Testimony Concerning Globally Accepted Accounting Standards

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Chairman Reed, Ranking Member Allard and Members of the Subcommittee:

Thank you for the opportunity to testify today on behalf of the Securities and Exchange Commission (Commission) concerning ongoing efforts to foster development and use of high quality globally accepted accounting standards. This testimony is presented jointly on behalf of the Office of the Chief Accountant, which advises the Commission on accounting and auditing matters, and of the Division of Corporation Finance, which is responsible for overseeing disclosures by domestic and foreign issuers of securities.

This testimony highlights the Commission's long history of supporting the goal of high quality globally accepted accounting standards. Global accounting standards help investors to understand investment opportunities more clearly and increase access to foreign investment opportunities. They reduce costs for issuers, who no longer have to incur the expense of preparing financial statements using differing sets of accounting standards. And lower costs facilitate cross-border capital formation as well as benefit shareholders, who ultimately bear the burden of the entire cost of the financial reporting system.

This summer, the Commission began a process to determine whether it is appropriate and timely to allow foreign and domestic registrants the alternative to submit for SEC filing purposes financial statements prepared in accordance with International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Board (IASB). Under the Commission's current filing requirements, foreign registrants have two alternatives for the preparation of financial statements, either (1) prepare them under U.S. GAAP or (2) prepare them under IFRS or a national GAAP and provide reconciling information to U.S. Generally Accepted Accounting Principles (U.S. GAAP). So, the Commission's proposal would allow foreign registrants to file IFRS financial statements without a required reconciliation to U.S. GAAP. The Commission has also asked questions about whether it would be appropriate to give domestic registrants the option of preparing their financial statements using IFRS in contrast to the current requirement that domestic registrants prepare their financial statements only under U.S. GAAP.

A Long History of Promoting Robust Global Accounting Standards

The Commission has long advocated reducing the disparity between the accounting and disclosure practices of the United States and other countries as a means to facilitate cross-border capital formation while ensuring adequate disclosure for the protection of investors and the promotion of fair, orderly and efficient markets.

- In 1981, the Commission encouraged the efforts of standard setters and other market participants to do the same.

- In 1988, the Commission explicitly supported the establishment of mutually acceptable international accounting standards as a critical goal to reduce regulatory impediments that result from disparate national accounting standards without compromising investor protection.

- In 1996, in the National Capital Markets Efficiency Act, Congress directed the SEC to respond to the growing internationalization of securities markets by giving “vigorous support” to the development of “high-quality international accounting standards as soon as practicable.”

- In a 1997 report to Congress, the Commission encouraged the efforts of the International Accounting Standards Committee, the part-time volunteer international accounting standard setting body at the time, to develop a core set of accounting standards that could serve as a framework for financial reporting in cross-border offerings, and indicated the Commission’s intent to remain active in the development of those standards. Those standards have now become part of IFRS, which we discuss further below.

- In 2000, the Commission issued a concept release seeking input on convergence to a high quality global financial reporting framework while upholding the quality of financial reporting domestically.

- In 2002, when Enron and the wave of accounting scandals called into question the intensely rule-based approach of U.S. GAAP, Congress, in section 108(d)(1) of the Sarbanes-Oxley Act, directed the SEC to undertake a study on the “adoption by the United States … of a principles-based accounting system.” SOX expressly required that we examine the length of time that would be necessary to change from a rules-based to a principles-based financial reporting system. Also that year, the Commission supported the announcement by the Financial Accounting Standards Board (FASB) and the IASB of a memorandum of understanding—referred to as the Norwalk Agreement—to formalize their commitment to the convergence of U.S. and international accounting standards.

- In 2005, as the European Union (EU) and others first adopted IFRS, the Commission adopted an accommodation to allow foreign first-time adopters of IFRS to file two years rather than three years of IFRS financial statements in their Commission filings.

- In February 2006, Chairman Cox endorsed a previously published “roadmap” containing the SEC staff’s evaluative work plan. This “roadmap” makes the case for high-quality, globally accepted accounting standards and suggests several considerations that the SEC staff would include in evaluating the appropriateness of permitting foreign private issuers to use IFRS for purposes of the U.S. capital markets without a U.S. GAAP reconciliation.

- In March 2007, the Commission hosted a roundtable regarding IFRS reporting by foreign private issuers.

- In July 2007, the SEC staff published a review of the 2005 filings of the foreign private issuers who currently submit IFRS financial statements that are reconciled to U.S. GAAP.

