Statement
Of
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On
International Accounting Standards: Opportunities, Challenges, and Global Convergence Issues."

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Thank you Chairman Reed and Ranking Member Allard for holding this hearing on an issue important to investors in America's capital markets. Before I start with my personal perspective on international accounting standards, it might be worthwhile to provide some background on my experience. I serve as a trustee of a mutual fund and $40 billion public pension fund, both of which invest in foreign as well as domestic public companies. I serve on the board of directors of a small cap domestic public company. In the past, I have also served as chief accountant of the U.S. Securities and Exchange Commission (SEC) where I was deeply involved with the process leading to the creation of the International Accounting Standards Board (IASB) and its trustees as we know them today. I was also an audit partner in one of the major international auditing firms and the managing director of research at a financial and proxy advisory firm. In addition, I have also been a professor of accounting at a major U.S. public university and an investor representative on the Public Companies Accounting Oversight Board Standards Advisory Group and the Financial Accounting Standards Board's (FASB) Investor Technical Advisory Committee.

High quality financial reporting has been called the life blood of our capital markets by former SEC Chairman Levitt. I couldn't agree more. It is this information that provides investors with the ability to make informed judgments as to where they should allocate their capital, thus resulting in allocations which yield higher returns, with lower risks, thereby attracting a supply of capital. When the quality of this information is lowered, markets pay a price as we have seen throughout this decade both here in the U.S. and abroad.

Based on my experience, I believe maintaining high quality financial reporting is important to the competitiveness of US markets. As a former chief financial officer and business executive, I also know the importance of striving to provide investors with a product that is better than those of competitors, not just one that matches their performance. The U.S. markets will not maintain their current prominence if they simply become the equal of other markets, employing the same strategies and approach to business. Certainly the fallout from the subprime fiasco and Structured Investment Vehicles's around the globe is a classic example of this and how a lower quality in transparency can affect competitiveness.

What Is True Convergence

I would like to clarify what convergence is, not what some intend to avoid. Convergence is:

- A **SINGLE** set of high quality financial reporting and disclosure standards that result in companies reporting the true economics of the transactions they enter into.

- Standards that result in consistent reporting methods from period to period and comparable reporting by companies who enter into comparable transactions.

- A complete set of standards covering all significant industries that exist such as mining and oil and gas, and financial services including insurance.

- Transactions being reported in the financial statements and not left off the balance sheet and out of the income statement as investors have seen time and time again in recent years with special purpose entities, structured investment vehicles and off balance sheet financing of securitizations and other assets.

- Effective audits that ensure CLAIMED compliance has been achieved.

- Authorities with the expertise and experience to globally enforce these accounting standards and audits, wherever they are used in reporting to investors.

Unfortunately, few of these conditions exist globally today as I will discuss further below. No regulators and governments have fully committed themselves to this effort, to fund it and provide sufficient resources. And no timetable has been set among all countries internationally to fully achieve the changes needed to ensure complete and timely convergence. Instead efforts are at best, being done in a piecemeal, haphazard fashion.

As such, removing safeguards and protections for investors before these conditions are achieved bring with it significant risks for investors and capital market participants. It so will increase the likelihood of future scandals with an increase in the cost of capital for all companies, and a reduction in available capital in the markets. Unfortunately, the actions some propose taking are all too similar to what has led directly to the current subprime mess.

Let me also say convergence is not one of selection of the FASB standards over the IASB standards or vice versa. In fact at this time, due in part to the newness of the IASB standards, there is little if any meaningful fact based research that indicates one is that much better than the other albeit the FASB has a much more robust and complete set of standards. For example, the standards of both with respect to off balance sheet transactions have left global investors in the dark, and without sufficient transparency. For that, both bodies get a "D" at best, if not a failing grade. And while some FASB standards such as guidance on accounting for derivatives is complex and difficult to implement, likewise some IASB standards such as accounting for property, plant and equipment and research and development expenses are more complex and difficult than their comparable FASB standards. And unfortunately, both boards and their trustees, as Arthur Levitt recently noted in an op ed, lack adequate voting members and representation from the investor community, and both have allowed way to many optional accounting treatments making it difficult and costly for investors to analyze and compare companies and their performance.

So this raises the question of why does the SEC feel compelled to remove the reconciliation at this point in time? Is it to make the U.S. capital markets more competitive? I seriously doubt it as today just over 100 foreign companies listing in the U.S. from among over 1,100 such companies who file with the SEC, and over 12,000 publicly listed companies, use International Financial Reporting Standards (IFRS) as published by the IASB. In addition, approximately 70 more reporting foreign companies prepare their financial statements in accordance with a jurisdictional adaptation of IFRS which is a way of saying their countries have picked and chosen among the IFRS they like and don't like. A concept far, far away from convergence and endorsement of the IASB and its work.

