



U.S. Securities and Exchange Commission

Speech by SEC Staff: Remarks at IASC Foundation: IFRS Conference

by

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Introduction

Good afternoon. Thank you to the IASC Foundation for inviting me to speak at this very important conference. International convergence is probably the most important initiative in the accounting profession today. Converged accounting standards provide investors and creditors around the world with the quality and consistency of financial reporting that they need, and should rightly expect. Achieving high quality financial reporting for investors is, however, about more than the accounting and disclosure standards; rather, high quality standards are one of the underpinnings to a sustainable and reliable international financial reporting system. Such a sustainable and reliable system also has underpinnings related to standard setting, education, application or implementation, interpretation, and regulation. All of these are considered in the context of the balancing of costs and benefits.

The interaction of these underpinnings and thus the functioning of the international financial reporting system as a whole can be either as precise as that of a Swiss watch or, well, not so precise. I think a term that some use to describe this "not precise" category is "complexity." So let me first comment on it first and I will conclude with comments about the underpinnings of an international financial reporting system, and later more specifically about IFRS which is the reason for this conference.

Even high quality global financial reporting standards will not yield useful information for investors unless there are effective internal controls associated with their application, thus I will also comment upon the internal control reporting regimes aspect of application. My remarks on this topic will be quite current as, just one hour ago, I utilized a video conference from here to participate in the open hearing of the SEC where the Commissioners

approved our new management guidance for internal control reporting. Also, tomorrow, our U.S. auditing standard setter for public companies, the PCAOB, will meet to consider establishing a new auditing standard, AS-5, to replace the controversial AS 2 standard concerning the audit of internal controls. I will be covering both of these new developments and more broadly the implications of internal control reporting for high quality global financial reporting on businesses, the accounting profession and the investor.

I will also turn the spotlight on myself as a regulator in discussing how financial information prepared pursuant to high quality global accounting standards can be made available to investors. To that end, let me discuss extensible business reporting language, or XBRL. In the U.S., the SEC is the one who is in the position to allow and encourage its use for reporting by public companies to investors. I know the IASC Foundation has long had an initiative to foster the use of XBRL for IFRS financial statements so I will have a few comments on XBRL as well.

Before I go any further, this is probably a good time to express our usual SEC disclaimer. The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication or statement by any of its employees. The views I express here today are my own and do not necessarily reflect the views of the Commission or of my colleagues upon the staff of the Commission. Now let me turn to complexity.

Complexity

Reducing unnecessary complexity in financial reporting is one of my top priorities for this year. This is an issue of great concern in the global business community. In November 2006, I participated in the "Global Public Policy Symposium" held in Paris. At the symposium, the CEOs of the six largest accounting firms issued a paper entitled "Global Capital Markets and the Global Economy." The paper included the following thoughts on complexity:

1. Today's rules can produce financial statements that virtually no one understands.
2. Unnecessarily complex rules must be resisted and withdrawn.

If left unchecked, I am concerned that unnecessary complexity in our financial reporting system has the potential to weigh on the efficiency of capital markets. First and foremost, complexity can impose significant costs on investors by making it difficult for the average investor to understand the amounts and disclosures in a company's financial statements.

With a GAAP that has been in broad use a bit longer than has IFRS, we find that unnecessary complexity can also impose significant costs on companies and auditors, who find it increasingly difficult to ensure that they have identified and properly analyzed all of the pronouncements and interpretive guidance that may speak to the accounting for a particular transaction. This

could result in excessive compliance costs, and an increased risk of errors in financial reporting, even for the most well-intentioned companies.

One important step we must take to reduce unnecessary complexity is to continue to pursue the "P" in GAAP, instead of using rules for standards. There is no "R" in GAAP, and never has been. Complexity is particularly challenging in a cross-border setting such as the case with IFRS, where the good news is so many people are involved in its pursuit but the risk for complexity is that indeed so many people are involved.

We are committed to doing our part, but if we are truly going to be successful in decreasing unnecessary complexity, this effort must be a two way street. We will need the buy-in of all participants in the financial reporting process, so I need your help. If you are serious about reducing complexity, I must ask issuers to do their part and refrain from entering into accounting-motivated transactions. I think that attempts to structure transactions to achieve a financial reporting result that is not reflective of the underlying economic substance of the transaction work contrary to the goal of reducing complexity and moving toward principles-based standards. Such attempts can only breed additional rules and regulations. I believe that all standards setters must ask the questions before establishing a standard: Is this principle based? Is this easy to understand by all? Is this easy to implement?

