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Meeting the Challenges of Financial Reporting in an Era of Change

Thank you for inviting me to participate in this important conference. Today, I'd like to share with you what we at the FASB are doing in terms of trying to fulfill our critical mission as the primary accounting standard setter in this country and, therefore, how we hope to contribute to improving the overall state of financial reporting in the US and internationally.

Certainly, for all of us these are very challenging times, and for those of us with key roles in the financial reporting system and in the efficient operation of the capital markets this is definitely not a time for business as usual. Thus, at the FASB we have been approaching our tasks and responsibilities with both a sense of urgency and a dedication and commitment to making sure that we are doing everything possible to play our role in improving the financial reporting system. This is manifested both in the many technical activities we currently have under way and also very importantly in the way we have set about charting a new course for accounting standard setting in this country. Today, I will cover some of the main things we are doing in these areas, and you can then judge whether you think we are on the right track.

Clearly, the events of the past year have shaken confidence in our reporting system and in our capital markets. While it would seem that many or most of the problems stem from outright violations of rules and fraud by greedy and unscrupulous executives, apparent audit and corporate governance failures, structuring of sham transactions by investment bankers, and research analysts conflicts, I also think the problems have prompted broader questions about virtually every aspect of our corporate reporting system, including accounting standards and accounting standard setting. I think those questions are appropriate, are healthy, and, quite frankly, I think they were overdue. As with crises in other areas of business or life, this prompts reflection, introspection, a better understanding, and then rebuilding, change, and renewal. So it must be with our corporate reporting system. Throughout my own career as an accountant, I have believed passionately in the importance of accounting and good financial and corporate reporting to the overall soundness of our capital markets, and thus I think a major lesson and an indelible reminder from the current crisis are that sound financial reporting is indeed very key to the health and vitality of our capital markets and, therefore, to our economy and to our whole society. It matters! Reporting is a bit like the air we breathe . . . as long as it's clean, we kind of take it for granted. But bad reporting, misleading

reporting, and fraudulent reporting is like dirty air. It pollutes and clouds—it threatens the health of all those around it and makes people want to stay away from the polluted area. So, while I certainly applaud the many market, structural, and legal reforms that are under way, I am convinced that lasting change and improvement will only come if ALL of us who have a role in the reporting system and in the capital markets rededicate ourselves to the basic proposition that sound, honest, and transparent financial and corporate reporting really matters. Just like the air, it is a public good and we must be committed to keeping it clean.

And, we must regard reporting as an exercise in good communication—good communication about performance, financial condition, prospects, and uncertainties and not as, on the one hand, an exercise in mere compliance or, on the other hand, an opportunity to spin, to paint a picture that is more flattering and appealing than the underlying reality. It means reporting that meets the needs of investors and other key users, that is operational, and that faithfully reflects the underlying business and economic realities. It means reporting that satisfies the key qualitative characteristics described in the FASB Conceptual Framework—relevance, reliability, neutrality, timeliness, and understandability.

In an era of continuing globalization of business and capital markets, I think it means financial reporting that is comparable across borders. And I think it means looking for ways to modernize and upgrade the whole reporting model to replace some of the traditional but perhaps seldom used information with more meaningful information on cash flows, on key performance indicators and business value drivers and to better harness the power of technology in the reporting and data analyses processes.

All of us in the reporting supply chain have a vital role to play. So what are we at the FASB doing to fulfill our mission and to play our important role in helping improve financial reporting and restore confidence? The answer is many things—both in regard to specific technical areas and in terms of our own operations and the whole approach to, structure of, and direction of standard setting in this country.

On the technical front, a year ago before the wave of financial reporting scandals, the FASB had a number of important projects under way relating, for example, to the application of the purchase method of accounting, accounting for restructuring costs, reporting on financial performance, improving disclosures relating to the fair value of financial instruments, and developing

new disclosures relating to intangibles. While some of those projects have now been completed and others continue, we've also significantly modified our agenda and priorities in direct response to issues that have come to light in the recent financial reporting scandals including accounting for special-purpose entities (SPEs), guarantees, equity derivatives and obligations settleable in shares, energy trading contracts, and the very important but broad area of revenue recognition. Let me touch on a few of these.