Likewise, Goldman Sachs has appropriately noted it is not our U.S. regulatory scheme that has the most significant impact on the competitiveness of our capital markets.[1] Rather it is economic factors such as the growth in our GDP that currently lags emerging economies such as China and India where their growth, and growth in business, is three to five times what it is here. And as a study from Ernst & Young has pointed out, it is most common that foreign companies list in their home markets, which quite frankly, is not a new or novel idea here in the U.S.[2]

Convergence is an objective many people are in agreement on. But as is often the case, the devil is in the details as to how one gets to a common financial reporting language. However, one must stayed focused on the objective of development of accounting and disclosure standards that result in a company most accurately portraying the economics of its balance sheet, income statement and liquidity from cash being generated.

In striving to achieve that objective and convergence, a few key points are worth noting. These include:

1. Convergence on high quality accounting standards will best be achieved through the private sector standard setting process, not by one influenced by outside special interests, overbearing regulators and a lack of direct investor involvement.

2. There needs to be assurance that the necessary supporting infrastructure is in place, as set forth by the SEC in its 2000 Concept Release on International Accounting.

3. There are concerns regarding the independence of the IASB and lack of any meaningful representation of investors as members of its board or among its trustees.

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[1] Global Economics Weekly, Is Wall Street Doomed? Goldman Sachs. February 14, 2007
[2] Global Capital Market Trends. Ernst & Young. January 2007.

4. Comparability and consistency in reporting by companies has been a hallmark of high quality financial reporting by investors and the FASB's conceptual framework for several decades. Negatively impacting that will have consequences for the investing public around the globe.

5. In the U.S., there is a lack of resources, skills and training to make an orderly transition to IFRS any time soon. To require a change in the near term would disadvantage small auditing firms and result in significant costs for smaller companies.

Need To Continue Convergence on High Quality Standards

The SEC in its 2007 proposing release states:

"…audit firms have not been required to opine on IFRS as published by the IASB but have limited their opinions to jurisdictional variations of IFRS, consistent with a company's basis of presentation. In light of this wide-scale use of IFRS being less than two years old, the degree of experience, familiarity and understanding among companies, audit firms, investors, analysts, brokers, regulators, and others is continuing to develop….However, developing high-quality standards and issuing high-quality interpretations of IFRS may take some time."[3]

The SEC portrayal is a fairly accurate one and there is indeed much work that remains to be completed before high quality standards are achieved internationally. Accordingly, while elimination of the reconciliation at an appropriate time is to be applauded, that time has not yet come. Instead it begs the question as to the reason for the current change in direction and rush. Why now when the SEC has indicated there is much work that remains to be done?

Rather than have the SEC eliminate the reconciliation, a significantly better approach yielding a better product for investors is to continue to have the IASB and FASB, along with other international standard setters, continue to pool resources to develop a comprehensive set of international standards. As they achieve convergence on standards, they will also eliminate items reported in the reconciliation to investors over a reasonable period of time. In turn, the reconciliation will disappear without unintended consequences occurring.

Standards & Poors has recently stated "We believe elimination of the reconciliation would occur as a natural byproduct of the International Accounting Standards Board (IASB) and the U.S. Financial Accounting Standards Board (FASB…) on-going convergence process. As efforts to converge U.S. Generally Accepted Accounting

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[3] Securities and Exchange Commission 17 CFR Parts 210, 230, 239 and 249
[Release Nos. 33-8818; 34-55998; International Series Release No. 1302 File No. S7-13-07] Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards Without Reconciliation to U.S. GAAP. Pages 31 and 32.

Principles (U.S. GAAP) and IFRS continue, differences between the models would be rationalized within the context of a comprehensive joint framework."[4]

Accordingly, the FASB and IASB have demonstrated they will eliminate the reconciliation as higher quality standards are completed, and there is not a compelling need at this time for the government regulator to unduly interfere with this process. Periodically as the FASB, IASB and other international standard setters move forward with their convergence process, they should periodically publish updates on their progress including providing investors with an inventory of differences among their standards. This would greatly aid in training and educating investors, auditors, company accountants and students. The International Organization of Securities Commissions, the SEC and other international regulators should continue to encourage and oversee these efforts.

I believe strongly if the SEC reconciliation is eliminated, it will also eliminate the incentive for standard setters to work together. Indeed, each of the standard setters is likely to go their own way and I suspect within 10 years, if not sooner, the FASB will cease to exist, leaving the U.S. without a viable private standard setter responsive to the needs of U.S. investors. Ultimately this will contribute to a slow down or reversals in global efforts to improve the quality of financial information investors receive. It also results in a lack of competitive market incentives brought on by competing standard setters, which, as we have seen with the demise in number of auditing firms, is a negative event, not a positive one.

