Statement
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Before the Subcommittee on Securities, Insurance and Investment
Committee on Banking, Housing, and Urban Affairs
United States Senate

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

October 24, 2007

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

I am Robert Herz, chairman of the Financial Accounting Standards Board. I am very pleased to participate in this very timely hearing. Thank you for the opportunity to discuss our progress on international convergence of accounting standards.

I am pleased to be joined today by Sir David Tweedie of the IASB and our colleagues from the SEC, Conrad Hewitt and John White.

I would also like to take this opportunity to commend the Banking Committee for its steadfast support of the FASB, independent accounting standard setting, and our international convergence activities. Your support has been very important in our efforts to develop and improve standards in a manner that best serves investors in capital markets around the globe.

The FASB

I would like to preface my remarks with some brief background on the FASB. Our mission is to establish and improve standards of financial accounting and reporting for both public and private enterprises, including small businesses and not-for-profit organizations. Those standards are essential to the efficient functioning and operation of the capital markets and the United States' economy because investors, creditors, and other consumers of financial reports rely heavily on sound, honest, and unbiased financial information to make rational resource allocation decisions.

The FASB employs an exhaustive due process for establishing standards, which involves extensive consultation with all key participants in the financial reporting system. As part of this due process, we listen carefully to the views expressed by investors and other capital providers, the companies that prepare financial statements, the firms that audit those financial statements, and governmental bodies. In addition, our funding and governance mechanisms provide us the independence that is essential to ensuring the integrity of the standards we produce and the neutrality of the financial information that companies provide to investors. Again, we thank the subcommittee for its long-standing support of this system.

FASB's Mission and International Convergence

The FASB's views on financial reporting and international convergence are shaped primarily by our perceptions of the costs and benefits of providing financial information to investors and the capital markets. We give priority consideration to the needs of investors because, in our view, the principal reason for developing high-quality accounting and external financial reporting standards for public companies is to enhance the efficiency of the capital markets by giving potential investors the information and the confidence to buy and sell securities.

Recent years have been marked by a continuing and rapid globalization of capital markets, cross-border investing, and international capital-raising. In light of this rapid change, we agree with the Securities and Exchange Commission that a widely used single set of high quality international accounting standards for listed companies would benefit the global capital markets and investors. The ultimate goal, we believe, is a common, high-quality global financial reporting system that can be used for decision-making purposes across the capital markets of the world.

However, achieving the ideal system requires improvements and convergence in various elements of the infrastructure supporting the international capital markets, including a single set of common, high-quality accounting standards, a well-funded, global standard-setting organization, and a global interpretive body to handle guidance and implementation issues. Improvements are also needed in disclosure requirements; regulatory, enforcement and corporate governance regimes; auditing standards and practices; and education of capital market participants.

We believe reaching this ideal financial reporting system would significantly improve the overall usefulness and comparability of reported financial information, increase investor confidence, and reduce the complexity and costs investors and companies face, resulting in global capital markets that function more efficiently.

There are many challenges involved in developing the ideal financial reporting system, including differences in institutional, regulatory, business, and cultural environments; the inevitable resistance to change; differing priorities among jurisdictions; and the existing U.S. demand for detailed guidance and specialized industry standards. We believe the benefits the ideal system offers, however, well justify the cost and effort of confronting these many challenges.

The Current State of Convergence of Accounting Standards

The FASB, with the IASB and other national standard setting bodies, has been working for many years to improve and converge accounting standards. The pace of these convergence activities has increased since the formation of the IASB in 2001 and there has been a clear movement in many parts of the world toward International Financial Reporting Standards established by the IASB. Many jurisdictions around the world have mandated or permit the use of IFRS and many others are planning to move in this direction. However, in some of these jurisdictions, the standards issued by the IASB have been modified, resulting in so-called “as adopted” versions of IFRS. Also, differences in implementation have resulted in “national variants” of IFRS.

In the U.S., the FASB and IASB committed in 2002 to the goal of developing a set of high-quality, compatible standards. The 2002 Norwalk Agreement describes the plans for achieving that goal, such as coordinating the agendas of both Boards so major projects are undertaken jointly, and eliminating narrow differences in other areas through short term convergence projects. The 2006 Memorandum of Understanding sets specific milestones to be achieved by 2008.