SPEs

This issue was very much brought into the spotlight through the Enron debacle. While, as we all know, Enron violated the so-called 3 percent rule, the whole episode clearly threw into question the appropriateness of that rule (which, by the way, did not come from an FASB standard but rather was contained in an SEC staff discussion in a Q&A supplement to an EITF issue). In early July, we issued an Exposure Draft of a proposed standard relating to the consolidation of SPEs. We held a public roundtable discussion at the end of September, and have now agreed upon a final document which should be out early in the new year. The subject is a challenging one, for SPEs cover a wide variety of structures and arrangements ranging from those used and controlled by a single sponsor in order to obtain off-balance-sheet financing (in the extreme version

the Enron-like structures that involve sham or dummy corporations set up for the sole purpose of shifting assets and financing off the books and for self dealing) to large multiparty vehicles created to diversify risks and issue market-based securities to a variety of interested investors. And, in between those extremes we find SPEs that are used for a variety of securitizations, leases, and other purposes. So you can understand that developing a single, consistent model for when those entities should be consolidated by someone else has been challenging. However, I think we have developed a workable model under which companies with investments or other relationships with an SPE would carefully need to assess their involvement in order to determine whether, in our words, they are the “primary beneficiary” of that SPE and, therefore, would need to consolidate it. The approach will set out a framework for making those assessments, and although judgment will be required, we expect that by using this model, many, but certainly not all, of the SPEs that currently are not consolidated by anyone would in the future be consolidated. We will also improve the disclosures related to the use of and involvement with SPEs.

Now I’ll say a few words on the very important topic of revenue recognition.

This is an area of continuing financial reporting problems and regular SEC enforcement actions. The existing accounting guidance, of which there is

plenty, can be found in a variety of sources emanating from a number of different bodies. That guidance has been developed to a large degree in an ad hoc fashion over the last 40 years. There is FASB literature, there are EITF consensuses, and there are AcSEC Statements of Position and industry accounting and auditing Guides. There are SEC Staff Accounting Bulletins and SEC staff announcements. It is no wonder, therefore, that there are a variety of different and sometimes apparently inconsistent models for recognizing revenue. We have, therefore, added to our agenda a major project on this whole area. Our overall objective is to develop a coherent, conceptually consistent model for revenue recognition that would replace much of the existing literature and that would serve as a principles-based source for developing future accounting guidance as new types of transactions emerge in the marketplace. We are attacking the subject from both a top-down approach of trying to develop a conceptually consistent set of principles and a bottom-up approach through cataloguing, comparing, and contrasting all the many different current methods for revenue recognition. Our timetable, a very ambitious one given the magnitude of this whole area, will be to have a final standard in about two years.

Now a few words about the use of fair value in accounting. As we know, over the past 15 or so years there has been a slow but steady increase in the use of fair

values in our standards. First this was mainly in the area of financial instruments. But more recently it has also been part of new standards in other areas, but only generally so far as initial recognition of assets and liabilities and not subsequent accounting. For example, the new standards on accounting for business combinations (FAS 141) and on purchased intangibles (FAS 142) require the identification and measurement of fair value for more items than were required under the prior standard for business combinations. And fair value is the approach for initial recognition of guarantees in our new standard on that subject and for asset retirement obligations in FAS 143.

