



## U.S. Securities and Exchange Commission

### **Speech by SEC Staff: Remarks Before the 2007 AICPA National Conference on Current SEC and PCAOB Developments**

*by*

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Good Morning. It is certainly an honor for me to have the opportunity to speak to you today. In fact, given the distinguished members of the profession who have been and are currently a part of this conference, it is humbling to have the chance to share a few of my views with you. Which, by the way, is exactly what I will be sharing with you and thus I need to remind you that the views I express here today are my own and do not necessarily reflect the views of the Commission, the Commissioners, or other members of the Commission staff.

In my brief time this morning I want to provide some thoughts in two areas. First I want to spend just a few minutes discussing what I'll refer to as having increased confidence in reaching accounting conclusions; you'll hear more about this topic over the course of the conference I'm sure. With the remainder of my time I wanted to provide some thoughts that might be helpful in framing how you listen to the remarks you hear at this conference.

#### **Increased Confidence in Reaching Accounting Conclusions**

The fact that there are challenges faced in getting to the "right answer" in our current financial reporting system has been an issue of significant attention over the last several years. On the one hand, there are those who express concern that the volume of interpretive guidance that exists makes it

difficult to comply and thus difficult to have confidence in reaching a conclusion (think about the accounting for liabilities and equity). On the other hand, in areas where the volume of interpretive guidance is less expansive there are those who express concern that, in the absence of detailed rules, they lack confidence in reaching a conclusion due to fear of having the conclusion overruled (think about fair value measurements). Those two views seem to be diametrically opposed. While I do not proclaim to have the answer to this issue, I would like to provide some thoughts that I believe could be helpful in providing an increased level of confidence when you make an accounting determination whether dealing with detailed guidance or broader objectives.

*Make sure you have a complete understanding of the transaction or arrangement*

It sounds obvious, but an analysis of accounting for any transaction starts with the accountant obtaining an understanding of the terms and the economics of a transaction or event. This is true regardless of whether you ultimately conclude that the transaction is covered by detailed guidance or under broader objectives. While it may be obvious, in the world in which we operate, the complexity of business arrangements (the sharing of risks and rewards, the carving up of rights and obligations) has evolved significantly in a short period of time. It is important to obtain an understanding of the terms of a transaction as well as address issues such as: what rights have been obtained, what obligations have been incurred, what are the risk and what are the rewards. Consider for example current questions regarding the impact of liquidity support type arrangements related to vehicles that are otherwise "off balance sheet." Understanding the full terms (the obligations and the risks) of the entire arrangement is an obvious first step in order to address the appropriate accounting (whether it is FIN 45, FIN 46(r), or some other accounting model).

*Involve those with adequate knowledge and experience up front*

The involvement of and consultation with other knowledgeable and experienced individuals prior to the accounting for a transaction can be extremely helpful in providing increased confidence surrounding an accounting conclusion. This is particularly the case where such advice is provided from an unbiased perspective. That is, where the object of the advice is to accurately report the economics rather than advice given on how to structure an arrangement to achieve an accounting objective. An important element of the critical thought process (for example the selection of an accounting conclusion) should include consideration of the expertise of the individuals performing or reviewing the critical thought process.

Let me assure you that this is something that the SEC staff does on a regular basis. It is routine, in dealing with a difficult accounting issue, that we seek additional input from knowledgeable and experienced individuals, including input from the FASB, in order to help form our views. To illustrate, we have recently received a number of questions related to the application of revenue

recognition standards to the fairly complex arrangements in the biotech arena. In general, the issue(s) related to the application of EITF 00-21 in situations where an entity that is performing research and development and is receiving upfront and ongoing payments, including milestone payments, in a multiple element revenue recognition transaction. If I haven't already lost you, my point is not to discuss the answer to the issue at hand, rather my point is this: While our initial inquiries may have indicated some preliminary thoughts related to the accounting for these types of transactions, after consulting internally and after discussions with other knowledgeable parties, it became more clear that, in fact, the application of GAAP may not always result in one view as it relates to the accounting for all such arrangements. This leads me to my next observation.

*Realize that there may not always be one "right" answer*

I think as accountants we generally *understand* that accepting standards that provide for broader objects will result in some level of diversity in practice. In fact, to suggest otherwise might lead to a conclusion that there is only one "right" to every accounting issue. I stated my view at a conference early this year and I'll say it again, accounting, at least in my opinion, is not a series of immutable truths. There certainly will occur, from time to time, situations where the reasonable application of judgment will result in more than one acceptable accounting or financial reporting conclusion.