Internal Controls

Moving now to internal controls, while the benefits that strong internal controls bring to contributing to the application of accounting standards are perhaps intuitive, we have heard concerns about the cost and difficulty of the implementation of our internal control reporting requirements for those companies listed in the U.S and from foreign private issuers, large and small. At the same time, I want to note that the issues of management responsibility for internal controls over financial reporting, management reporting on those controls, and the auditing of internal controls, are all matters that are getting greater attention all around the world. Following the spate of financial reporting and auditing failures in 2001-2003, regulators and legislators in many of the world's capital markets have moved to enhance the infrastructure for financial reporting. The subject of internal controls has been high on the list of matters receiving attention. In several national jurisdictions around the world and here in Europe, we see additional guidance and requirements being proposed or adopted on the subject of internal controls. It is interesting to note that updates for European Union Directives are also addressing management responsibility for internal controls.

Many of these proposals around the world focus only on management responsibilities for internal controls and/or management reporting on those controls, and do not involve separate reporting on internal controls by auditors. But the recognition of the importance of management developing and maintaining a system of internal controls over financial reporting is very

evident.

In our U.S. market, the Commissioners at the SEC directed us to focus our work on four areas:

1. Aligning AS5, the PCAOB's auditing standard on internal controls over financial reporting, with the SEC's proposed new management guidance under Section 404, particularly with regard to prescriptive requirements, definitions and terms;
2. scaling the 404 audit to account for the particular facts and circumstances of companies, particularly smaller companies;
3. encouraging auditors to use professional judgment in the 404 process, particularly in using risk-assessment; and
4. following a principles-based approach to determining when and to what extent the auditor can use the work of others.

You can see that we are committed to making the internal control requirements more efficient while maintaining and enhancing effectiveness, by focusing the effort on what truly matters to the integrity of the financial statements. I think the management guidance approved by the Commission earlier today helps in that objective.

The PCAOB's proposed new auditing standard on internal control over financial reporting, which was proposed for public comment on December 19th, is expected to be issued as AS No. 5. It is a new standard that will replace the controversial AS No. 2 if it is adopted by the PCAOB and approved by the Commission. 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. What should be achieved with AS 5 is a better balance of costs and benefits. The PCAOB meets tomorrow to vote on AS 5.

We are very interested in the cost versus benefit relationship for smaller companies in the U.S. and elsewhere who are SEC registrants (4500 public companies with a public float under \$75 million — micro-cap). In that regard, the proposed standard includes a separate section on scaling the audit for smaller and/or less complex companies. This separate section will serve as the foundation for additional guidance that we understand the PCAOB, with the assistance of a task force of auditors of smaller companies, is in the process of developing. We are reviewing the feedback that the PCAOB received on this part of the proposal, and are committed to a final auditing standard that can be applied to smaller companies in a way that balances the cost-benefit relationship. This is important because Section 404 implementation and auditing costs can be regressive for smaller companies. The Commission held an open meeting last month to discuss comments that

we and the PCAOB received on the proposed replacement audit standard, AS 5, and management guidance for 404. At that meeting, the Commissioners endorsed my staff's and my recommendations to eliminate waste and duplication in the Sarbanes-Oxley compliance exercise. The Commissioners urged us to continue to work closely with the PCAOB to make the internal controls provisions of Section 404 of the Sarbanes-Oxley Act of 2002 more efficient and cost effective.

Extensible Business Reporting Language (XBRL)

In discussing one aspect of the regulator's underpinning, I said that I would discuss how regulators provide for making financial statement information available to investors. One technique is via interactive data. In commenting, in particular on my home capital market, the SEC pledged major funding to quickly complete the eXtensible Business Reporting Language (XBRL) taxonomies for US GAAP. When completed, these taxonomies, or dictionaries, will provide the basis for any company to report their financial statements and notes to the financial statements in XBRL. Of course there's no reason to wait until later this year to get started. Already, over 40 pioneers in the use of interactive data are using the current taxonomies to report their company's data in the XBRL format, and we look forward to additional companies volunteering to join our test program even while this new set of taxonomies is being finalized. In our endeavor, we're fortunate to have the participation and commitment of the Financial Accounting Foundation, the Financial Accounting Standards Board, and many of their able leaders so that when complete, these taxonomies will be of the highest quality.

It is also important to note that the team developing the taxonomies for US GAAP works closely with other similar efforts around the world including the team developing the IFRS taxonomy. Today, those discussions are primarily focused on the consistent use of technology between the projects, however the technology might also be used to help document the convergence project undertaken by the FASB and IASB and highlight both areas where the standards are converged, and those where they are not.

Currently, the SEC has several foreign private issuers participating in its voluntary XBRL pilot program, however to date it is limited to those which file in US GAAP. Over the course of our test program we have been tracking the development of the IFRS taxonomy with a view to some day make IFRS filings part of our test program. If there are foreign private issuers who do not file in US GAAP who have an interest in the program, please contact Jeff Naumann in the Office of the Chief Accountant and we will try to accommodate your interests.

International Financial Reporting Standards (IFRS)

Let me now move from the marvels of modern technology to the relatively simple topic of International Financial Reporting Standards.

