

**Remarks of Robert H. Herz**  
**Chairman, Financial Accounting Standards Board**  
**On**  
**Convergence and Change**  
**At**  
**The Twenty-Ninth Annual SEC and Financial Reporting Institute**  
**Conference Sponsored by the Leventhal School of Accounting,**  
**University of Southern California**

**June 3, 2010**

**The views expressed in this presentation are my own and do not necessarily represent official positions of the Financial Accounting Standards Board. Official positions of the FASB Board are arrived at only after extensive due process and deliberations.**

- I'm very pleased to be with you today, and not just because it provides a break from our virtually round-the-clock, transatlantic standard-setting activities. For this will be a great opportunity for Jim Leisenring, Russ Golden, and me to shed a little light on our standard-setting activities and to answer some of your questions.
- As many of you know, we are on the cusp of major changes in a number of our accounting standards, which, in turn, may create major changes in our reporting system. The goal is to create a common set of high-quality international accounting standards that will enhance the comparability and overall usefulness of financial statements, thereby providing a platform for common high-quality financial reporting around the world and enabling global markets to operate with less friction in terms of financial reporting.

- Since last October we have been meeting jointly with the International Accounting Standards Board (IASB), full Board to Board, for many days each month. A good bit of this is accomplished by the FASB Board and some staff members flying to London for 3-day meetings—which we did in December, January, March, and May and we’ll be doing later in June. We were also set to go to London in April before the volcanic ash cloud grounded travel. Having us do most of the traveling makes sense, because there are only 5 of us vs. 15 on the IASB Board.
- We’ve also had numerous joint Board meetings via teleconference. In March, for example, in addition to our 3-day meeting in London, we had five meetings by teleconference. I am proud to say that so far my fellow Board members and our staff (both FASB and IASB) have risen to the occasion. But I do fear potential burnout, as it’s not so easy to be running a marathon at sprint speed.

- So changes in accounting and financial reporting are in the works. Now, not all of us react to the prospect of major change in the same way. For some of us, change represents opportunity. But for others, change can be unsettling—and even threatening. Both reactions are understandable. Winston Churchill said, “There is nothing wrong with change, if it is in the right direction.” So, it’s very appropriate to question whether all the changes we are proposing are the right ones. I hope we can answer some of those questions in the time we have together today.
- But I think it’s also true to say that without change, there can be no progress. As Benjamin Franklin said, “When you’re finished changing, you’re finished.” Accounting and reporting are no different from every other aspect of human endeavor—they are all subject to the natural laws of change. Even the ancient Greeks taught that change is the only constant. History’s lesson has always been adapt and move forward, or stand still and risk becoming irrelevant.

- If you find yourselves leaning more toward uneasiness than enthusiasm at the prospect of change, it might help to look back a bit.
- For over the last 80 or so years, our reporting system has been subject to many major changes—changes that we now take for granted and that, with the benefit of hindsight, I think most people would view as progress. Yet, at the time, they were highly controversial and strongly resisted.
- Let me touch on a few examples:
  - The idea of setting official standards for accounting, reporting, and disclosure took shape in the aftermath of the 1929 stock market crash and the Great Depression. These resulted in the creation of the Securities and Exchange Commission and the landmark decision to delegate the establishment of accounting standards to the private sector.

I think it's fair to say that these weren't universally or immediately embraced as changes for the better.

- Indeed, before the 1930s, many companies viewed sales and the cost of sales as highly proprietary information. Many New York Stock Exchange-listed companies did not provide profit and loss statements. It was common in those days for the reporting of income to start with gross margin and to report all other expenses as a simple lump sum.
- Flash forward to the 1960s and the merger wave that created a number of large diversified companies—the so-called conglomerates. In May of 1966, the SEC Chairman called for reporting to be expanded to include disclosure of both sales and profits at a divisional level. That created an uproar in the corporate community, a level of dismay that was echoed in the mainstream financial media. We saw headlines such as “How Much Data Must Conglomerates Bare,” spelled B-A-R-E; and “Last Stand over Full Disclosure.”

- But the changes in the business landscape necessitated commensurate changes in financial reporting and disclosure. First, there was a 1967 nonbinding APB Opinion that suggested disclosures by diversified companies. Next came a 1969 SEC requirement for such disclosures in registration statements, which the SEC later extended to annual reports. Finally, in 1976, after much debate, the FASB issued Statement 14 on segment reporting. None of those went down easily at that time.
- The 1960s also saw the rise of company-sponsored pensions and postretirement healthcare plans. But pay-as-you go accounting and a variety of actuarial methods remained common until the FASB in the 1980s completed a 10-plus-year effort to create a consistent model for measuring pension obligation and pension cost, and followed up with a standard covering OPEBs.