On the one hand, I think it's hard to argue with the conceptual merits of fair value as the most relevant measurement attribute. Certainly, to those who say that accounting should better reflect true economic substance, fair value, rather than historical cost, would generally seem to be the better measure. However, on the other hand, we are also very cognizant of the potential operational difficulties, reliability concerns, and room for abuse in implementing a fair value approach for items for which there are not active markets and readily ascertainable market prices and for components in compound financial instruments. Certainly, there have been apparent abuses and reliability issues in, for example, the accounting for energy trading activities, the valuation of CMO

residuals, and the use of purported fair values in accounting for capacity swaps in the telecom industry. And, so, we have been discussing these issues and concerns with many groups—preparers, auditors, valuation specialists, regulators, and users—to better understand the issues and concerns in order to make sure that our promulgation of standards that require fair value measurements doesn't outstrip the ability of people in the real world to properly implement the concept. In fact, we are considering going a step further by formally establishing a Valuations Advisory Group to assist the Board in identifying, discussing, and resolving fair value measurement issues both as we develop new standards and in regard to implementation issues being encountered in practice relating to existing standards.

Speaking about fair value measurements, I think my brief discussion of technical topics would not be complete if I didn't touch upon the subject of accounting for employee stock compensation, including the controversial subject of accounting for stock options. I'm sure most of you know the history of this topic, so I won't repeat it here except to say these are clearly different times. Last year the International Accounting Standards Board (IASB), to the displeasure of some, took up the subject. It needed to do so, not only because of the growing use of equity-based compensation in other parts of the world, but also because there

was no existing literature in the international standards on this topic. After a year of thorough deliberations by the IASB Board, like the FASB almost 10 years ago, it has concluded that the appropriate accounting for stock options is to measure compensation for the fair value of the options at the grant date and recognize it over the vesting period. And also like the FASB, the IASB has concluded that the best way to measure the fair value at grant date is to use established option-pricing models and then make certain adjustments for the unique features of employee stock options. However, its particular set of adjustments and allocation methods are somewhat different from those under the fair value approach in FAS 123. There are also some other potentially important differences between the IASB's proposal and the approach in FAS 123. Nevertheless, the fundamental conclusions are the same.

Coming back to our shores, over the past six months and in the wake of the major financial reporting scandals in this country, we at the FASB have received numerous requests that we mandate expense treatment. Initially, most of these came from individual investors, institutional investors, and analysts as well as certain members of Congress. More recently, they have also come from some of the companies that over the last few months have announced their intention to switch to the fair value approach. Some of those companies also requested us to

change or supplement the existing transition requirement under FAS 123, whereby companies voluntarily adopting the fair value approach would have to do so prospectively; that is only for new grants of options. They do not like the “ramp up” effect this would have on their reported compensation expense and, thus, the dampening effect it would have on the trend of their earnings over the next few years. As you can imagine, we have also received letters and other input from those that oppose expense recognition. And we have received suggestions regarding the valuation techniques and potential expanded disclosures.

So what is our game plan and what are our objectives? Our objectives are simple—to come up with sound accounting and informative disclosures and hopefully do this in a way that achieves international convergence in this important area. As a first step, we have tried to deal with the transition issue in rapid fashion. To that end, we are about to issue a final statement that will allow companies that are voluntarily changing to the fair value method under FAS 123 to effect the change as currently required, on the prospective basis only for new stock options granted, and only if they make the switch before the end of 2003, or to make the change for all unvested stock options outstanding or to restate all periods presented. However, we also recognize that by allowing choices in

transition methods, we are also potentially creating some comparability concerns. Therefore, we also are requiring clearer and more prominent disclosures about the cost of employee stock compensation and the related pro forma effects on reported earnings and earnings per share and increased frequency of key disclosures from just the annual financial statements to also quarterly financial statements, so that users such as S&P with their core earnings can better make those calculations on a quarterly basis.

