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Plenary 2

Accounting and Auditing – An International Perspective

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Remarks of Commissioner Roel C. Campos
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I. Introduction.

Good morning. At the outset, I'd like to thank M. Damodaran for being such an excellent host to this conference. In addition, it's definitely a pleasure to be part of such a distinguished panel, and I appreciate all of the work that Arthur Doctors van Leeuwen has done in organizing the topics for it. In any event, before I begin, I must remind you that the comments I make today are my own and do not reflect the opinions of the staff or the other Commissioners of the Securities and Exchange Commission.

II. A Critical Mass?

Let me start by noting that in the nearly five years in which I've worked with IOSCO, I've never seen more interest with respect to the growing globalization of the securities markets and international securities regulation than in the last few months. Perhaps this is just an American perspective and that we're just late to the party, but I do sense that we may be approaching critical mass on some of these issues.

Of course, much of what I'm referring to does not directly involve audit or accounting standards, but rather concerns the fact that there has been increasing globalization of the securities markets. Most notable is the recent NYSE-Euronext merger, which I think will add significant pressures to the desire for seamless global securities trading and will likely bring requests from the combined entity to allow the sale of listed European securities in the U.S., and vice versa.

Further, SEC staff – notably, Ethiopis Tafara, the head of our international affairs office, and Erik Sirri, the head of our market regulation division – have written and spoken about mutual recognition and cooperative approaches with other jurisdictions and their regulators, particularly with respect to foreign trading screens and foreign broker-dealers. As I've noted previously, there is much promise in these ideas, and hopefully we can see a rule proposal at the SEC, perhaps before the end of the year.

I also think it is time to consider the broader issue of mutual recognition and to what extent this could be accomplished. That said, there are many issues to be worked out, particularly with respect to the ability of regulator to maintain regulation and standards over domestic issuers. Specifically, if reporting standards are different in the foreign jurisdiction, it seems inevitable that a domestic issuer would question why they should be subject to more demanding standards. The critical question thus becomes whether a regulator can successfully impose more demanding standards on domestic issuers than it imposes on foreign issuers whose securities are freely sold through screens.

Questions like this are why many of us have urged a reasonable degree of convergence before embarking on any of the discussed approaches. And that is my point here: convergence is possible and doable, especially when the underlying realities of the

global securities markets drive the process. It's one thing to propose one set of standards and convergence when the world is not ready for them. But if one can clearly see the benefits of international standards and convergence, then we are a long way down the road to making it happen. That said, nothing will be easy. Great things can happen. But it will take time; it will take the efforts of many people; and it will take international will and cooperation.

III. The Roadmap – Elimination of Reconciliation.

Let me talk about convergence as it relates to accounting and auditing topics. I'll start with the "roadmap" outlined by former SEC Chief Accountant Don Nicolaisen back in 2005. The roadmap outlines the path toward eliminating the need for non-U.S. companies to reconcile to U.S. GAAP the financial statements they prepare pursuant to IFRS issued by the International Accounting Standards Board (IASB). This would obviously be extremely beneficial to foreign private issuers, and this is another topic where the SEC is trying to eliminate barriers and to promote convergence of standards in the international arena. However, I want to caution that IFRS-GAAP reconciliation – and the elimination of the reconciliation – is still a work-in-process, not just for the U.S. but for others as well.

The good news is that the SEC is absolutely committed to doing what we can to facilitate meeting the goals of roadmap. To reiterate my theme, I think there has been increased focus on the roadmap given the fact that globalization issues have moved to the forefront over the past year. From the standpoint of the U.S., we hosted an IFRS roadmap roundtable at our SEC headquarters a few weeks ago. It was designed in large part to raise the profile of the roadmap in the U.S. At the roundtable, our Chairman Chris Cox and EU Internal Markets Commissioner Charlie McCreevy both affirmed their commitment to eliminating the need for reconciliation between IFRS and U.S. GAAP. So, the U.S. is serious about the roadmap and the timeline, and we're trying to make it work.

