



Speech by SEC Chairman: Chairman's Address to the SEC Roundtable on International Financial Reporting Standards

by

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Good morning, and welcome to the SEC's Roundtable on our International Financial Reporting Standards "Roadmap."

Today's forum is focused both on where we've been, and on next steps. It's been two years since our then-Chief Accountant, Don Nicolaisen, first laid out the Roadmap, which I endorsed as Chairman a few months later. But this has been a much longer journey than that.

Eleven years ago, in the National Capital Markets Efficiency Act, Congress directed the SEC to respond to the growing internationalization of securities markets by giving "vigorous support" to the development of "high-quality international accounting standards as soon as practicable". Four years later, in February 2000, the SEC issued a Concept Release that solicited comment on whether we should consider accepting International Financial Reporting Standards in the United States.

Two years after that, when Enron and the wave of accounting scandals called into question the intensely rule-based approach of U.S. GAAP, Congress again urged us to take action. In section 108(d)(1) of the Sarbanes-Oxley Act, the SEC was directed to undertake a study on the "adoption by the United States ... of a principles-based accounting system." SOX expressly required that we examine the length of time that would be necessary to change from a rules-based to a principles-based financial reporting system.

And so, in 2002, with the SEC's express support, the Financial Accounting Standards Board and the International Accounting Standards Board began in earnest to achieve short-term convergence between their respective sets of accounting standards. In the "Norwalk Agreement" that was struck between the FASB and the IASB in September 2002, the respective Boards agreed to work toward making their existing financial reporting standards fully compatible "as soon as is practicable" — the same phrase that Congress used in the National Capital Markets Efficiency Act. That same year, the European Parliament and the Council of the European Union determined that all listed European Union companies (including banks and insurance companies) would have to prepare their consolidated financial reporting using IFRS, beginning in 2005.

So when the Roadmap was laid out two years ago, we had already covered a lot of ground.

The Roadmap commits us to eliminating the current U.S. GAAP reconciliation requirement, with the result that eligible firms listing on U.S. exchanges could choose whether to report under IFRS or U.S. GAAP. If an issuer chose IFRS, it would not be required to reconcile the

differences with GAAP — just as today, issuers reporting under U.S. GAAP aren't required to reconcile the differences with IFRS.

Once unveiled, the Roadmap took on a life of its own. Governments, regulators, and standard setters around the world have been relying on it to determine their actions. And so it is important that I repeat today what I have said before: We are committed to this process, and we aren't looking back.

Have you ever tried to refold a roadmap? It's not pretty. Not only is it impossible to divine which side folds where, but you're generally required to make the attempt while the car is in motion, and the driver is yelling, and you're not entirely sure whether you're on the right track, or else you wouldn't need the map in the first place. So we're not going to refold the map, or try to stuff it, creased and mutilated, back into the glove box.

I am here to tell you that not only I as Chairman but all of us at the SEC are committed to the Roadmap. And in that regard, I would particularly like to welcome EU Internal Markets Commissioner Charlie McCreevy to this Roundtable — because I know that he, too, and the EU likewise, are committed to the Roadmap.

As the world's securities markets continue to integrate, it's easy to imagine that the process of continued harmonization of standards is inexorable — somehow impelled by forces of nature. But it isn't so. As everyone in this room knows, you shoulder a heavy burden each day to turn that vision of seamless integration into reality.

And a great deal rides on your eventual success. As issuers and investors increasingly look beyond their borders for opportunities to invest and raise capital, it is critical that the financial information they use to make their decisions be accurate and timely. One of the obstacles that investors have to overcome in making investment decisions is the different ways that this information can be reported. Sometimes the differences are due simply to the happenstance of the country in which an issuer happens to find itself. That's why virtually everyone — issuers, investors, and stakeholders alike — agrees that the world's cap markets would benefit from the widespread acceptance and use of high-quality global accounting standards.

The rationale for a global standard, rather than the Babel of competing and sometimes contradictory national standards, has been often stated. But it is so important that it bears repeating. Global accounting standards would improve investor confidence in the market, so long as the standards are high-quality, comprehensive and rigorously applied. They'd allow investors to draw better comparisons among investment options. They'd also lower costs for issuers, who would no longer have to incur the cost of preparing financial statements using different sets of accounting standards. And those lower costs would benefit the company's shareholders, who ultimately bear the burden of the entire cost of the financial reporting system.

