



U.S. Securities and Exchange Commission

Speech by SEC Staff: International Reporting: The Way Forward

Remarks by

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Thank you, and good morning to all of you. My remarks today are going to focus on three areas:

- Status of the SEC Concept Release on International Accounting Standards (IAS)
- Our expectations for future international standard-setting – for both accounting and auditing standards, and
- The importance of a global financial reporting infrastructure, and the roles and responsibilities of some of the key players in that infrastructure

First, the International Concept Release.

International Concept Release

The [International Concept Release](#) was issued on February 16, 2000. It requested comment on numerous issues relating to the international accounting standards developed by the International Accounting Standards Committee (IASC), and on other aspects of international reporting and auditing. Over the ensuing months, we've received 93 comment letters. The letters came from a wide variety of interested parties in the U.S. and in other countries.

The responses to this release show that people have strongly-held and far from uniform views. On the issues of whether or not IAS are now of sufficiently high quality and whether the SEC should accept IAS without reconciliation to U.S. GAAP, most Europeans say "yes, definitely" while most U.S. respondents say "not yet."

Inside the U.S., the Business Roundtable and several large and prominent U.S. registrants cited the strength of the U.S. capital markets and the importance of high quality information in preserving investor confidence. They reiterated the need to maintain high quality standards to ensure the success of our markets, and said that international accounting standards have improved, but are "not there yet." They urged that the existing requirements for reconciliation be continued until the international accounting standards – and the necessary interpretation and auditing infrastructure – reach a higher level of quality.

The AICPA's comment letter stated that the organization fully supports the development of a single set of high quality accounting standards to be used in the preparation of transparent and comparable financial reports throughout the world. The AICPA notes that it was a founding member of the International Accounting Standards Committee, and has supported the IASC's work since 1973. But the comment letter also notes concerns about the current body of IAS and interpretations, and calls for reconciliation to continue as an interim measure.

You can get an excellent picture of the diversity of the responses we received by looking through the comment letters that are on the SEC's website at www.sec.gov.

So where does that leave the SEC? Right now the staff is hard at work, considering the views expressed in comment letters and related research. We're formulating possible approaches, and evaluating the alternatives for action. What is the SEC likely to do? SEC action could include rulemaking to modify the existing reconciliation requirements, or making other changes to modify the process for foreign issuers that are using IAS. Alternatively, the Commission could decide to continue present requirements and take other actions besides rulemaking. In other words, stay tuned.

The SEC, as you may know, is a member of IOSCO, the International Organization of Securities Commissions. Earlier this year, IOSCO completed a comprehensive assessment of 30 core IASC standards, and recommended that IOSCO members accept cross-border filings in IAS, subject to three supplemental treatments: reconciliation, interpretation, and disclosure, where needed to meet national requirements. The SEC already accepts IAS with reconciliation to U.S. GAAP, which is consistent with IOSCO's recommendation.

There is a strong interest in recognizing and supporting the work of the IASC, while maintaining the high level of investor protection that has made our U.S.

markets so strong. And we also want to continue to recognize and support the work of FASB, AcSEC and the EITF, who have done so much to provide the transparency in financial reporting that is an essential underpinning of investor confidence.

As the staff evaluates the best course of action, we will be guided by the key elements the Commission originally established for further acceptance of IAS:

- The standards must constitute a comprehensive, generally accepted basis of accounting
- The standards must be of high quality – they must result in comparability and transparency, and they must provide for full disclosure; and
- The standards must be rigorously interpreted and applied.

I cannot give you a timetable for our next steps, but I can tell you that we are giving this work high priority. I can also assure you that any proposed changes in Commission rules would be published for public comment.

Now let me turn to the future of international standard setting.

Future Standard Setting – Accounting and Auditing

Accounting Standards

The IASC has made major accomplishments in its work, but it is clear that a great deal remains to be done in the future. Next week will be the final meeting of the "present IASC board," and part of its work will be to finalize a statement to pass on to the "new board" regarding issues and potential actions for the future. The IASC Trustees have been conducting a search for new board members, and in due course we shall see the announcement of the persons who will be setting the accounting standards in 2001 and thereafter. We are fortunate to have with us at this conference the Chairman of the new IASC Board, Sir David Tweedie, so perhaps we shall hear more about the IASC's restructuring later.

I want to say a bit about what we believe lies ahead in international accounting standards setting, and then I am going to address the subject of international auditing standards.

On the accounting front, we expect significant progress to come about in international financial reporting, through cooperative efforts between the newly restructured IASC and its liaison mechanism with national standard setting bodies such as the FASB. There is a great passage in the AICPA's comment letter on this – let me read it:

"All accounting regimes, including U.S. GAAP, evolve over time and require improvement. With convergence of IAS and national regimes around high

quality standards, fewer reconciling items will exist over time, and at a future date, reconciliation will become unnecessary. By convergence, we mean a movement toward higher quality standards from all jurisdictions, not simply a movement toward IAS or only toward U.S. GAAP or some other existing regime."