Throughout this process, the SEC has pursued these goals through a variety of international multilateral and bilateral fora, including the International Organization of Securities Commissions (IOSCO), a bilateral dialogue with the Committee of European Securities Regulators, and with fellow securities regulators from countries that have moved to or are moving to IFRS reporting. The SEC's staff has also participated, in some cases on behalf of IOSCO, as an Observer to the IASB's Advisory Council, its Interpretations Committee, and certain of its Working Groups.

International Financial Reporting Standards

For many years there has been a dedicated group of practitioners, standard setters, business leaders and others from around the world who have worked to establish a single set of globally accepted accounting standards for the benefit of the capital markets. In 2001, these efforts were transformed from part-time voluntary efforts to full-time paid efforts with the establishment of the London-based International Accounting Standards Committee Foundation (IASC Foundation), which is a Delaware non-profit corporation whose core operation is the activities of its standard setting board, the IASB, which develops and maintains the body of IFRS.

The IASC Foundation is governed by a Board composed of twenty-two Trustees, six of whom constitutionally are from North America. Five of the North American Trustees currently serving are from the United States, with the other from Canada. Constitutionally, an additional six Trustees are from Europe; six are from Asia/Oceania; and four are "at large." The founding Chairman of the Board of Trustees was Paul Volcker. Having completed his term as Chairman, Mr. Volcker now chairs the Trustee Appointments Advisory Group, which is composed of nine individuals from international public sector banking, finance, and securities regulatory organizations who are consulted on new Trustee appointments. The incoming Chairman of the Board of Trustees is Gerrit Zalm, a former Netherlands Deputy Prime Minister and Minister of Finance. Because the IASC Foundation lacks the power to require contributions, it is currently funded through voluntary contributions, although it has an objective of establishing a permanent and independent funding structure. Some countries have or are instituting a local levy system to fund contributions.

The IASB is composed of fourteen members: twelve full-time and two part-time. The IASB members are appointed by the IASC Foundation Trustees. IASB member seats are not geographically driven; rather, members are chosen based upon an objective of assembling a group with the best available combination of technical skills and background experience of relevant international business and market conditions. Currently, three of the Board members are from the United States: two full-time and one part-time. In addition to the Board members, approximately thirty technical staff members from around the world are employed by the IASC Foundation to support the IASB's work.

Almost 100 countries now either require or permit the use of IFRS for the preparation of financial statements by their domestic listed companies. Under a regulation adopted in 2002, the EU required its listed companies to report using endorsed IFRS beginning in 2005. Japan's accounting standard setter and the IASB have agreed to work to accelerate convergence between Japanese accounting standards and IFRS, with certain interim target dates in 2008 and 2011. Other countries, such as China, Israel and India, have either begun to move toward use of IFRS (China and Israel) or have announced plans to do so (India). Closer to home, Canada has announced plans to move to IFRS reporting around 2011, while we understand Mexico is working to incorporate IFRS aligned content into Mexican accounting standards. The incentives and reasons for these national IFRS policy decisions, as well as the method and timing of the transition to IFRS reporting for companies in a particular country, are as varied as the profiles of the countries involved.

The Financial Accounting Standards Board and the Convergence Process Between U.S. GAAP and IFRS

The FASB is the independent, private-sector body whose pronouncements establishing and amending accounting principles the Commission has, since 1973, recognized as "authoritative" and "generally accepted" for purposes of the federal securities laws, absent any contrary determination by the Commission. Consistent with the FASB's objective to increase the quality of standards used in the United States and international comparability, the FASB is engaged in international accounting standard setter activities. This objective is consistent with the FASB's obligation to its domestic constituents, who benefit from comparability of information across national borders. In pursuit of this objective, the FASB as noted above entered into the Norwalk Agreement with the IASB in 2002, which marked a significant step towards formalizing their commitment to the convergence of U.S. GAAP and IFRS. In the Norwalk Agreement, the two bodies acknowledged their joint commitment to the development, "as soon as practicable," of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting.

In a further 2006 memorandum of understanding, the FASB and the IASB indicated that a common set of high quality global standards remains the long-term strategic priority of both the FASB and the IASB and set out a work plan covering the next two years for convergence with specific long- and short-term projects. The FASB and the IASB continue to work to align the content of U.S. GAAP and IFRS – an effort that has now been underway for five years. The better part of the two standard setters' current agendas (fourteen projects on the active agenda and four projects on the research agenda) are part of this effort. Areas of this work include addressing the manner in which information is displayed and presented in the financial statements as well as the accounting for revenue and leases.