The effort to get these standards in place was protracted, controversial, and downright nasty at times. The auto industry

and other smokestack companies were especially vocal in their opposition. They, among others, argued that the liabilities were not real or, even if they were, that they were much too soft to include in financial statements. Indeed, the September 1989 *Business Week* issue captured the firestorm over the FASB's proposal on OPEBs in an article entitled "First Thing We Do Is Kill All the Accountants." Does that sound to you like everyone was embracing change? Hardly.

But some 20 years later, I think almost everyone would agree that the pension and OPEB liabilities were quite real and very significant in evaluating the long-term prospects and viability of those companies—the very companies that argued most vociferously against the improved accounting.

Our reporting system has also undergone some very significant changes over the past 10 years. Think about some of the changes



that came out of the Sarbanes-Oxley Act, including the establishment of the PCAOB and Section 404.

And recently, we had the fight over expensing stock options—and now the debate over the use of fair value by banks and other financial institutions. And the Codification and the advent of XBRL also represent important changes in our reporting system. So, yes, change is the only constant.

And, that brings us back to our present efforts at convergence and improvement of standards . . .

- The intensified efforts by FASB and by the IASB represent our attempt to respond to the G20 leaders, who, following their meeting last fall in Pittsburgh, called on us to “redouble” our efforts to complete convergence by our 2011 targets.
- By “completing convergence” we mean completing major projects in the Memorandum of Understanding (MOU) that we first published in 2006 and that we have updated periodically.

- While this would bring U.S. Generally Accepted Accounting Principles, or GAAP, and the International Financial Reporting Standards, or IFRS, closer and—just as important—would *improve* the standards in a number of key areas, it would not, as some have suggested, mean that U.S. GAAP and IFRS would be fully converged. Many differences would remain. The SEC staff, as part of its recently announced work plan, will inventory and evaluate the significance of those continuing differences. Its evaluation of these remaining differences, along with many other considerations, will feed into the Commission’s decision on whether, how, and when to incorporate IFRS into the U.S. reporting system for public companies.
- Why the 2011 dates, and why in particular did the G20 call for June 2011 as the target date by which to complete the MOU projects? (Was it foretold in the writings of Nostradamus or something divined from studying the Mayan calendar?)

- Well, on the IASB side a number of countries, including Brazil, Canada, India, and Korea have announced plans or intentions to adopt IFRS for their listed companies on or around 2011 or 2012. If at all possible, it would make sense to have the new standards issued before their companies have to make the change to IFRS in order to avoid them having to switch twice.
- Another reason to try to get projects completed by mid-2011 is that is when Sir David Tweedie and two of his fellow IASB Board members' terms end (and three current IASB Board members' terms end this June). These people have been at the IASB throughout the development of these projects, and Board member turnover can significantly delay or change a project.
- Now on our side, the FASB side, expeditiously completing the projects is important and we have been working hard to achieve this. But our emphasis also has been and will continue to be on seeking not only expeditious completion and convergence but also genuine improvement in the standards. In that regard, I think

it's important to note that under the law that sets out our accounting standard-setting responsibilities, the Sarbanes-Oxley Act, and a related 2003 SEC Policy Statement, international convergence is only one of the things we are supposed to consider and then only to the extent it is in the interest of U.S. investors and the U.S. public. So our aim is to try to achieve both improvement and convergence together. Not always easy!

- We're also stressing the importance of maintaining full and proper due process, including extensive constituent outreach and engagement.
- In that regard, over the past few months both we and the IASB have heard concerns voiced at our advisory council meetings and in letters from constituent organizations over the very significant challenges that constituents would face in responding to numerous proposals on major projects if released simultaneously. They very rightly expressed concerns over their ability to properly review, evaluate, and provide well-developed comment letters on

what they were expecting to be a virtual “tsunami” or “blizzard” of Exposure Drafts (EDs) on major topics to be issued by us and the IASB all at once. And they are concerned that compressing our due process could undermine the quality of the resulting standards.