Convergence on the highest quality standards – a "best of breed" approach to accounting – is a goal that should be established and achieved. We will be looking for the world's standards setters to provide leadership in making this happen. In fact, we believe that the best way to deal with the reconciling items we commonly see today, is for the IASC to set an initial agenda in cooperation with the national standards setting bodies, which would result in all of the standard setters converging on the highest possible standard. That would in and of itself eliminate some of the items requiring reconciliation today. The SEC will continue to take a keen interest in monitoring and supporting this work.

Auditing Standards

Turning to the subject of international auditing standards, when I look ahead, I see many parallels to what has occurred with international accounting standards and the IASC.

International Standards on Auditing, or ISAs, are set by the International Auditing Practices Committee (IAPC), a technical committee within IFAC, the International Federation of Accountants (IFAC). ISAs are where the IASC accounting standards were at a number of years back. There is a body of ISAs published and used in a number of countries around the world, but major improvements are needed to update and amplify the current body of standards. The IAPC has projects underway to address some of these needs, and I expect that additional efforts will take place in the future. I also expect that both the SEC and IOSCO will be monitoring work on international auditing standards in the future.

The IAPC, in its the role of a standard setter of international auditing standards, must work vigorously towards the creation of a set of high quality auditing standards that can be accepted globally – standards that will outline what is required for completion of a high quality audit. Only then can the IAPC's auditing standards gain global acceptance. The international auditing recommendations in the Report of the O'Malley Panel on Audit Effectiveness are an important starting point for the IAPC to reference in planning its work, and set an appropriate benchmark from which to measure IAPC achievements. As noted in the Panel report, international auditing standards should be "comprehensive and sufficiently specific and rigorous so that they serve as appropriate benchmarks to judge the work of auditors."

As also mentioned in the O'Malley Report, the IAPC should conduct its meetings in the public eye. Transparency in the setting of standards will add legitimacy to the process by which standards are created.

Quality Assurance, Monitoring and Discipline

IFAC and its technical committees are also responsible for setting quality assurance standards for international auditing. Those quality assurance standards, their implementation and the necessary quality controls within the firms as well as their ongoing effectiveness must all become subject to a substantive and rigorous review or testing process performed by a third party. As with the auditing practice standards set by the IAPC, standards for quality assurance, monitoring and discipline should be set in an open and public process.

Independence

The Ethics Committee of IFAC is currently in the process of finalizing a new standard on ethics and independence of auditors. I commend the Ethics Committee's efforts and would point out that the SEC recently issued new rules on independence. These rules are based on the need to maintain investors' confidence and trust in the reported numbers, through the services of an auditor that will be perceived as objective and unbiased. An approach based on the concept of "threats and safeguards" will not achieve this goal.

I would like to emphasize to the Ethics Committee, and any other body considering independence rules, that in addition to looking at the SEC's final rules, it would be beneficial to examine the public testimony and comment letters on this important subject. Those documents will provide any interested party with the results of a massive outreach effort that included a comprehensive and public analysis of independence issues and concerns.

I am sure that we all will be hearing and considering much more on international auditing issues in the future.

I want to open up the lens now to take a broader view of the international financial reporting environment. Specifically, I want to examine elements, besides standards, that are an essential prerequisite to an effective global financial reporting infrastructure.

A Global Financial Reporting Infrastructure... And the Roles and Responsibilities of Key Players

While the IASC has made good progress via the completion of its core standards project, the issuance and adoption of IAS does not mean the same thing as rigorous interpretation and application of those standards. In fact, in order for *any* set of accounting standards to produce information that is transparent, comparable and consistent, there must be an effective financial reporting infrastructure that assures the standards will be rigorously interpreted and applied.

The starting point of any financial reporting infrastructure is the reporting company's management. Management is responsible for implementing and properly applying generally accepted accounting standards. Management's

front-line role is supplemented by the auditors, professional organizations, and regulatory bodies. And all of these players must fulfill their duties and responsibilities in order for the infrastructure to be effective.

When we are talking about IAS, we are dealing with a body of standards that has come about largely as an overlay to individual country standards, and that has many relatively recent standards. Effective auditing cannot be achieved without both auditor organizations and individual audit firms stepping up to their international responsibilities. As I mentioned earlier, the International Federation of Accountants and the IAPC have a long-term project underway to update and improve the quality of auditing standards. Enhancing international auditing standards is one necessary step. Necessary, but not sufficient. What is also needed is a way to ensure that high quality audits occur today and not after another international financial crisis.