Our next step will be to consider whether we change the U.S. GAAP requirements relating to the accounting for employee stock compensation, including whether we should mandate the fair value approach for stock options. Again, if we are to make such a change, we would like to do so in a way that achieves as much international convergence as possible. Therefore, as the IASB released its exposure draft last month on this subject, we issued an Invitation to Comment document that explains in detail the similarities and differences between the IASB proposals and current U.S. GAAP and will solicit comments on that document. We also will take this opportunity to gather input on potential ways to improve the consistency of valuation of stock options and, as some have suggested, on whether there are additional disclosures that might be particularly informative. Our objective is to be in a position early next year to start

considering whether we change the U.S. rules. I would note that other major national standards setters around the world are going through a similar exercise on this whole subject, so that hopefully come next year we can all decide on a common approach. But, again, the overriding goal is not just convergence but sound accounting and informative disclosure. For us it is not, on the one hand, about arguments that expensing stock options would have negative impacts on capital formation or employee ownership of companies or, on the other hand, about forcing companies to expense stock options in order to promote better corporate governance and curb abuses of excessive executive compensation. Consistent with our overall public policy mission, it's about getting to the right accounting. So, in summary, we are going to have one more look at this area, try to make a decision, and then move on. As important as the subject is, I hope you will agree that there already has been enough emotional, political, and economic capital spent on it.

In wrapping up my comments relating to technical matters, let me say that beyond the immediate issues of the day, I believe there are also a number of other areas like lease accounting and pension accounting that warrant our attention as well as broader matters relating to enhancing and modernizing the current reporting model, some of which I will touch upon in a few minutes.

I now would like to discuss some of the major issues, challenges, and opportunities facing not only the FASB as an organization, but U.S. accounting standard setting in a broader context. In order to get a better handle on this before joining the FASB, I spoke with many, many constituents, current and former FASB members and senior staff, our Trustees, members of our Advisory Council, many members of Congress, officials at the GAO, the Treasury, and Federal Reserve Board, the SEC and other regulators, and many others familiar with the FASB and financial reporting to discuss their views on the subject. As you can imagine, there were a variety of perspectives and in some cases significant differences in views. For example, many in the corporate community feel that the FASB has not been sufficiently responsive to their concerns about disclosure overload, operationality and cost-benefit, and particular accounting approaches that, in their view, do not properly reflect the operating realities of their business. On the other hand, users and many in Congress seem to feel the opposite. Rightly or wrongly, they feel that the FASB and the SEC have been overly accommodative to the corporate community and have permitted too many exceptions in standards and rules and too much flexibility that have enabled off-balance-sheet financing, inadequate disclosure, and form over substance transactions to proliferate. Implicit in these comments is a view that standard

setters have been too focused on the views and needs of preparers and auditors and must be more attune to the needs of investors and other users of financial information.

On the positive side, just about everyone I spoke with agrees that the FASB should be independent. But Congress and users emphasize that independence more in terms of freedom from undue influence from the corporate and audit communities, while those groups are fearful that the FASB might effectively become an arm of the federal government and subject to all the attendant political pressures. In that regard, I think that the Sarbanes-Oxley legislation strikes an appropriate balance. While providing for mandatory funding of the FASB, it also clearly emphasizes that such is not intended to federalize the organization or to put it in a position that would subject it to political pressures. Time will tell whether that balance is achieved in practice.

Most people seem to believe that international convergence of accounting standards across the major capital markets of the world is a highly desirable goal, and many also support a move toward a more principles-based system feeling that our standards have become too complex and too detailed with too many rules emanating from too many bodies. However, many I spoke to are

considerably skeptical about whether a principles-based approach could work in this country. Finally, many are critical that the FASB has been too slow in identifying and dealing with emerging problem areas, and, there is a general urging to the FASB that as the independent and primary accounting standard setter in this country we need to take more responsibility and control of the overall situation.