I should also point out some provocative new ideas that were bandied about at the roundtable. These ideas definitely moved beyond the main topic about when the SEC would accept IFRS financial statements without reconciliation. In particular, there was a discussion about whether U.S. companies – not just foreign private issuers – should be given a choice to use IFRS or U.S. GAAP. Given that the roadmap contemplates that foreign private issuers have such a choice, it certainly raises a legitimate question about whether U.S. companies should also have that choice. Interestingly, when the question was put to Don Nicolaisen, who was spurred on by Chairman Cox, he responded by stating that the SEC should consider requiring that all U.S. companies use the same standard as foreign companies, and not merely giving them a choice.

Very interesting. This is yet another topic in which people have expressed a willingness to consider previously taboo or unheard of subjects. But, frankly, it makes a great deal of sense. If one looks out over a long horizon, it's hard to argue that one set of accounting standards is not an ideal that we should be aiming at. It certainly seems to me that this would be best for a global marketplace, and would make ideas like mutual recognition more feasible. Now, obviously, there will be difficulties, limitations and constraints. And at this point it's tough to commit to something like this. It's not easy to go from a system of many to a system of one. But, as in other areas of the financial world, momentum is building. If people aren't willing to at least talk about embracing a global standard, then we should explore why not.

Let me briefly discuss a more current topic with respect to the roadmap. In particular, as our Deputy Chief Accountant Julie Erhardt has noted,¹ there has been a notable lack of foreign private issuers filing audited financial statements with the SEC that either use or are compliant with IFRS in the manner in which it is issued by the IASB. We had expected to see approximately 300 or so companies file their 2005 financial statements prepared using IFRS. Instead, we received only about 40 filings – hardly a critical mass. This fact is perplexing, given that the early goal is – to quote the roadmap itself – “to see convergence in action.” So, the question is: why did only 40 companies so file?

There are likely a number of different reasons, and I’ll focus on just one here. That is, in many cases, financial statements prepared in accordance with home country adaptation of IFRS did not also contain a reference by both the company and its auditor that the financial statements also complied with IFRS in the form issued by the IASB. Indeed, the roadmap contemplated that we would see filings of financial statements prepared using IFRS **as promulgated by the IASB**. However, various jurisdictions have not accepted IFRS exactly as promulgated by the IASB, and have instead made various changes thereto. Consequently, we have seen filings containing financial statements based upon national jurisdictional adaptations of IFRS. These financial statements certainly fit within the SEC’s filing requirements, but without the reference to IFRS as promulgated by the IASB, they do not appear to be financial statements that fit under the one set of global accounting standards that we wrote about in the roadmap.

Now, we certainly understand why a jurisdiction may wish to adopt its own version of IFRS. After all, we have U.S. GAAP. However, one goal of the roadmap was to allow the elimination of the reconciliation requirement, and as a consequence, have two versions of robust standards developed by independent standard setters in the U.S. capital markets, not thirty different versions. The question then occurs: how do we reach the “critical mass” – to use a term from the roadmap – of filers using IFRS as promulgated by the IASB? What will happen this year – year two of the roadmap? While the answer is not clear at this time, I think that serious discussion by issuers with their auditors may be necessary. I am hopeful that auditors could prepare opinions stating that the audited financial statements were prepared according to IFRS as promulgated by the IASB, and not solely the “Jurisdiction X IFRS.” In any event, we need to get to the bottom of this issue, and see more companies filing audited financial statements in the manner contemplated by the roadmap. My bottom line, though, is that the roadmap is going well overall and that we will achieve our objectives.

IV. Auditing/PCAOB.

Let me move to the auditing front and discuss some recent developments involving the PCAOB, including – everyone’s favorite topic – the implementation of Section 404 of the Sarbanes-Oxley Act. Last week, the SEC held an open meeting to discuss and give instruction to our staff about a number of broad issues raised by commenters about proposed auditing standard #5 (AS 5), which is the standard proposed to replace AS 2. This was definitely an unusual meeting – certainly the most unusual since I’ve been at the Commission. And, I have to confess, it was probably the most free-form and unscripted meeting I’ve attended.

In any event, the purpose of the meeting was to discuss four broad issues that our staff viewed as the most significant matters that were raised by commenters about proposed AS 5. The idea behind the meeting was that the Commission would give our staff input on these matters, and

¹ See Julie A. Erhardt, *Remarks before the 2006 AICPA National Conference on Current SEC and PCAOB Developments* (Dec. 11, 2006), available at <http://www.sec.gov/news/speech/2006/spch121106jae.htm>.

that our staff would then discuss the input and recommended approaches with the PCAOB staff. Mark Olson, the Chairman of the PCAOB, was kind enough to attend the meeting and give us his thoughts as well.