Even if a country's local auditing standards do not require equivalent procedures to U.S. Generally Accepted Auditing Standards, even if there is not yet a definitive international auditing standard providing an equivalent level of quality, the multinational audit firms should assume the responsibility to adhere to the highest quality auditing practices that the public associates with their brand names, on a *worldwide* basis – and they should do so now.

I also believe that using the highest quality auditing standards ought to be a matter of obligation and best practice in local country audits. The reality is that some countries lag behind in imposing high quality auditing standards that would provide the level of reliability that investors in U.S. capital markets expect. I believe that member firms of the worldwide audit firms should follow the same high quality auditing practices wherever they operate – even if local laws do not require those auditing standards or practices.

Some may say "but we cannot go beyond what is required in a given country" – I say "and why not?" The laws of other countries typically prescribe minimum requirements; they do not prohibit an auditor from doing more than the minimum. The function of providing assurance is so valuable to international financial reporting in the capital markets, with all the additional complexities that a global scale introduces, that it is hard to see why audit firms should feel constrained by minimum requirements.

I am concerned that we are not seeing enough progress in the area of international auditing within and among the audit firms themselves. I question if we are seeing the sense of urgency and the level of audit firm action that is needed in today's global investing environment.

In today's international environment, a lack of high quality auditing and individual auditor accountability could seriously affect the quality of information that investors need to make the best resource allocation decisions.

So what should audit firms do?

In addition to executing high quality audits, audit firms should have effective quality control policies and procedures that include elements such as:

- Assurance of independence, integrity and objectivity;
- Personnel management, including proper training and supervision;
- Guidance for acceptance and continuance of clients and engagements;
- Evaluation of engagement performance; and
- Monitoring.

The public should be able to have reasonable assurance that the systems used within audit firms will result in compliance with quality control policies and procedures by all partners and staff conducting audits. Firms need to assure that compliance occurs on an international scale.

A key element of a global infrastructure is the quality assurance system of the accounting and auditing profession. The system for quality assurance should include elements such as effective monitoring systems, and continuing education and training. In the U.S., we maintain a well-developed system that contributes to our financial reporting system.

The development of the accounting profession is at a crossroads. The major firms, the International Federation of Accountants and its standard setting committees, especially the International Auditing Practices Committee – each of these has a critical role to play. I am concerned that other organizations are lagging behind the progress made by the IASC. I challenge each of these participants to put forward vigorous and timely efforts to reach our shared goal – a high quality, global financial reporting infrastructure.

So, what needs to be done? And who should do it?

The way to move forward begins with the auditing profession's international organization, IFAC. Representing approximately 140 national and regional organizations of the accountancy profession, IFAC is in the best position to develop high quality auditing, ethical and quality assurance standards that could be used in enhancing the global financial reporting infrastructure. I believe that the O'Malley Panel on Audit Effectiveness has provided a very good road map for the leadership of IFAC. Within the Report of the Panel, several key recommendations should be implemented without delay. Let me first address *oversight*.

A key element of a global financial reporting infrastructure is the role of oversight of the various inter-working elements of the infrastructure. Independent assessment of the many elements that comprise the accounting profession portion of that infrastructure is important to high quality financial reporting and auditing.

Public Oversight

In my mind, perhaps the most crucial recommendation of the O'Malley Panel is the establishment of a self-regulatory structure for the international

auditing profession. The first step in creating such a structure is the formation of an international Public Oversight Board (POB). The POB should have but one goal: serving the public interest. It must have the broad mandate to actively oversee and publicly report on international standard setting, self-governance and disciplinary activities of the profession.

In order to create a public interest POB, the initial selection of the members of the POB must be done in an open manner that considers the views of all of the constituents served by IFAC, including organizations representing the public interest, such as securities regulators. The POB members *must* be public interest representatives without ties to the accounting profession.

The operation of the POB and its structure will be crucial to its viability, and to its acceptance by the investing community as the guardian of investors' interests. In my view, there are six key elements that must be present if the POB is to be successful on a long-term basis. First, the funding for the POB must be independent, in fact and in appearance. The POB must have oversight over *all* of the activities of IFAC, including its standard setting committees. The POB must have the power to approve the chairs of those committees. The POB must be subject to an independent review by representatives of the public interest. The POB must have the power to initiate special reviews of the accountancy profession, as deemed necessary by the POB. Finally, the POB must prepare, at a minimum, annual reports to the public on its activities and progress of the profession.

I believe that these recommendations are consistent with both the report of the O'Malley Panel and the United Kingdom's new framework of independent regulation for the accountancy profession. The UK model appears to be quite innovative, but only time will validate its success or lack thereof. A copy of that framework is available on the UK Department of Trade and Industry's web site and will be effective January 1, 2001. I encourage the leadership of IFAC to carefully consider both of these initiatives.