In order to address these many issues, challenges, and opportunities, in July, we launched a series of wide-ranging reviews covering such matters as our approach to standard setting, including our agenda setting and project management processes, whether developing a more principles-based approach to standard setting would help reduce the level of detail and complexity in U.S. standards, evaluating what we can do to more actively foster international convergence, seeking ways to increase the level of investor and key user involvement in all our activities, and addressing other internal organizational issues relating to human resources, internal processes, and constituent relations. Moreover, as part of these reviews we have been considering whether modifications in the current structure of U.S. accounting standard setting including the roles, composition, and processes of the EITF and AcSEC would improve the overall quality and effectiveness of U.S. accounting standard

setting. While these reviews are being spearheaded by the Board and our senior staff, we have been actively seeking advice from a variety of other parties. Our goal is to present a comprehensive report of our findings and recommendations to our Trustees around year-end. We already have been implementing improvements to internal processes as they were identified, and recommendations related to broader matters such as implementing a principles-based approach or to significantly changing the structure of U.S. standard setting are being discussed with key constituents, including the SEC.

So let me touch upon some of the key aspects of our reviews and findings, including what we have been doing to improve our speed and timeliness, the subject of a principles-based accounting system, international convergence, and how we see all of these things impacting on the structure and direction of U.S. accounting standard setting.

With regards to speed and timeliness, I think our Trustees took an important step recently, by approving a change in our voting requirements, whereby it now requires only a four to three vote of the Board, rather than as in the past a five to two vote, to issue both Exposure Drafts and final Statements. Additionally, we recently implemented a reorganization of our senior staff to enhance the focus

and accountability of our staff activities. Among other actions, this involved splitting the responsibilities of the single Director of Research and Technical Activities into three different roles, with one director focusing on major Board projects, another focusing on the EITF and other implementation activities, and a third focusing on internal processes, HR, and special projects. Moreover, we are conducting a thorough process mapping of all our procedures in order to identify and to hopefully eliminate those that are redundant or do not add value, while at the same time not compromising our thorough open due process. Board member John Wulff has been actively involved with this effort with the assistance of an outside process-reengineering consultant.

Those of you who may have attended recent meetings of the Board may have noted that those meetings are now longer, that we addressing more subjects and larger chunks of subjects at each meeting. We strongly believe that by spending more time together as a Board, we will increase both the efficiency and effectiveness of our work. And our meetings with constituent groups are now focused more on the identification of emerging problem areas and trends.

In terms of constituent relations, while the Board has always received significant and valuable input from preparers, auditors, and regulators, over the years we

have heard considerably less from users about their needs and views. Therefore, in order to obtain more active user involvement, we are in the process of establishing a user advisory council, and we will be initiating a series of user forums. To that end, we have gathered nominations for people to serve on that group. As part of that, I wrote a letter to the CEOs of the 25 largest mutual funds groups, the major investment and commercial banks, the rating agencies, and other groups that represent investors and other key users soliciting names of candidates to serve on the user advisory council. I am happy to report that the response has been generally good, and we expect to get the user advisory council up and running early next year. We are also conscious that with all the emphasis on public companies, we also need to make sure we are properly focusing on other important constituencies, including private companies and not-for-profit entities, and have dedicated staff resources to those areas.

Let me now move on to the subject of principles-based accounting standards. As I suggested before, many have expressed concerns that the accounting standards have become too detailed and too complex. They say it has become increasingly difficult for both preparers and auditors to stay current in order to comply with an ever expanding set of rules. Further, there are concerns that this detail and complexity has fostered a “check the box” mentality and has

encouraged financial and accounting engineering to structure transactions around the rules to attain form over substance results. And, it is pointed out that many of the standards include numerous exceptions, exceptions to accommodate the concerns of particular constituents, exceptions intended to limit the volatility in reported income, and exceptions to mitigate the effects of transitioning to new accounting standards. I believe that many of these criticisms are valid but let's also remember that the standards we currently have are largely a product of what people have asked for over the last 10 to 15 years in the context of the overall financial reporting, capital markets, regulatory and legal systems in this country and that these standards and rules emanated not only from the FASB but also from the EITF, AcSEC, and the SEC staff. People have argued that their particular "special" circumstances require exceptions in the standards, and companies and auditors fearful of second-guessing by the SEC and the trial bar have sought bright-lines, clarity, and detailed implementation rules. Accordingly, any attempt to address those criticisms by moving to more principles-based accounting standards not only must address how the FASB does this but also must address the wider issues in the system. As I previously mentioned, our series of reviews have specifically included the subject of principles-based accounting standards, and the Sarbanes-Oxley Act requires the SEC to evaluate the feasibility of implementing such an approach in the U.S.