First let me say that when I started out in this profession there was not even such an idea as International Financial Reporting Standards. At that time just communicating with folks overseas was a special event that just didn't happen everyday. Now, many of you have probably received email messages from colleagues overseas just in the time since I began making my remarks a few minutes ago. So, it is especially interesting for me to be continuing in my career at a time when IFRS is not only an idea, but forms the accounting standards in many, many countries. It is an amazing feat and all associated with it are to be congratulated on this progress. Acknowledgment of progress of course prompts the question of "What's next?". To that end my SEC colleague, Julie Erhardt, spoke to you last year at this conference about the challenges that confront us as we strive to create a world in which we have one set of global accounting standards. Today, as we stand here with another year of experience under our belts, I would like to revisit one of the challenges that Julie spoke of last year and would like to address the progress of what you all know so well as "the Roadmap".

The challenge that I would like to focus on relates to the variations of IFRS that we have observed over the past year. Before I begin, I should make it clear that I understand that some countries have adopted specific versions of IFRS and that I have no opinion on the actions of another jurisdiction with respect to policy decisions for their own capital markets as I have not walked a mile in their shoes. I would, however, like to take a moment to address what I perceive to be the consequence of creating local variations of IFRS.

Those who raise capital globally may immediately have the incentive to use IFRS as promulgated by the IASB because they are best off if their financial statements are a "passport" they can use to raise capital in any market. Those who raise capital only locally in their home jurisdiction may, initially at least, believe they are best off with their local standards, including if those are a version of IFRS. The Roadmap acknowledges that different jurisdictions will take different roads to the same destination of a single set of global standards, and this is understandable. The contemplation of the possibility of eliminating an IFRS to US GAAP reconciliation requirement, however, was written in the context of statements that comply with IFRS in the form issued by the IASB as opposed to in the context of "recognition" of financial statements prepared using jurisdictional versions of IFRS pursuant to which the financial statements cannot also be asserted to comply with IFRS itself. To the Roadmap's goal of the benefits of having a single set of global standards, I encourage companies moving to IFRS to walk the extra mile and adopt IFRS as issued by the IASB.

Turning now to the US capital markets, I continue to be pleased with the concept behind the Roadmap and the goal and progress of this initiative. Thus, the SEC staff continues to work very hard and expeditiously to do the work related to and promote the conditions for eliminating the need for foreign private issuers to reconcile to US GAAP their financial statements prepared in accordance with IFRS as issued by the IASB.

To that end, just about a month ago our Commission issued a press release announcing the next steps we intend to take relating to the acceptance of

IFRS. Specifically, the Commission anticipates issuing a Proposing Release this summer that will request comments on proposed changes to the Commission's rules which would allow the use of IFRS in financial reports filed by foreign private issuers that are registered with the Commission. In addition, the Commission plans a Concept Release relating to issues surrounding the possibility of treating U.S. and foreign private issuers similarly in this respect by also providing U.S. issuers the alternative to use IFRS. The Commission would appreciate its constituents taking the time to comment on either one or both of those releases, and I in particular look forward to receiving your comments. As to how our Commission process works, after a proposing release is issued, the Commissioners will set a deadline by which constituents must submit their comments. After the deadline passes, the Commissioners consider the comments received on the proposing release and make another decision to issue a final release, the content of which would be determined after receiving the input on the proposing release. Advance notice of an open meeting is given to the public. At the time it is determined that a final release will be issued, the Commissioners will then decide on an effective date for the release.

Undertaking the proposing release for foreign private issuers at this time allows us to be expeditious in our Roadmap work, which among other things involves us considering how, if appropriate, we might make operational the use of IFRS in our capital markets by those foreign private issuers that elect to report in it. Investing the time to work on a proposing release now is based on an assumption of anticipated continued progress on the other considerations described in the Roadmap. For example, the IASB and FASB are in the middle of working through their 2006 – 2008 convergence plan. I also encourage preparers to continue with the faithful and consistent application of IFRS, especially those who responded to securities regulators that they would make improving changes in their next year's IFRS reports. Because the benefits to investors are expected to be enormous, all of this hard work toward convergence is well worth the effort.

While we are on the topic of IFRS, I would like to point out that we do have an area of our website that is devoted specifically to relevant topics for foreign private issuers and those that work with (or invest in) them, including various resources the Commission has on the topics of IFRS and ending the reconciliation requirement. I would encourage everyone to visit it frequently and to give us your comments and feedback about how it can be more useful and a better resource for you and for the foreign registrant community.

Closing

In closing, I would like to applaud the standard setters, regulators, preparers and academics for the enormous efforts made to provide investors with the highest quality of financial reporting possible. We have made tremendous strides in improving financial reporting and the future of financial reporting looks brighter each day, but there is still progress that needs to be made before we can claim to have an international financial reporting system that is as precise as a Swiss time piece. I look forward to my involvement and

the involvement of my staff in building such a financial reporting system.

In looking at my precise Swiss watch, I know that I stand before you and the reception. However, I will take a few questions.

Thank you for your attention and time. It has been a pleasure to be here.

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[Home](#) | [Previous Page](#)

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