The purpose of today's Roundtable on the Roadmap is to consider the possibility that International Financial Reporting Standard and U.S. GAAP might co-exist in U.S. capital markets — and to assess the impact that this would have on the markets, on the decisions investors make, and on our program of investor protection.

Not only the European Union but also many other jurisdictions including Canada, Australia, New Zealand, Israel, China, and Hong Kong are adopting IFRS — and so, without question, it is becoming a widely used set of standards. But we should not forget that it is also a new set of accounting standards. IFRS has existed as a truly comprehensive set of accounting standards for only a few years. And because of that relative newness, it necessarily has a limited history of interpretation and application. We are all now engaged in the exercise of ensuring that IFRS is being applied consistently, faithfully, and transparently.

This exercise is important to our friends at the European Commission because consistency and faithfulness in the interpretation and

application of IFRS are critical to the creation of a seamless, integrated capital market comprising the EU's 27 member states. The exercise is also of critical importance to the SEC. Allowing the use of two different sets of accounting standards in the United States would mark a significant change for us. But allowing two standards is as nothing compared to two dozen — and for that reason, we have got to be able to demonstrate that IFRS is indeed a single set of international accounting standards, and not a multiplicity of standards going by the same name.

It is the premise of the Roadmap that if we can do this, then the potential benefits to U.S. investors of allowing the use of IFRS in the United States almost certainly outweigh the risk. These benefits include increased investor access to foreign investment opportunities, and entry into the U.S. capital markets by issuers that might otherwise be deterred from listing here by the high costs of reconciling their financial statements to U.S. GAAP.

The risk, by contrast, is not that IFRS cannot provide sufficiently high quality information to U.S. investors about an issuer that uses it. Instead, it is that financial statements prepared using IFRS cannot be compared to one another because of a lack of consistent and uniform implementation. That imperative of a consistent application and interpretation depends on policymakers, governments, issuers, and accountants. Regulators like the SEC also play a role, because it's our job to review financial statements (whether they're filed using IFRS or U.S. GAAP) to see whether the accounting standards are being applied consistently and faithfully.

Last summer, the SEC saw the first wave of filings by non-U.S. companies using IFRS. While the number of IFRS filings was smaller than we had expected it would be, those we did receive were helpful in orienting us to the kinds of issues we can expect to face as the number of filings rises over the coming years. While these were the first IFRS filings we've had the opportunity to review, the SEC has long been in the business of reviewing filings by foreign private issuers. The kind of review that SEC staff has done of these first IFRS filings is the same that we've done for years for filings reconciled to U.S. GAAP. Nonetheless, given the relative newness of IFRS, the staff of the Office of the Chief Accountant and the Division of Corporation Finance have worked hard to understand the new standards and how issuers are using them to state their financial results.

The initial comments of the staff reviewing these filings are most appropriately described as "information seeking." They're not intended to be conclusions about the application of IFRS. They are instead meant to be an effort to better understand things that may be unclear or call attention to items that may be omitted. I want to emphasize that the staff's comment letters shouldn't be viewed as an effort to straitjacket the interpretation of IFRS, or to make it more rules-based and less principles-based. It is one thing to say that IFRS should be interpreted and applied consistently and another thing to say it should be stripped of its flexibility and its essential principles-based nature.

One of America's early icons, a rough-and-tumble frontier lawyer who was Tennessee's first Congressman, once memorably said that "It is a damn poor mind indeed that cannot think of at least two ways to spell the same word." Old Hickory, as he came to be known, was our seventh President. Andy Jackson's folk wisdom is appreciated by some of today's great Americans who work in the SEC's Division of Corporation Finance, and in our Office of the Chief Accountant. They know as well as anyone that in the same way that a poem, short story, or novel is subject to multiple interpretations, so too are the standards set forth in IFRS — even if accounting standards don't often rise to the level of poetry.

But just as it is true that any piece of literature can be subject to multiple interpretations, it is also true that some interpretations can be incomplete — or just wrong. For example, an essay on *Moby Dick* that does not mention the whale may raise questions that the writer has perhaps missed something important about the novel. Or when an essay on *Hamlet* begins with a statement that "Lady MacBeth is the key to

understanding the play," we know that something has gone seriously wrong. So while there may be more than one reasonable interpretation or understanding, it has to be susceptible to explanation. And a comment letter that asks for more detail or greater explanation does not mean that the SEC is trying to impose its own interpretation.