Assurance The Necessary Infrastructure Is In Place

In the Concept Release on International Accounting Standards issued by the SEC in 2000, it states:

"Accordingly, while the accounting standards used must be high quality, they also must be supported by an infrastructure that ensures that the standards are rigorously interpreted and applied, and that issues and problematic practices are identified and resolved in a timely fashion. Elements of this infrastructure include:

- effective, independent and high quality accounting and auditing standard setters;
- high quality auditing standards;
- audit firms with effective quality controls worldwide;
- profession-wide quality assurance; and
- active regulatory oversight."[5]

[4] Standard and Poor's comment letter to SEC dated September 24, 2007. Pages 1 and 2.

[5] Securities and Exchange Commission, 17 CFR PARTS 230 and 240, [RELEASE NOS. 33-7801, 34-42430; International Series No. 1215] File No. S7-04-00. International Accounting Standards. 2000.

As both an auditor of major international foreign companies, as a regulator, and as the director of research of financial analysts, I have learned standards that are not enforced are the equivalent of no standards at all. It is vitally important to provide U.S. investors adequate protections through proactive enforcement of the accounting standards, achieved by both effective audits by independent auditors and rigorous regulatory oversight. Yet today no single regulator or law enforcement agency has responsibility for enforcement of standards issued by the IASB.

Unfortunately, in their recent proposing release, the SEC provides little evidence the necessary infrastructure exists to ensure compliance with international standards. For example, actual regulatory actions being taken in many countries where foreign companies are domiciled are almost nonexistent. In some countries, including those with well known public markets, the ability of the securities regulators to take enforcement actions is severely limited. This has resulted in U.S. regulators finding themselves having to enforce such basic fundamental standards for foreign participants in the U.S. capital markets as those that ensure the independence of an audit. I believe this affects investor confidence in those markets. And not all international audits are adequate today as was demonstrated when in the past year; the Japanese regulator was forced to effectively shut down the affiliate of a major international auditing firm that was accused of engaging in fraud in its audits.

The international auditing standards also continue to be set by the auditing profession itself, with little direct voting involvement by investors. Such a process, while improved from what it has been in the past, continues to lack adequate independence and investor input.

Therefore, prior to elimination of the SEC reconciliation, I would urge the SEC provide Congress and investors, if it has it, data which demonstrates effective auditing and regulatory schemes actually operate in countries for which the reconciliation would no longer be required. The SEC proposing release falls way short of the target in this regard.

Concerns Regarding the Independence Of The IASB and Representation Of Investors On Its Board

In the past, the independence of the FASB has been strongly protected to ensure it is able to develop unbiased standards designed to provide transparency for investors. More recently, Congress enhanced the independence of the FASB by providing independent funding. This contributed to the FASB being able to recently adopt a new and badly needed standard on accounting for stock options, despite attempts by some to unduly influence its processes and outcomes.

When the FASB issues a new standard in the United States, it effectively becomes “law” without further review by the SEC or U.S. Congress. Only in very few instances, has the SEC or Congress overturned a new accounting pronouncement in the U.S. and it is almost universally acknowledged that intervention in those cases proved to be fatally flawed. This process has also contributed to the independence and lack of bias in the standards issued by the FASB.

Unfortunately, the IASB lacks this level of independence. It must go hat in hand to companies impacted by its standards, and their auditors, to obtain funding for its operations, which are relatively small in size given its responsibilities and obligations. The IASB's meager preliminary budget for 2008 is for just 45 full time staff equivalents at a staffing cost of $11.7 million pounds. It is difficult to understand how this organization can even remotely keep up with the financial reporting needs of the world's capital market. Indeed, its manpower is less than half the staffing of the U.S. national office of just one of the Big 4 auditing firms.

One should also be mindful that corporations and auditing firms currently provide 60 to 70 percent of the annual budget for the IASB. These organizations overwhelming control the seats of the members of the IASB and its trustees. As such, the IASB risks a negative outcome were it to anger those who provide funding with rules they oppose.

Equally importantly, new pronouncements of the IASB do not become law in Europe until after the European Parliament votes on and approves them. This process begins when the European Financial Advisory Group (EFRAG) and Accounting Reporting Committee (ARC) reviews the standards and make recommendations for changes or their adoption to the EU. This process has major flaws as special interests in recent years have unduly influenced the IASB's international standard setting process resulting in the EU not fully adopting all IASB standards and their interpretations. In turn, European companies are not required to comply with IASB standards in which EU jurisdictional differences have been approved by the EU. In the most recent meeting of the ARC just this month, some recommended once again that a new IASB standard be modified before it is accepted.

