



U.S. Securities and Exchange Commission

Speech by SEC Staff: Remarks before the 2007 Foundation of Accounting Education SEC/FASB Conference

by

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Washington, D.C.
January 22, 2007

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Good morning. I am pleased to be here with you today for this important conference. It was snowing when I left DC yesterday afternoon. I know that this is a busy time of the year for you, but you should certainly benefit from this conference. I would say that you are practicing during an extraordinary time of change in the accounting and auditing profession.

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I will try to update you on some of our ongoing projects. Then, I will look back at my first five months in office and mention some projects for the future. Finally, I will discuss the Interim Report of the Committee on Capital Markets Regulation. This report has received much publicity.

Ongoing Projects

I will begin with the PCAOB's proposed new auditing standard on internal control over financial reporting which was proposed for public comment on December 19 by the PCAOB. The proposed standard, which is expected to be known as AS No. 5, is a new standard that will replace AS No. 2. There is a

70-day comment period, ending February 26. AS 5 should result in significant changes in auditing internal controls, including a more integrated approach to both the internal control and financial statement audits. AS 5 emphasizes a top-down, risk-based approach that is designed to focus auditors on the controls that are most likely to prevent or detect material errors in the financial statements. An important part of AS 5 is the elimination of the "large-portion" coverage requirement, which was often translated into quantitative coverage ratios of assets or revenues by the external auditing firms. Importantly, the proposal also eliminates the requirement for the auditor to evaluate management's process — which we understand has been at least partly the reason that many companies designed their evaluations perhaps as much to satisfy their auditors as to meeting the assessment objectives. Only one opinion rather than two will be required as to the effectiveness of internal controls.

We are very interested in the cost versus benefit relationship for smaller companies. In that regard, the proposed standard includes a separate section on scaling the audit for smaller and less complex companies. This separate section will serve as the foundation for additional guidance that the PCAOB, with the assistance of a task force of auditors of smaller companies, is in the process of developing. We will be especially interested in reviewing the feedback that the PCAOB receives on this part of the proposal.

A second new standard proposed by the PCAOB addresses the auditor's consideration and use of the work of others such as internal audit and management. The proposal provides a framework under which the auditors can use the work of others by considering both the competence and objectivity of those that have performed the work. This proposal should help to improve efficiencies by avoiding redundancies and over-auditing.

My staff and I will continue to work with the PCAOB on revisions to both of the PCAOB's proposals based on feedback from the comment letter process. Our decision concerning the staff recommendation to the Commission for approval of these standards will consider feedback about whether the standard will reduce audit costs and whether or not the standards can be both effectively and efficiently implemented by auditors.

Moving on to our proposal of management guidance for section 404 of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), which we exposed for comment on December 20, 2006, the comment period ends on February 26, coincidentally the same as the PCAOB's proposal. We hope that this guidance will be helpful to those companies that will be conducting their first assessments of internal controls in 2007. This should be especially important to the 4500 small companies which have not filed their management assessment of internal controls.

Further, we hope that companies that have already completed assessments over the past three years will use this guidance to review what they have been doing with an eye towards making their processes more efficient and effective. We want companies to focus their efforts and resources on those

controls that are most likely to prevent or detect material misstatement to the financial statements.

The proposed guidance addresses the identification of financial reporting risks and controls, the evaluation of evidence of operating effectiveness of controls, documentation, and reporting considerations. Again, our emphasis is to encourage companies to devote their resources and attention to what matters most about internal controls. As with the PCAOB comment letters, we are looking forward to your comment letters on our proposal. I strongly urge you to comment on both of the PCAOB proposed standards and our management guidance proposal. We need your input. We will listen to you and we will use your suggestions.

Although there will be change to the proposals, I believe that audit firms should be thinking how they would implement AS 5. For example additional training is likely. As to our management guidance proposal, I think companies could benefit now from considering this guidance, because there was none before.

International convergence is another ongoing major project for us, and we are monitoring very closely what is commonly referred to as the "Roadmap," which my predecessor laid out. The Roadmap sets forth the milestones toward eliminating the need for the US GAAP reconciliation requirement for foreign issuers who list in the US capital markets and who prepare financial statements using International Financial Reporting Standards ("IFRS") by 2009 or possibly sooner. The SEC staff continues to review foreign registrants' IFRS filings to help us better understand the differences and application of IFRS. You will hear more about this from Joe this morning.

The Past and the Future

Next, I want briefly to look back at my first five months in this Office. They have gone by fast. As a former auditor, it is easy for me to look back. Quickly, what have I accomplished?

- Published letter guidance for the accounting of backdated stock options. As you know, there were many questions in this area.
- Issued SAB 108 regarding the correction of accounting errors.
- Obtained Commission approval of the PCAOB's 2007 budget.
- Worked with the PCAOB as they developed their two new auditing standards discussed earlier.
- Issued the SEC's 404 management guidance proposal.
- Focused on the international convergence issue.
- Started a project for the systematic development of XBRL taxonomies.