- We recognize and agree with these concerns. Enabling all parties to properly review, evaluate, and provide input is essential to developing high-quality standards. And so we and the IASB have been discussing ways to try to balance the need to continue to work expeditiously on major convergence projects with the need to maintain proper due process, including allowing constituents the time and ability to provide us with their well considered input. As a result, we and the IASB are in the process of developing a number of revisions to our MOU work plan that involve changes in the timing and scope of and approach on certain joint projects. The goals in making these changes to the work plan are to prioritize our efforts in order to better enable us to complete key

projects as expeditiously as possible while also maintaining proper due process including enabling constituents to properly review, evaluate, and provide input. Accordingly, we will stagger the release of and the comment periods and roundtables on major EDs over the next year and will limit to four the number of significant or complex EDs we issue in any quarter. The inevitable and necessary result is that although we are still targeting completion of many of the projects by June 30, 2011, we will not complete all of them by that date and a few of the projects will now be targeted for completion in late 2011. We expect to issue a joint communiqué with the IASB detailing the updated work plan soon. In that regard, it's also important to understand that projected completion dates on projects are always subject to reevaluation and change based on the extent and nature of comments and other input we receive on EDs, which could impact our project timelines.

- OK, so what does all this mean?

- To us as standard setters?
- And, more important, to you as constituents in the financial reporting system and to our whole reporting system?
- First, to us as standard setters, it has meant greatly intensifying our efforts. We have gone far beyond “redoubling” our effort, as the G20 leaders asked us to do last fall. In fact, we have come closer to quintupling or more our joint efforts and joint deliberations.
- To put this into historical context and even with the modifications to the work plan, I believe this clearly represents something unprecedented in the annals of U.S. accounting standard setting. At the FASB, there has been only one year when we issued more than three major new standards. That was in 2001, when four major standards were issued—Statements 141, 142, 143, and 144. Even that year, you could argue that 141 and 142 could be viewed together, which takes us back down to three . . . whatever. My

staff also tells me that we have never had more than two or three EDs on major standards out for comment at the same time.

- Now, on the IASB side, since it started work in 2001, it has issued nine IFRSs, but several of them were based on existing U.S. standards and others were not, in my view, that substantive.
- So, by historical standards our plan is a very ambitious one, even with the staggering of the release and comment periods on EDs.
- On the other hand, many countries and parts of the world completely switched to IFRS from their own national standards, arguably an even more challenging task, and they did so successfully. Think about the countries in the European Union, all of which did this in 2005.
- But clearly for us as standard setters, both we and the IASB are working very hard on our joint projects.
- OK, so we are working very hard, but what does all this mean for you as constituents and for our reporting system?



- First, for you as constituents, it means that over the next year there will be numerous EDs on major topics to consider. As I said, your comments and your input on our proposals are essential to us. To make this possible, we will generally have four-month comment periods on the major EDs. In addition, we plan to conduct various education and outreach efforts, including holding public roundtables in the U.S. and other parts of the world on major proposals.
- We will also be seeking ongoing and focused input from advisory and resource groups, from users, preparers, and auditors, and from regulators around the world. And we have been doing and will continue to conduct field visits and field testing, as appropriate.
- If you care (and I think you should care), get engaged. I know there are other priorities and issues beyond accounting and financial reporting that require your attention. But this is important. It matters.

- Second, for you and for our whole reporting system, the likely result of all this is further significant CHANGE. Whether or not completion of major MOU projects and other factors provide the necessary and sufficient conditions for the SEC to decide to incorporate IFRS into U.S. reporting, there will be new accounting standards in a number of important areas, standards that change in major ways the accounting and reporting for many—if not most—U.S. companies. In effect, we will have rewritten major chunks of U.S. GAAP. While, in my view, a lot of this is overdue because we've needed to improve a number of our standards, make no mistake about it, it will represent significant change.
- OK, so having previewed (and probably scared some of you about) the degree of potential change, we will talk later more specifically about some of the major projects, what some of the more significant issues and potential changes to current practice might be involved, and our planned process going forward.

- Besides all our work on international convergence, we are also working on some other important U.S.-only technical projects including disclosure enhancements relating to loss contingencies, going concern, and involvements with multi-employer plans. We also have a very important project to establish a Disclosure Framework.
- And while a significant portion of our attention has been and continues to be focused on international convergence of standards and other matters that affect U.S. public companies, privately held companies and not-for-profit organizations remain very important to our mission. We extensively outreach to these sectors during our due process and carefully consider their differential needs, with the result often being a deferral of effective dates of new pronouncements and sometimes a reduction in disclosure requirements for those sectors versus public companies. For example, we deferred the effective date of Interpretation 48, *Accounting for Uncertainty in Income Taxes*, for

nonpublic entities by two years and we exempted them from some of the quantitative disclosure requirements. And, we have proposed deferring by four years, for many nonpublic entities, some of the significant requirements in our proposed ASU on Accounting for Financial Instruments.