If the SEC (and Congress explicitly or implicitly) determines it is appropriate to eliminate the reconciliation, then they should also determine whether or not it is appropriate to accept the IASB standards in this country without reconciliation when jurisdictional differences are reported and used in preparation of the financial statements. I believe any company reporting using jurisdictional differences should have to continue with the full reconciliation.

Comparability And Consistency In Financial Reporting – Significant Differences in International and U.S. Accounting Standards Exist.

There remain significant differences in financial reporting by users of International Accounting Standards and those using U.S GAAP. For example, a recent research report by The Analyst's Accounting Observer based on a review of Forms 20-Fs filed with the SEC found significant variations in income reported by preparers using IFRS versus U.S. GAAP. A copy of this report is attached. Similarly, Maverick Capital, a $23 billion investment fund cited numerous differences in the two GAAPS in a comment letter to the SEC which is attached hereto and which provides excellent, practical examples.

Some of these differences are the result of both more complex, detailed and more costly accounting standards issued by the IASB, than those issued by the FASB. Examples include IFRS related to accounting for property, plant and equipment and intangible assets.

Being able to compare the financial results of companies with one another is critically important to investors in making a determination as to where they should allocate their capital. It is a hallmark of an efficient capital market. Without comparability, and consistent reporting by companies period to period, it makes such comparisons difficult at best and extremely time consuming and costly. That is why the reconciliation has been very useful for investors.

The CFA Institute, the largest worldwide organization of financial analysts has stated to the SEC that:

"The current SEC reconciliation requirement is an important tool that allows them to compare companies in different countries on an apples-to-apples basis. To the extent accounting standards have not yet converged (or new differences develop) investment professional rely on the reconciliation as an efficient and cost effective way of bringing to their attention, the material differences in accounting."[6]

The credit rating agency Standards & Poor's has also recently stated; "…the reconciliation, although perhaps not a vital input to our analysis, nonetheless serves a useful function in highlighting differences in accounting conventions, thereby supporting our analytical process and aiding us in making comparisons among global peers. This is particularly relevant because IFRS is still in its early days in terms of its application and interpretation."[7] It is interesting that at a time when credit rating agencies have been criticized for their analysis and ratings, Congress and the SEC would take steps to reduce the information they have available when making their rating determinations.

SEC staff has also found the reconciliation useful when assessing whether foreign registrants have complied fully with international accounting standards. For example the reconciliation process has highlighted instances of noncompliance with IFRS that in turn were disclosed or proposed to be disclosed in the reconciliation of IFRS to U.S. GAAP. This information has provided useful information to SEC staff in reviews of such filings.

Lack Of Resources, Skills And Training

For the vast majority of U.S. companies, financial management is sufficiently challenged running their business, complying with existing accounting standards and ensuring they have adequate risk and accounting internal controls. I know of very few companies that have sufficient resources to comply with IFRS in their filings with the SEC and disclosures to investors.

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[6] CFA Institute comment letter to SEC, October 2, 2007.
[7] Ibid. Page 2.

Small public companies are even more challenged and the costs to convert to IFRS at this time or in the near future would be astronomical. I know of no cost study by the SEC or others that has adequately studied and captured these costs to U.S. companies and the American economy. These costs would include the need to hire additional competent people trained in IFRS, train existing people, make necessary modifications to their systems for the significant differences in accounting conventions and fund major changes required in accounting education. As mentioned earlier, some of these changes, such as how technology companies might account for research and development expenditures could involve significant costs and added complexities.

Smaller auditing firms are challenged to comply with US auditing standards as noted in a recent report of the PCAOB. Very few of these currently have the resources, including staffs, which are knowledgeable of IFRS. At a time when the Treasury Committee on the Auditing Profession is looking for ways to make the auditing profession more competitive, moving to IFRS in this country is likely to have just the opposite effect on many small CPA firms in the U.S.

U.S. universities also do not have the resources or funding required to train new students in international accounting and auditing standards. I have recently surveyed leading professors of accounting and auditing in the U.S asking if there are adequate accounting texts for teaching IFRS in the universities as well as teaching international auditing standards. The response was universal they were not aware of such texts. In addition, they noted they were not teaching such courses at their universities. With very few accounting professors currently having a working knowledge of IFRS, and a large portion of them retiring in the next few years, it leaves a nonexistent ability of the education system to provide new graduates to industry or the auditing firms during this decade.

Concluding Remarks

Let me wrap up by noting there are many challenges, and yet opportunities as well on the road to convergence. It is a road that has been well engineered and laid out in the past with proper course. Now is not the time to take off over country roads in a new direction, if investors are to be well served and the competitiveness of American markets maintained. I believe that will bring with it a bumpy road with an unclear outcome.

Thank you and I would be happy to take any questions you might have.