As I mentioned earlier, I believe that the international accounting profession and IFAC have arrived at a significant crossroads; I see two paths ahead. I have spent the last few minutes describing one path – the path that I firmly hope that IFAC will take. Unfortunately there is another path, one that does not include proactive oversight that is clearly in the public interest. The other path meanders through insufficient measures and approaches with more style than substance. That path falls far short of where the international accountancy profession needs to be.

I call on the leadership of IFAC to take the path that represents the high road – to present a plan for the establishment and operation of a POB that contains all of the elements I have spoken of. I want to be here at next year's conference commending IFAC for the establishment of an international POB that clearly demonstrates its commitment to the public interest. I hope that investors will not see their trust and confidence in the profession diminished by an effort that results in a lot of form, but little substance.

IFAC and its creation of a POB are essential to making progress in the formation of a sound global reporting infrastructure.

There is one additional organization that I believe has a crucial role in international auditing: IFAD, the International Forum for Accountancy Development (IFAD).

Following the 1997-98 Asian financial crisis, IFAD was assembled as a new group, in June 1999. Beginning in discussions between IFAC and the Big-Five accounting firms and reaching out to other concerned organizations, IFAD has a mission to develop accounting capabilities and has put forth a plan, a "vision," to improve reporting and auditing practices worldwide.

The IFAD and other members of the profession have publicized the vision plan with great fanfare and high hopes. Obviously, everyone agrees on the importance of improving financial reporting and auditing on a worldwide basis. But, unfortunately, the promise of progress has so far been impeded by IFAD's focus on country-by-country efforts, and what appears to be an absence of substantive actions within the audit firms themselves.

Why am I somewhat critical of IFAD? Principally because the group of firms that formed IFAD seem to be focusing on what others can do to improve international financial reporting, rather than on what they can do to improve audit quality worldwide.

Thus far, from the information reaching us, we see IFAD devoting efforts to identify what countries around the world need to do on a legal and regulatory basis to bring their auditing and regulatory practices up to snuff – IFAD has labeled these "country action plans." While there is nothing wrong with looking at country situations and legal environments and this could serve a useful purpose, there is everything wrong if this is ALL that is being done.

Any efforts to encourage legal changes in individual countries will inevitably involve a slow process. We question the degree of emphasis this is receiving in IFAD's efforts, because country laws and regulations are *not always* an impediment to well-planned efforts to achieve more than the minimum that is required.

Instead of relying exclusively on Country Action Plans, IFAD's members could be asking themselves: "what can we do today, while we are waiting for countries to improve their frameworks for auditing standards?"

The answer seems clear: IFAD, with the experience and the resources of the Big Five and other international accounting firms, could begin now to make a significant difference in the quality of international audits and in international financial reporting. IFAD could promptly undertake major voluntary actions by the firms themselves to agree on best practices, and to sign their firm names only to audits conducted in accordance with high quality internationally acceptable standards and practices.

On February 23, 2000, SEC Chief Accountant Lynn Turner sent a letter to the leadership of IFAC and IFAD, responding to an invitation to participate in a meeting on IFAD's work. He expressed concern about IFAD's focus on regulatory reforms as a pre-condition for action by the accounting profession. He urged that IFAD, and in particular, the "major firm" members, take a leadership role by raising their own firms' minimum standards. And he noted that one of the first steps IFAD could take is to encourage accounting firms to require, on a worldwide basis, a uniformly high quality of financial reporting as a condition for association with a major firm name.

It is now almost ten months later. Even more concerning, it has been over three years since the Asian crisis. In the intervening months and years, there have been many conversations. We are still waiting for action. After this length of time, I have to say that I am reminded of the little old lady in the television commercial, staring at a sandwich that looked big on the outside but lacked the most important ingredient on the inside, asking "**Where's the beef?**"

Investors would benefit greatly if the audit firms would find a way to work together with counterparts in other countries to raise audit quality and to establish practices for dealing with problem audits and enforcement cases.

We are convinced that rapid and widespread improvement in international auditing could be achieved if the large multinational audit firms got together and established a set of rigorous best practices. This can be done if they set audit firm procedures and quality control policies to a standard of the highest common denominator. But the role of the individual audit firms – and the actions of individual auditors – is critical. **Everyone** must step up to the challenge of reporting to investors on a global basis.

Closing

In closing, let me leave you with a few thoughts. Tremendous work has been done, but everyone still has a great deal more to do. In proceeding with work to improve the quality of international financial reporting and auditing, we must look to a beacon to guide us. That beacon is the public interest.

The success of our work will be measured not only by completion of specific tasks and products, but also by the openness of the process by which the results are achieved, and by how well these products and processes serve the public interest. International financial reporting is already here. The future is upon us. The way forward is for each one of us to deal with it, effectively, and in the public interest.

Thank you.

<http://www.sec.gov/news/speech/spch443.htm>