- In our outreach to privately held companies and not-for-profit organizations, we benefit from the input received from important advisory groups. For private business enterprises, we regularly consult with both our Small Business Advisory Committee (whose members also represent small public companies) and our Private Company Financial Reporting Committee (PCFRC) on specific areas in proposed or existing standards where differences for private companies might be appropriate based on user needs or cost-benefit considerations.
- Beyond these routine consultations, however, there are a number of forces in play that have challenged the approach that the U.S. has traditionally had of one set of standards for both public and

private companies (with exceptions as appropriate) rather than the type of parallel system of “Big GAAP/Little GAAP” that is present in certain other countries. These include the potential move to IFRS for public companies (and the uncertainty that potential move has created for private companies), the available use of IFRS for Small and Medium-Sized Entities by U.S. private companies, recent developments in other countries that have adopted IFRS for their public companies but not for their private companies, and continuing concerns expressed by some constituents over the relevance and cost/benefit to private companies of certain U.S. GAAP requirements. In response to hearing these concerns from private company constituents during the FAF Trustees’ listening tour last summer, as well as receiving input from the PCFRC, in December 2009 the FAF created a “Blue-Ribbon Panel” on Standard-Setting for Private Companies (the Panel), sponsored jointly by the AICPA and the National Association of State Boards of Accountancy. The Panel, which

includes a cross-section of private company financial reporting constituencies, including lenders, investors, and owners, as well as preparers and auditors, is examining these matters and plans to issue a report with recommendations to our Trustees in early 2011.

- Standard setting for not-for-profit organizations is also an important part of our mission. We have recently formed a Not-for-Profit Advisory Committee (NAC). The NAC will provide us with input on reporting issues in that sector, including issues that may arise if and when U.S. public companies move to IFRS, because IFRS does not explicitly cover not-for-profit entities.
- So there's a lot of potential change and a lot of uncertainty about the future of our financial reporting system—uncertainty about whether, how, and when IFRS may be incorporated into U.S. public company reporting and uncertainty about private company reporting and reporting by not-for-profits.

- And we clearly recognize and understand that implementing major new accounting standards represents a significant endeavor for just about everyone in the reporting system—for companies, for auditors, for the regulators, and also for the users. It will require ample lead times and careful consideration of effective dates and transition approaches.
- Recognizing this, we will be issuing another document later this year asking for input on the key issues relating to effective dates, transition approaches, and the whole change management process. We want to know how much time will be needed to implement the various new standards, whether implementation should be done all at once or staggered, and to what extent it should depend on IFRS adoption. These are issues of national importance on which we hope to get insightful input from folks like you.

### Conclusion

So here we are, in the thick of what may turn out to be important changes in our reporting system. As I've noted, major change is almost always contentious at the outset. And proposed changes in accounting and reporting are no exception. They can be quite controversial and are often most strongly opposed by those with a vested interest in preserving the status quo. But in the grand sweep of history, I think we can see that many of the most hotly contested changes were eventually taken for granted, and now count as some of the most important improvements to financial reporting. But in pushing forward change, it's critical to try to make sure the changes represent improvement and are put in place in an orderly manner.

And that's why at the FASB, we are committed to maintaining our thorough due process, to ensuring that we carefully evaluate all input, and to playing our role in this change. Your engagement



and your input and advice are not only welcome, but also absolutely vital to our “getting it right.”

And while many of the changes may be overdue, they must be put in place in an orderly and effective manner. As much as possible, that means we must try to minimize the cost and disruption they create in our reporting system. The next few years will be very challenging—challenging to us as standard setters, challenging to the SEC and other regulators, but most important, challenging to all constituents in our financial reporting system—to investors and other users, to companies, and to auditors. Working together, we can maximize the chance of getting it right. History will certainly look back on this period as a period of great change and challenge. We have every hope that history will also look back on it as a period of real progress.

I’ll leave you with this last thought about change. Mark Twain once said, “Even if you’re on the right track, you’ll get run over if

you just sit there.” That’s clearly not our goal. So, again, I encourage all interested parties to get involved in carefully reviewing our proposals and in providing us with your input.

Thank you.