Now, let's look to the future. I hope to be announcing my new deputy for accounting in the near future as we are currently reviewing resumes. My deputies are preparing a three-year operating plan for their respective areas. I have always used a three- to five-year plan as a very useful and successful management tool to get everyone focused on the future and what needs to be done.

I want to work with the FASB, AICPA, PCAOB, FEI and others to begin a project to eliminate unnecessary complexity in financial reporting. The more I am involved with our accounting standards, the more I am convinced that we need to eliminate standards that are overly complex, difficult for issuers to implement without extensive outside assistance, and that are difficult for the average investor to understand. I could see an independent body headed by a prominent person to begin this project. The study should probably focus on what created the need, if any, for our complex financial reporting standards and on solutions to the underlying issues that create those complexities.

In connection with the standard-setting process, the task force or committee should create guidelines that would result in more understandable and transparent information for the users that balance the costs involved and time needed to implement those standards. Also, the task force or committee should consider the value of the standard to the many types of investors. Maybe we should get back to the "P" in GAAP, instead of using rules for our standards. As you know, there is no "R" in GAAP.

Concerning complexity, I was pleased to see that the FASB formed a committee to provide advice on how its rules are written and applied. This committee, the Investor Technical Advisory Committee (ITAC) should provide the FASB with important user perspectives and insights on Board projects. This is certainly a step in the right direction. You will hear more about "complexity" later in the program.

Other projects that I want to accomplish this year include:

- Reviewing materiality guidelines, and
- Completing the XBRL taxonomy project, which will transform the use of financial data into a new interactive database that I believe will benefit everyone.

The Interim Report of the Committee on Capital Markets Regulation

The last topic I want to cover with you is the Interim Report of the Committee on Capital Markets Regulation. This report was released on November 30, 2006.

The Committees 32 recommendations fall within four key areas. The key areas are: the regulatory process, public and private enforcement, shareholders rights, and section 404 of the Sarbanes-Oxley Act of 2002. I will

focus on only recommendations concerning section 404. The Committee believed that all four areas will improve the regulatory system and give U.S. capital markets a competitive boost. If you have not read this report, you may want to do so.

So what does the interim report say about section 404?

Section V of the report has several comments and recommendations about section 404. The Committee believes that by requiring companies and their auditors to attest to the effectiveness of internal controls over financial reporting, section 404 raises significant concerns relating to the competitiveness of the US capital markets.

The Report's summary findings with respect to section 404 are as follows:

1. There needs to be an appropriate cost-benefit balance. Section 404 audits need to be more risk-based and cost-effective.

AS 5 is an attempt in this direction — replacing AS 2, the implementation of which did not achieve the correct balance between costs and benefits.

2. SEC original estimate of 404 internal costs would average \$91,000 per issuer. Actual implementation costs in 2004 were 35 times higher than SEC estimate.
3. SOX costs for small companies are regressive. Compliance costs for smaller companies with less than \$700 million of market capital were five times greater relative to the costs for larger companies.

This is why we are concerned about the 404 audit costs to small companies.

4. Precise quantification of benefits is uncertain.

There are, however, benefits. Uncertainty of benefits relative to high costs argues in favor of a more efficient approach to section 404.

5. Revise definition of material weakness in the auditing standard to eliminate the "remote likelihood" threshold, as well as revise guidance on materiality.

Both our proposed management guidance and revised AS No. 5 replace "remote likelihood" with "reasonable possibility." This change should address the Committee's concern, which was also expressed in some of the comment letters we received to our concept release.

In addition to addressing many of the findings listed above through its scalable top-down, risk-based approach, AS5 will also encompass many of

the report's recommendations, including the recommendations to (1) redefine material weakness; (2) clarify and permit greater judgment as to the auditors; (3) incorporate frequently asked questions into text of standard; and (4) permit increased auditor reliance on the work performed by others. Our proposed guidance addresses the recommendation to permit rotational testing by allowing management to scale their efforts significantly in those areas it believes are lower risk.

In addition, the PCAOB is actively working to develop audit guidance for small issuers as suggested by the Report, and we are observing their process and providing feedback. The PCAOB has also focused its inspection process this year on evaluating auditor efficiency under the internal controls auditing standard.

The report recommends that section 404 audits for companies with less than a \$75 million market cap be deferred until benefits/costs of section 404 are more in line. The SEC in December provided this relief. Any recommendations not already addressed by the SEC and PCAOB proposals that I've discussed today are being considered.

In closing, I believe that the section 404 requirements need to have an appropriate cost-benefit balance. Ultimately, the investor and shareholders have the greatest interest in efficient regulation because they pay the price in reduced share value. When the cost of such regulation exceeds its benefits the investor is not a winner.

Thank you for your attention, and I hope that you will enjoy and benefit from the rest of this Conference.

<http://www.sec.gov/news/speech/2007/spch012207cwh.htm>