Since 2002, we have made steady progress toward convergence. Standards have been issued by both Boards that improve financial reporting by eliminating differences between IFRS and U.S. GAAP, including improved standards concerning inventory, nonmonetary transactions, share-based payments, segment reporting, and the use of a fair value option to simply financial instrument accounting. Both Boards will soon issue a common standard that converges the accounting for business combinations. In upcoming months, both Boards will issue discussion documents relating to major improvement initiatives on financial statement presentation, liabilities and equity, revenue recognition, and an improved and converged conceptual framework.

Although the FASB and IASB have made significant progress in improving and converging IFRS and U.S. GAAP, that work is incomplete. Improvements are needed in a number of key areas. In addition, many differences between U.S. GAAP and IFRS remain, which can result in significant differences in the reported numbers under the two sets of standards. Thus, while we have been making steady progress in our convergence program, it will take many more years to reach the goal of full convergence using our current approach. Accordingly, and in light of the growing use of IFRS in many other parts of the world, we believe that now may be the appropriate time to consider ways to accelerate the convergence effort and the movement in the U.S. toward IFRS. For to be truly international, any set of standards would need to be adopted and used in the world's largest capital market, the United States.

Thus, we believe that planning for a transition of U.S. public companies to an improved version of IFRS would be an effective and logical way forward to achieving the goal of a set of common global standards.

Managing the Complex Process of Moving U.S. Public Companies to an IFRS-based System

However, moving all U.S. public companies to an improved version of IFRS will be a complex process. A smooth transition will not occur by accident, and to manage this change, we suggest that a blueprint for coordinating and completing the transition should be developed and agreed to by all major stakeholders in the process. The blueprint should identify the most orderly, least disruptive, and least costly approach to transitioning to an improved version of IFRS and should set a target date or dates for U.S. registrants to move to IFRS that allows adequate time for making the many necessary changes.

Changes Needed Internationally

The blueprint should identify the changes considered necessary both in the U.S. and internationally to reach the goal of a single set of common, high-quality standards. My written statement enumerates these in detail, but let me touch upon some key issues. First, the blueprint should address a range of institutional issues, including examining the post-issuance endorsement processes currently in place in many jurisdictions to reduce or eliminate the “as-adopted” versions of IFRS, which we think are inconsistent with the goal of a single set of high quality standards. The blueprint should also address strengthening the IASB as an independent, global standard setter by establishing mechanisms to ensure the sufficiency and stability of its funding and staffing.

Changes Needed Within the U.S.

In regard to the U.S., the blueprint should identify and establish timetables to accomplish changes to the financial reporting infrastructure necessary to support the move to an improved version of IFRS, including training and educating issuers, auditors, investors, and other users of financial statements about IFRS; how a transition to IFRS will affect audit firms and auditing standards; how a move to IFRS would change regulatory agency policies, contractual arrangements, or state legal requirements that are currently based on U.S. GAAP financial reports; the impact of this transition on private companies and not-for-profit enterprises, which currently use U.S. GAAP; and how to enable the use of more principles-based accounting standards and less specialized industry accounting requirements.

Similarly, the blueprint should enumerate the steps U.S. public companies would need to implement significant changes to align to IFRS, including training, system changes, internal control changes, and various contractual matters.

We expect that the myriad changes to the U.S. financial reporting infrastructure would take a number of years to complete. During that time, the FASB and IASB should continue our cooperative efforts to develop common, high-quality standards in key areas where both existing U.S. GAAP and IFRS are deficient. Those common standards, issued by both the FASB and IASB, would be adopted by companies in the U.S. and internationally when issued. In other areas that are not the subject of those joint improvement projects, we envision that U.S. public companies would adopt the IFRS standards "as is" over a period of years. The adoption of those IFRS standards by U.S. companies would complete the migration to an improved version of IFRS.