Therefore, we have been working closely with the SEC staff on this, and in October we issued for comment a proposal on this whole subject, and we will be holding one or more public roundtables during the winter. The proposal seeks to better define what we mean by principles-based standards including the format, style, content, and level of detail in the standards and whether we need an overall standard similar to IAS 1, which guides the preparation and presentation of financial statements. While I think that some have tended to exaggerate the differences between what they see as the U.S. rules-based approach and the more general or principles-based approach in other parts of the world, I also feel that there are some real differences. To me it's a matter of where you start, where you stop, and what's your home base. Under a principles-based approach, one starts with laying out the key objectives of good reporting in the subject area and then provides guidance explaining the objective and relating it to some common examples. While rules are sometimes unavoidable, the intent is not to try to provide specific guidance or rules for every possible situation. Rather, if in doubt, the reader is directed back to the principles. And there are few, if any, exceptions to the principles. The proposal also touches on the implications of moving to a principles-based approach on the role, approach, and processes of the EITF and AcSEC and on the FASB's own implementation activities. Finally and very importantly, it examines the implications for the

behavior and actions of other parties in the financial reporting system, because successful implementation of a principles-based approach would require some major changes in ingrained behavior by virtually all constituents. In short, it requires preparers, auditors, audit committees, and boards to be willing to exercise professional judgment and to resist the urge to seek specific answers and rulings on every implementation issue and to view accounting and reporting as an exercise in good communication and not just compliance. It requires investment bankers and the accountants and lawyers that work with them to stop trying to invent ways to create products and structures to loophole standards and it necessitates that the SEC staff temper demands for bright lines to facilitate their review and enforcement activities. Moreover, it may also require some changes to the legal and litigation framework surrounding financial reporting and auditing.

Having been an auditor both in the U.S. and in the U.K and a standard setter both in U.S. and at the IASB, I believe that there are many potential advantages to a more principles-based approach if properly implemented including:

- Allowing (some might say forcing companies and auditors) to exercise professional judgment thereby enhancing professionalism in both the reporting and auditing of financial statements;

- Having accounting standards that are easier to understand and that focus more on economic substance;
- Reducing the opportunities for form over substance structuring and arbitraging of rules because there would be fewer exceptions to the principles and because of the reduction in the number of potentially conflicting rules;
- Helping avoid the potential double jeopardy that preparers and auditors could face in situations where compliance with detailed rules may not be sufficient to avoid enforcement and litigation if the substance is lacking;
- Making it easier to converge with the IASB and other major national standards that already use more of the principles-based approach.

On the flip side, however, there are some important potential disadvantages. Many that point to recent events in the U.S. say that companies and auditors cannot be trusted to properly exercise professional judgments and that comparability could be reduced both because different good faith judgments about the appropriate accounting treatment can occur on similar facts and because the generality of standards leaves more room for different interpretations by preparers and accommodations by auditors. And it may also be harder to properly enforce a principles-based system. It would also likely require more disclosures in financial statements explaining how a company

implemented the particular principles. In the end I believe whether or not implementing a more principles-based system is worth the effort will depend on whether it results in financial statements and financial reporting that are more useful, that are more understandable, and that are more trustworthy to investors and other users. I personally favor such an approach, but I do not discount the hurdles in properly implementing it in this country. In that regard I'm reminded of Jack Nicholson's line in the movie *A Few Good Men* where when asked by Tom Cruise who was interrogating him in the court martial scene, "Isn't that the truth?" Nicholson retorts, "You want the truth, you can't handle the truth." The question is whether in the U.S. we can handle a more principles-based approach.