The Commission's Current Efforts Regarding Globally Accepted Accounting Standards

The most recent and significant aspect of this current phase of the Commission's work involves the issuance of two releases regarding the potential use of IFRS in the U.S. capital markets. The first is the publication of a proposal in June to allow foreign private issuers to report using IFRS financial statements without a U.S. GAAP reconciliation. The comment period on the foreign private issuer proposal ended September 24, 2007. The second is the issuance of a concept release in July to explore a more far-reaching prospect – the possibility of giving domestic issuers the alternative to report using IFRS. The comment period on the concept release is still open and closes on November 13, 2007.

These recent initiatives address the core policy issue of what role, if any, should the use of IFRS play in the U.S. public capital markets at this time along with U.S. GAAP. As with any policy decision, such a determination includes giving due consideration to the benefits and costs. In all of the Commission's work to date, a consistent premise is that investors are better served by having high quality financial information across issuers, regardless of domicile. This aids investors' ability to make informed capital allocation decisions among competing alternatives. Investors also benefit if costs of compliance for issuers in entering and staying in our capital markets are reduced, thereby encouraging additional investing opportunities from the global economy.

Of course, there are issues to consider in adjusting to a new set of accounting standards. With respect to the foreign private issuer proposal, for those not already familiar with IFRS this would include working with IFRS financial statements without a U.S. GAAP reconciliation. The impact of the loss of the reconciliation depends on the extent to which investors currently use it and the extent to which IFRS and U.S. GAAP continue to differ in some respects. The effect also depends on the number of issuers that would potentially avail themselves of this alternative. Currently, approximately 110 reporting foreign private issuers, out of a total of over 1,100 who file with the Commission, provide in their filings financial statements that are prepared pursuant to IFRS as published by the IASB, which is the subject of the foreign private issuer proposal. In addition, approximately 70 more reporting foreign private issuers prepare their financial statements in accordance with a jurisdictional adaptation of IFRS. If these issuers could also state that their financial statements are prepared in accordance with IFRS as published by the IASB, they would be in a similar position. Looking to the future, the Commission also has approximately 100 issuers from Israel and approximately 500 from Canada; both countries have announced moves to IFRS reporting.

Public Response to the Foreign Private Issuer Proposal

As noted above, the comment period on the foreign private issuer proposal closed on September 24, 2007, and the Commission received approximately 120 comment letters. The vast majority of commenters agreed that, overall, the use of high quality globally accepted accounting standards was an important and worthwhile goal in helping the global capital markets function effectively.

- Some commenters stated that IFRS were suitable to be used as an internationally accepted set of standards and that allowing IFRS without a U.S. GAAP reconciliation would be perceived as recognition of the adequacy of the convergence process to date and would not hinder the ongoing convergence process. However, other commenters stated that the time was not yet ripe for accepting financial statements prepared using IFRS without a U.S. GAAP reconciliation. Some of these commenters also expressed concern over the adequacy of the governance and funding for the IASC Foundation and/or that removing the reconciliation requirement would sap momentum from the overall convergence project.

- Many commenters stated that the reconciliation information is highly technical, not widely understood and is typically not available on a sufficiently timely basis to be useful. These commenters also generally expressed confidence in the quality of application of IFRS in practice. Others noted the usefulness of both the quantitative and qualitative aspects of the U.S. GAAP reconciliation.

- Many commenters urged the Commission to go further than just accepting without reconciliation financial statements prepared in accordance with IFRS as issued by the IASB. These commenters advocated a number of ideas, including: allowing financial statements prepared pursuant to jurisdictional adaptations of IFRS without a U.S. GAAP reconciliation; allowing financial statements prepared pursuant to jurisdictional adaptations of IFRS if reconciled to IFRS as published by the IASB; and allowing financial statements prepared pursuant to any home country GAAP if reconciled to IFRS as published by the IASB.

Conclusion and Next Steps

The Commission is currently analyzing the comments received thus far on the releases and for the proposal to remove the reconciliation process we have begun the process of evaluating the important issues raised. Given the increasing globalization of capital markets, it is imperative that the Commission be vigilant in keeping our regulatory standards up-to-date for the protection of investors, for the maintenance of efficient and orderly markets, and for the promotion of capital formation. Our ongoing work in the area of accounting and financial reporting is an important part of the Commission's wide-ranging efforts in this regard.

Thank you for the opportunity to appear today, and we would be pleased to respond to any questions.