation to the Commissioners, the SEC staff would need to believe that U.S. investors could adequately work with various issuer financial statements prepared under one or the other of these two sets of standards. The roadmap article discusses the factors that would support such a conclusion—such as the necessary faithfulness and consistency of the application of IFRS by and across entities as well as the future filing review and other work of the SEC staff with respect to such a conclusion—but for the sake of brevity let me highlight a couple points.

First, the SEC staff would need to believe that investors can understand and work with IFRS-based financial statements. This is possible if IFRS is a high quality set of standards that is widely-used, and if the application of IFRS in practice is both faithful to the standards and consistent across entities. With these factors in place IFRS-based financial statements “stand on their own two feet”, if you will. Standing alone is precisely what the IFRS financial statements will need to do absent the U.S. GAAP reconciliation.

If such financial statements stand on their own two feet, then, second, we turn to considering how similar are financial statements prepared under IFRS and U.S. GAAP, and whether the differences between them are understood. Convergence of IFRS and U.S. GAAP facilitates an investor’s ability to “understand and work with” financial statements prepared under one or the other of the two sets of standards. This is because the more similar are the two sets of standards; the easier it is for investors to analyze and compare the resulting financial statements. I believe investors could “understand and work with” these financial statements short of IFRS and U.S. GAAP being twins.

Standard Setting Priorities for IFRS and U.S. GAAP

Lastly, let me address our tradition of the Financial Accounting Standards Board (“FASB”) establishing its standard setting agenda, since 2002 as affected by the “Norwalk Agreement’ with the IASB. I think this tradition should stay, because the greatest ratio of benefits to costs is if their convergence work is focused on both improving and converging accounting standards. Therefore, I think the standard setters should use the resources and talent that a convergence approach to standard setting brings to tackle the toughest, most intractable and problematic standard setting issues. To me, those are topics such as financial instruments, performance reporting, revenue recognition and topics for which the existing accounting model has off-balance sheet elements; as is the case, for example, with pensions, leases and consolidation policy. Accounting models that have off-balance sheet elements are a frequent source of financial reporting transparency issues in the U.S. capital markets, and I suspect this is the case in other capital markets as well.

I think the IASB’s and FASB’s convergence efforts are most effective if they make continuous progress on these toughest issues while also pursuing some other very targeted efforts along the way. This means a few shorter-term efforts that focus solely on a dominant difference between particular accounting models. This provides the rewards and other positive effects of making improvements along the way as the bigger and tougher subjects are handled. This does not, however, mean artificially paced convergence work targeted at a specific level of convergence. Nor does it mean engaging in a paragraph by paragraph comparison of IFRS and U.S. GAAP for the purpose of deciding which paragraph is “better than” or “worse than” the other. These approaches may not result in significant improvement in the standards. They also inflict much accounting standards change on those thousands of public and private entities that use IFRS and U.S. GAAP but that are not, and never will be, SEC foreign registrants.

Closing

In closing, I intend my remarks today to give you—especially those who work in the U.S.—the opportunity to get a sense of the tone of international financial reporting matters today, as well as the potential implications of changes for some of our U.S. capital market traditions. Suffice it to say that there are a lot of dedicated souls on the international front—and no doubt here at home—who are working very hard to make changes to move to a global environment. Changing the traditions rooted in varying financial cultures, legal traditions and disclosure protocols to one global standard is, however, a process that disrupts the traditions that have allowed investors and practitioners to keep their balance for many years. Thus, that the first steps may be somewhat unsteady is understandable; but what is important is the willingness to rebuild that balance through the second steps, and then the third. I have faith that this will occur. You, however, may be more skeptical. If you are, I ask you to at least take note of the fact that while “Fiddler on the Roof” includes the song entitled “Tradition”, it includes a song entitled “Miracle of Miracles” too.

Thank you very much for your attention.

http://www.sec.gov/news/speech/spch120505jae.htm