As I noted, a more principles-based approach could help in the drive for international convergence between the U.S. and other parts of the world. Clearly, the growth of cross-border investing and capital flows and a growing endorsement of international standards in many parts of the world mean that, on the one hand, the U.S. cannot go it alone in terms of development of accounting standards and, on the other hand, the development of international standards across the major capital markets of the world requires that the U.S. be a very active participant in the process, for there can be no truly international accounting standards if the largest capital market in the world, the U.S., is not

part of their development. Accordingly, we have been dedicating significant resources at various levels to this effort, including developing procedures and protocols used not only by the FASB but also by the IASB and other major national standards setters in working together, working with the IASB on several major joint projects including business combinations, revenue recognition, and reporting on financial performance, and closely monitoring the progress of the IASB on other key projects. Moreover, recently we have also agreed to try on the best-efforts basis to align our agendas and finally, and very importantly, we have agreed to undertake a specific project with the IASB and with the help and support of the SEC staff aimed at accelerating the convergence process by trying to eliminate or narrow some of the areas of difference between current U.S. and international standards. Since there are literally hundreds of differences between U.S. GAAP and international standards, realistically, this effort will still be ongoing, well, beyond 2005 when Europe adopts international standards en masse. But we need to set this process in motion now if we are to get to the Promised Land.

For the FASB, this is a major area of activity that is logistically challenging and that necessitates increases in both our people and monetary resources, but we need to do it. I think the trick is to do it in a way that does not significantly

delay or dilute our efforts to improve U.S. standards and that, by working with our international colleagues, results in better standards that can be applied both here and across the major capital markets of the world. And while most people seem to support international convergence, we all recognize that it won't be easy to achieve because by definition it will involve choices between existing standards, and thus changes to both U.S. GAAP and international standards are inevitable.

So what does all this imply for the structure of U.S. accounting standards setting? Well, as I said before, many are concerned not only with the volume and complexity of U.S. standards, but also with rules coming from many different bodies. Indeed, it is true that over the past 25 or so years we've had something of a four-legged stool in this country in terms of accounting standard setting. There's been the FASB as the primary standard setter. There also has been AcSEC as a senior standard setter. And although AcSEC was tasked generally with addressing particular industry matters, it also from time to time got into developing standards on much broader topics. There is also the EITF to address emerging issues and areas where there appears to be differences in particular interpretations in practice. And, of course, there is always the SEC staff. And the standards and rules that make up U.S. GAAP have been

promulgated in a variety of different forms—FASB Statements, FASB Interpretations, and Technical Bulletins, FASB staff announcements and Implementation Guides, APBs and ARBs, AcSEC Statements of Position and Industry Audit and Accounting Guides, EITF Consensuses, SEC Staff Accounting Bulletins, Accounting Series Releases, Financial Reporting Releases, and SEC staff speeches and announcements. In looking at this whole issue, we believe that many of these concerns are valid and that the FASB as the primary accounting standard setter needs to take responsibility for addressing this whole situation and as needed realigning the structure of U.S. standard setting. We feel that structural changes are necessary in order to better control the proliferation and consistency of standards and rules and, in line with the movement toward international convergence, to ensure that as new U.S. standards are developed they do not unnecessarily create new areas of divergence between U.S. GAAP and international standards. Further, if we were to go to a more principles-based approach, it would be important that the work of any other bodies be consistent with that approach and not undermine it. To their credit, about a year ago the SEC staff indicated that they would try to fore bear as much as possible from setting standards either through speeches or staff announcements and even wherever possible via formal accounting releases.