We and others around the world will instead be focusing on a shared understanding of the principles of IFRS. To this end, the SEC and the Committee of European Securities Regulators have entered into a joint work plan to further the consistent and faithful application of accounting standards. The Work Plan provides a forum in which the SEC and EU securities regulators can discuss questions about the application of accounting standards. The Work Plan also helps foster consistency and faithfulness by helping regulators to avoid conflicting decisions. The process is very much collaborative, and it recognizes that by their very nature, neither IFRS nor U.S. GAAP is the exclusive purview of a particular regulator — but rather, they are public goods for the common benefit of many. By consulting with each other, the SEC and CESR staff can help ensure that high-quality global accounting standards are consistently interpreted and faithfully applied.

At the same time, the FASB and the IASB have embarked on a project to converge accounting standards, which as I noted was formalized in the Norwalk Agreement. Over the past few years, these efforts have gone far to reduce differences between the two sets of standards, and by all accounts, have improved both IFRS and GAAP in the process.

But accounting standards are complicated, and changing them can be difficult. And that inherent difficulty has led some to the view that the convergence of IFRS and U.S. GAAP is impossible — thus rendering the elimination of the reconciliation requirement an eternally unattainable goal. So let me repeat that we do not expect to see total convergence or even a specific level of convergence before eliminating the reconciliation requirement. Instead, there must be a robust and active process in place for converging IFRS and U.S. GAAP. If the process is in place, then the current differences will be minimized in due course.

This is hard work. But the benefits for investors and our markets are enormous. Convergence of IFRS and U.S. GAAP will allow the United States and markets around the world to capitalize on the benefits of a single set of globally accepted accounting standards. The process of reducing the differences between IFRS and U.S. GAAP gives us the opportunity, at the same time, of taking both to the highest quality level. That is why the SEC originally committed to the Roadmap, and why, years later, we are still committed.

That original commitment was enormously consequential, because it implied a great deal. It meant that IFRS and U.S. GAAP would someday compete freely in America's capital markets, and that two accounting systems would operate side by side — at least until the process of convergence concludes with actual convergence, and there is truly one global accounting standard and seamless international comparability of reporting. It meant that issuers, markets, and investors would have a choice — because they, not the government, will decide between IFRS and GAAP. It also meant that the SEC was seriously contemplating a system in which not only foreign issuers, but also domestic issuers will have that choice. Most importantly, because the Roadmap has a timetable and an end date, it meant the work of standard setters toward convergence of the two systems that is necessary before reconciliation can be eliminated will not be of infinite duration.

As the name implies, the Roadmap has a destination, and an estimated time of arrival. We are now less than two years away from our planned arrival at the intended destination.

Whether or not complete convergence is susceptible of practical implementation in the short term, the elimination of the present reconciliation requirement is not dependent upon the FASB and the IASB resolving all major differences between their regimes. Rather, it requires sustained progress toward that goal. It is a significant implication of the Roadmap that once the reconciliation requirement is ended, there will be

no incentive for delay in truly converging IFRS and GAAP.

The Roadmap isn't an article of faith. It is a plan, nothing more or less. And just as with the garden variety roadmap, every once in a while it pays to stop and ask questions about the particular route you have chosen to make sure you have not missed points of interest along the way. That is why we have convened this distinguished group of panelists today, drawn from those who play a vital role in the capital raising process. We're interested in multiple points of view from issuers, accountants, investors, credit rating agencies, investment bankers, lawyers, and directors. Because you're observing this process first-hand, you're the experts. We aim to be empiricists, and to learn from your actual experience.

Twenty three centuries ago, Aristotle concluded that heavier bodies fell faster than lighter ones, because it seemed logical that they would. For almost two millennia afterward, most people continued to believe that — not only because it seemed logical, but also because Aristotle had said so. Not until Galileo constructed a careful series of experiments and meticulously observed and recorded their results was it proved once and for all that all bodies fall at the same rate of speed, whatever their weight.

As important as that discovery was, the far more important consequence was the triumph of empirical observation over ivory tower analysis. Or as the great American sage, New York Yankee legend, and unheralded empiricist Yogi Berra once put it, "You can observe a lot just by watching."

Today we have climbed down from our regulator's ivory tower and planted our feet firmly on the ground, in order to listen to and learn from the real-world experiences of our panelists. We are comfortable that as a matter of theory, the benefits of eliminating the reconciliation requirement seem reasonable and logical. But what remains to be determined is whether those benefits will in fact be achievable in practice.

That is the reason the SEC is hosting this Roundtable and why, as Yogi might put it, it's now my turn to observe by watching.

Thank you to all of our panelists and presenters. I look forward to an illuminating discussion.

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