We believe there are many advantages to employing such an "improve and adopt" approach in transitioning to IFRS. Financial statement users both domestically and internationally will benefit from the continued, cooperative efforts by the FASB and IASB to improve, simplify, and converge financial reporting in those areas of existing U.S. GAAP and IFRS that are clearly deficient. Under this approach, new standards or existing IFRS will be gradually adopted over a period of several years, smoothing the transition process and avoiding the capacity constraints that might develop in an abrupt mandated switch to IFRS. Moreover, this approach permits the Boards to focus their resources on improving standards in areas important to investors, rather than on eliminating narrow differences among our many existing standards.

FASB Views on SEC Proposing and Concept Releases

Let me turn to the two recent SEC Releases relating to the reconciliation requirement and the possible use of IFRS in the U.S. I commend the SEC for bringing these forward for discussion. Clearly, the issues raised by them are important and timely and have significant implications for the efforts to achieve an improved global financial reporting system.

The SEC Concept Release seeks comments on whether U.S. issuers should be allowed to prepare financial statements in accordance with IFRS, and envisions allowing individual U.S. public companies a choice of adopting IFRS or continuing to use U.S. GAAP. We are generally opposed to allowing companies to elect different accounting standards for economically similar transactions, because of the added cost and complexity such choices create for investors and others trying to use financial information, and the added cost and complexity involved in developing a U.S. financial reporting and educational infrastructure to support a two-GAAP system for U.S. public companies.

Accordingly, we do not support permitting U.S. companies a choice between IFRS and U.S. GAAP ***for any extended period of time***. Rather, we believe it would be preferable to move all U.S. public companies to an improved IFRS over a transition period of several years following the blueprint we are advocating be developed.

The Proposing Release—Whether to Remove the Existing U.S. GAAP Reconciliation Requirement

Finally, on the more imminent question of whether the SEC should remove the reconciliation requirement for foreign private issuers that use IFRS as issued by the IASB, we are aware of a variety of differing views on this issue. Foreign preparers and regulators, not surprisingly, support the elimination. Some U.S. companies support removal because reconciliations are costly, and they are concerned that they may face retaliatory reconciliation requirements in some foreign capital markets. Some financial statement users contend the reconciliation arrives too late to affect their decisions, while others say they find it useful in their analysis of financial statements. We also note academic studies showing that reconciling items between IFRS and U.S. GAAP are often material, and the differences could get larger once the reconciliation is removed. Of concern is evidence of low-quality application and enforcement of IFRS in certain countries.

We believe that either way, the decision ***in the near future*** whether or not to eliminate the reconciliation requirement may well have important implications for the continued development of the global reporting system. On the one hand, we acknowledge the concerns of those who believe it would be premature and would result in a loss of information that some investors and other users find important and useful. On the other hand, this change only relates to a relatively small number of SEC registrants in relation to the overall size of our capital market. And maintaining the current reconciliation requirement could be viewed by some parties outside this country as a clear signal that the U.S. is not truly interested in participating in an international reporting system. In turn, that could negatively impact the willingness of these parties to support continued convergence between IFRS and U.S. GAAP.

Conversely, we believe there are real risks that once the reconciliation requirement is eliminated, some parties who have viewed the convergence effort between the IASB and the FASB as the price of getting the SEC to eliminate the reconciliation may see no further benefit in continued convergence between IFRS and U.S. GAAP. In that regard, recent comments made in the public press and in public forums give reason to believe that eliminating the reconciliation requirement will result in calls by some from abroad for a cessation of any further improvements to IFRS, especially any improvements designed to achieve convergence with U.S. GAAP.

Ultimately, the decision whether, when, and how to remove the reconciliation requirement rests with the SEC. However, in doing so, we feel that it would be very important to make it clear that getting to a single set of high quality international standards remains the ultimate goal and that further convergence and improvement of standards is necessary to achieve that goal. In addition, we strongly agree with the SEC proposal that the reconciliation requirement only be eliminated for those foreign private issuers that fully apply IFRS as issued by the IASB and not for those who use an “as adopted” version of IFRS. To do otherwise would be inconsistent with the goal of getting to a single set of global accounting standards.

Conclusion

We are firmly committed to continuing to work with the IASB, the SEC, and others to achieve a single set of high-quality international accounting standards that benefit investors and the capital markets domestically and across the world.

Thank you again, Chairman Reed. I would welcome the opportunity to respond to any questions.