While I believe accountants generally *understand* that there isn't always one right answer, I'm less convinced that accountants as a whole are ready to *accept* it. Certainly there is a widely held concern that the SEC staff doesn't accept it. Take for example the FASB's recently issued standard on Fair Value Measurements (Statement 157). The purpose of the standard, among other things, is to provide for a common definition of fair value and to increase consistency and comparability. Keep in mind that the standard does not require the application of fair value to anything new. Subsequent to the issuance of Statement 157, the FASB has received literally dozens and dozens of requests for additional guidance that could be viewed as a search for the right answer. It had been indicated to me on many occasions that the reason for many of the questions is fear that the SEC staff will accept only one "right" answer related to the application of Statement 157. Let me assure you that we recognize that Statement 157 has not resolved every question in practice, remember the purpose was to increase consistency and comparability not to eliminate judgment or resolve every accounting issue. While I respect the decision of the FASB to defer the standard (for limited classes of assets and liabilities) and to take time to consider whether clarification of the objectives is necessary, it does seem that if the FASB were to address the dozens of questions in practice, we may find ourselves with another set of detailed rules.

*Provide transparent disclosure*

As I just discussed, in reaching accounting conclusions there will be cases where there are multiple reasonable conclusions. Confidence in reaching a

reasonable conclusion, in my view, can be enhanced by providing disclosure that explains in plain English the conclusion reached, how the accounting principle(s) was applied and the significant judgment(s) made.

Keep in mind that this is not a statement that good disclosure can cure bad accounting. In fact, if you think that is what I am suggesting you may be missing the point. I am simply suggesting that when an entity is faced with a difficult accounting conclusion, transparent disclosure should play a role in providing more confidence in reaching a conclusion.

I just outlined a few areas (I'm certain that there are many others) that I believe can have an impact on each of us as we strive to reach reasonable accounting conclusion. Let me now turn to a few observations that I think might be helpful in to keep in mind as you listen to the remarks over the next few days.

### **Concluding Comments**

In my 10 or so months at the SEC, I have become very accustomed to giving the "standard disclaimer" regarding my views. I bring this up as, and I am sure this in no surprise to anyone, people continue to express what I believe are sincere concerns about whether remarks at conferences like this are establishing GAAP. To be clear, the views of individual staff members at this conference do not set GAAP. Certainly there will be remarks expressing the views of how existing GAAP may be relevant to a given set of facts. If this causes you to take closer look at existing GAAP and rethink things, or confirms your view of how existing GAAP should be applied then you have the right mind set. If, on the other hand, you hear a perspective on the accounting for a transaction and believe that we have failed to consider other reasonable conclusions, please come talk to us. Finally, if you think that there is some hidden message in any of our remarks, at least from my perspective you've given us too much credit. Subtlety is not my strong suit, just ask those who know me well.

I have expressed my personal view before that it is a challenging time to be a member of the accounting profession; it is also an exciting time. While exciting is not often the adjective that one might use to describe accounting, especially if you were to ask a nonaccountant, let me explain why I'm excited about the future. As a profession we are faced with a number of challenges as we endeavor to improve upon our current system of financial reporting. We face large hurdles in addressing issues such as, improving the way(s) in which we communicate financial information to investors, addressing a move away from a system of voluminous detailed guidance, the appropriate use fair value measures in financial reporting, just to name but a few. You could chose to look at these issues and have the perspective that the glass is half empty.

However, while we are faced with a number of areas where improvement is warranted, the good news is that there are a number of important current initiatives underway that have the potential to reshape financial reporting.

That is the exciting part. While it is certainly a generalization, I think it is safe to say that the perception of accountants is that we tend to look at the proverbial glass as being half empty; in fact, accountants can be described as going on to ask why you're wasting money on a glass that is twice as large as it needs to be. However, as you hear about these important initiatives and projects over the next several days, I want to challenge you to keep an open mind, remember the goal is to improve upon our world class system of financial reporting and, finally, I would like to suggest that it is up to all of us to be part of the solution to these challenges.

*<http://www.sec.gov/news/speech/2007/spch121007jlk.htm>*

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