Subcommittee on Securities, Insurance and Investment
"International Accounting Standards: Opportunities, Challenges, and Global Convergence Issues"
Subcommittee Chairman Jack Reed, RI
October 24, 2007

This afternoon we are holding a hearing on "International Accounting Standards: Opportunities, Challenges and Global Convergence Issues."

In recent months, the Securities and Exchange Commission has been prioritizing a number of regulatory reforms aimed at providing foreign private issuers greater access to the U.S. securities markets. The Commission's proposal on the elimination of reconciliation to U.S. GAAP for foreign private issuers who apply the International Accounting Standard Board's (IASB) version of International Financial Reporting Standards (IFRS) by 2009 is one such proposal. The Commission also issued a concept release which raises the possibility of U.S. companies having the option of filing their financial statements using either IFRS or U.S. GAAP and the establishment of an advisory committee to examine complexities in the U.S. financial reporting system.

These proposals are part of an effort to establish a single set of global accounting standards. There is no doubt a single set of high quality accounting standards would benefit the U.S. as well as global markets. However, there are a number of significant issues which should be seriously considered. Most importantly, we need to ensure that this new single set of globally accepted accounting standards continues to protect and provide enhanced transparency to investors, while promoting market integrity. This effort should incorporate the best of both standards to build the strongest protections for investors. This hearing is an opportunity to discuss progress, opportunities, and challenges in achieving convergence but also to understand the impact of SEC's proposals on investors, regulators, auditors and businesses alike.

Increased globalization of markets and wide adoption of IFRS have been significant drivers of convergence. In recognition of this trend, in 2002, the FASB and the IASB agreed on a framework to eliminate differences between the two standards and to collaborate on future ones. This process has set a good balance for moving ahead with new standards mindful of eventual convergence. However, it is also important to note that these efforts provide not only truly comparable transparency and accurate financial results to investors but they must also ensure comparable enforcement, interpretation, and implementation by regulators.

To that end, it is clear that some countries using IFRS are tailoring these accounting standards to their needs resulting in "jurisdictional versions" of IFRS. In its review of more than 100 foreign private issuers' filings, the SEC has found that "the vast majority of companies asserted compliance with a jurisdictional version." As Sir David Tweedie has suggested, the "budding of these" jurisdictional versions and variances will ultimately make true convergence difficult.

There are also significant questions raised in the area of implementation and interpretation of IFRS. Again the SEC's study of the filings of firms reporting on an IFRS basis in the U.S. found problems with the implementation of IFRS, including in the area of the presentation of cash flow statements, accounting for common control mergers, recapitalizations, and similar transactions. According to an Ernst & Young report, "Because IFRS standards generally include only broad principles, preparers and auditors may in good faith interpret company-specific facts differently, which may result in different accounting treatments for the same or similar transactions among companies."

The issue of timing should also be considered carefully. Many prominent investors and users of financial statements including the CFA Institute and FASB's Investors Technical Advisory Committee (ITAC) concluded that "it is premature" for the SEC to eliminate the reconciliation requirement. Some have asked that with the projected convergence of U.S. GAAP and IFRS by 2011-2012, why there is such a rush before the frameworks are substantially harmonized. Additionally, while this effort may ease the filing requirements on foreign private issuers, IFRS is still in its infancy and may in fact be dependent on reconciliation to U.S. GAAP. Moreover, some companies like S&P have indicated that if the reconciliation is eliminated, it will continue to ask companies to provide reconciliation as part of the package of non-public information credit rating agencies request. If companies will indeed need to continue to prepare reconciliation information for credit rating agencies, why shouldn't the SEC require companies to provide that information to public investors as well?

There are numerous other issues which I hope we can address today, including: Will the elimination of reconciliation lead to the abandonment of convergence? How prepared are we for the greater use of IFRS standards in the U.S. markets when there are virtually no accounting programs in our universities that teach accounting students IFRS standards? And should we be concerned about the lack of knowledge of IFRS standards by U.S. accountants and CFOs? What does this mean for the future roles of the SEC and the FASB in providing oversight of U.S. financial reporting? And another key question is will investors be well served by this change?

These are challenging times for financial regulators. If done properly, convergence of international accounting standards can have a positive impact on U.S. and global markets. However, the events of recent months remind us of the ever increasing complexity of financial products and interconnectedness of our financial systems. We have learned that complex financial products, while spreading risk, can also hide that risk. Financial reporting and accounting standards play a critical role in decoding some of that complexity to investors and regulators and we must push to further enhance transparency to restore confidence in our markets. With our uniquely large retail base of investors and millions of individuals investing their futures in our capital markets, it is critical that we get this right and make certain that there are no unintended consequences.