In short, the Commission unanimously approved the staff approach with respect to each of the four issues, and hopefully the respective staffs of the SEC and PCAOB can now work to finalize AS 5 and the SEC's Management Guidance in a way that promotes effective audits while improving efficiency. In short, the Commission directed the staff to focus on these four broad areas:

- aligning AS 5 with Management Guidance, particularly with regard to the level of prescriptiveness in AS 5 and the inconsistent definitions and terms;
- scaling the SOX 404 audit to account for the particular facts and circumstances of companies, particularly smaller companies;
- encouraging auditors to use professional judgment in the SOX 404 process, particularly in using risk-assessment; and
- following a principles-based approach to determining when and to what extent the auditor can use the work of others.

I should note that while many commenters wrote letters supportive of these points, many in the institutional investor community have raised very legitimate concerns that we not weaken SOX 404. So, the SEC and the PCAOB must engage in a very deliberate and thoughtful analysis when creating final standards and guidance. In my questioning to our staff, I sought to make it clear that the SEC does not care less about investors and is not seeking merely to appease business or audit industry interests. I wanted to make it quite clear that we're not trying to roll back SOX 404 or to somehow make sure that investors never learn about material weaknesses.

Rather, the goal of the SEC – and hopefully the PCAOB as well – is to increase both the effectiveness of the audit and the efficiency in conducting the audit. If the only outcome of a proposed change to the standard is fewer disclosures to investors and less public reporting – without gains in effectiveness or efficiency – then there's no reason to make the change. I strongly favor a meaningful audit process to protect investors, and I will not be pleased with a document that simply allows for less disclosure without a more effective audit. I'm confident that we can achieve our goal, and we're off to a good start. Of course, it's early in the process of issuing final standards, and the devil will be in the details.

V. Audit Quality and Contingency Plans.

Let me make a few brief points on audit quality and contingency plans. On June 1, 2007, in Paris, the Technical Committee will host a roundtable on the Quality of Public Company Audits from a Regulatory Perspective. And just a few days ago, we discussed a working draft of a paper regarding contingency planning with respect to audit services. Both of these topics are especially important.

As regulators, our goal is to protect investors and improve the integrity of the capital markets. Investors rely on the integrity of financial statements in making investment decisions. Securities laws throughout the world vest in auditors the essential role of bestowing credibility on those financial statements. As markets become more globalized, audit quality likewise becomes a

global issue. If auditors fail to deliver a quality audit, investor vulnerability to misstated financial statements and fraudulent financial reporting can be expected to rise. The purpose of the Paris Roundtable is to examine audit quality from a global perspective, through the connection between audit quality and investor protection and confidence, and whether the current state of the audit market and potential future developments have or will affect audit quality. There will be a number of panels, and I expect that we will explore topics such as:

- the basic reasons and need for public company audited financial statements;
- whether there are other ways of assuring accurate financial statements;
- the viability of other approaches/structures for regulators to the current audit model;
- how one defines audit quality from the perspective of a securities regulator;
- whether there is a difference between regulators' and investors' expectations about an audit;
- to what extent the current organization form of audit firms stimulates quality and consistency across audit networks; and
- whether independent audit oversight boards have affected audit quality.

Audit contingency planning is also critical. We're now down to four major accounting firms, and an event negatively affecting the continuity of audit performance by another major audit firm has the potential to interrupt financial statement reporting for issuers and create a lack of confidence among investors. Given this, it is imperative that regulators across the world seriously consider contingency planning in this regard. The Technical Committee is in the midst of this, and we need to get out in front of this issue. Right now, we're in the midst of working on a contingency plan paper. I expect that it will consist of general guidance and broad suggestions as to how such plans may be written by securities regulators. I am sure that it will not be overly specific, because contingency plans may be confidential and because of the differences among the laws of the different countries. Stay tuned.

VI. Conclusion.

Thank you very much for listening – I think I've used up all of my allotted time. I'd be happy to answer any questions.