So what are we proposing? First, while we are very appreciative of the valuable contributions by AcSEC over the years, we have concluded that its role as a second senior level GAAP standard setter should, after a transition period, be discontinued, and that the maintenance and development of any industry-based standards in the future should reside with the FASB. So while the AICPA may choose to continue to issue industry accounting and auditing Guides by way of implementation guidance, it would cease issuing Statements of Position that create new GAAP. Like AcSEC, we would fully expect to actively use the work of properly constituted industry-based task forces to assist us in our efforts. We are currently working with the AcSEC chair and the AICPA staff to fashion an orderly transition plan.

With regard to the EITF, we believe it continues to serve a very valuable function in helping surface and resolve emerging and troublesome practice issues. But we also think more direct involvement by the FASB in the EITF's agenda, in the course of its deliberations, and in ratifying its final consensuses is in order. In this way, we believe we can continue to obtain the benefits from this group while at the same time making sure that its activities and conclusions are consistent with those of the FASB. Further, we are hoping to broaden the

composition of the EITF to include one or more user representatives to ensure that the user perspective is properly considered in its deliberations.

Lastly, I would like to say a few words about the subject of business reporting and the broader realm of corporate reporting, modernization of the reporting model including greater disclosure of nonfinancial information, key performance metrics, and information on business value drivers, as well as the whole subject of electronic delivery and XBRL. As you may know, I was the coauthor of a book a couple of years ago entitled *The ValueReporting Revolution, Moving beyond the Earnings Game*, which strongly urged the private sector to move forward quickly toward modernizing the whole reporting system. And, as you may know, the FASB led a major project called the “Business Reporting Research Project,” which included three separate legs: first, a survey across a number of industries of current practices in voluntary disclosure of key nonfinancial information, second, a report on electronic distribution of financial and other information, and, third, a project that I actually chaired aimed at eliminating redundancies between current SEC and GAAP requirements and streamlining information provided in disclosure documents. As you can tell from all my comments today, we at the FASB are currently very busy just with regard to financial reporting and while we stand

ready as appropriate to assist in the further development of the broader area of corporate reporting, my honest assessment is that currently we neither have the resources nor are the best positioned to lead such efforts. Rather, I think it is up to the private sector, and I think the AICPA has an important role to play, to cooperatively work together toward these goals. I also think that some regulatory stimulus, for example, through the SEC establishing a broad requirement for companies to make some disclosures relating to their primary business value drivers and the key performance metrics they use to measure progress and performance, would also go a long way to getting the ball rolling in this area. Further, I feel that the “click-down” model that the SEC was talking about a year ago that would use technology to enable differential levels and types of reporting is certainly worth investigating further.

Well, that’s my not so brief summary of the many things we are up to at the FASB in trying to meet the challenges and opportunities that face us and that face the financial reporting system. I hope you will agree that it is not as business as usual and that we are on the right track. On the technical front, we have been dealing with some of the problem areas that have been highlighted in the recent scandals such as SPEs and revenue recognition, while at the same time trying to move the ball forward in terms of the future of financial reporting

in such areas as reporting on financial performance and disclosures relating to intangibles. We are working hard to improve the speed, timeliness, and overall effectiveness of our own operations, we are proactively working to bring about international convergence, and together with the SEC we are exploring the feasibility of a more principles-based approach in this country. And, in line with all this, we are proposing a significant revamping of the standard-setting structure in this country. If I had to summarize what we are doing, I think it is all about three things – improvement, simplification, and convergence. Those are the strategic imperatives that are driving our agenda and that will shape our future standards and hopefully the future of US financial reporting.

In concluding, let me return to my opening comments. The overriding goal must be improvement of the overall financial and corporate reporting system in this country. That's what it's all about—sound, transparent information that the system needs to work effectively. All of us who are players in the system must rededicate ourselves to that proposition, we must work together toward that objective, and we must rise above short-term self-interests and recognize that some old ways of doing things need to change. I think the investing public is demanding this, the capital markets expect it, and I believe that our country deserves nothing less.

Thank you.