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Keynote Address on Recent International Initiatives
2008 Sarbanes-Oxley, SEC and PCAOB Conference
New York State Society of CPAs
New York City

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September 10, 2008

I am honored to have been invited back to the New York State Society of CPAs. This is a challenging, but rewarding, time to be an accountant. The profession has experienced many changes since the Enron debacle in 2001 and the Sarbanes-Oxley reforms, including implementation of Section 404's requirement for audits of internal control and Section 301's new audit committee requirements. Accountants and their audit clients have also reevaluated their tolerance for financial statement errors, resulting in a surge of restatements to correct latent problems that, in the past, might have been allowed to fester. In my view, the profession has emerged stronger than ever. Auditors still face challenges, but they have improved tools to address them.

Not everyone has been happy about this revitalization, though. Last year, I discussed the profession's role in the competitiveness of U.S. markets, and certain myths about whether our system of securities regulation is too strong, our accounting and auditing too rigorous, for the health of U.S. markets. Since then, numerous banks and other institutions have failed, due in part to weak regulatory supervision. The failures of Fannie Mae and Freddie Mac this week are so far the largest failures, but no one expects these to be the last. One would think talk of over-regulation would have been silenced.

Not so. Some corners of Washington continue to pursue initiatives rooted in contentions that U.S. securities regulation was causing managers to shun U.S. markets in favor of more lightly regulated ones elsewhere. To my mind, those initiatives are misguided and could weaken the competitiveness of our markets. I will focus on three of them today – switching to international accounting standards, reliance on non-U.S. regimes for auditor oversight, and converging U.S. auditing standards to those developed by the International Federation of Accountants. The ideas I express today are my own, and should not be attributed to the PCAOB as a whole or any other members or staff of the PCAOB.

I. International Financial Reporting Standards Are Not Likely to Result in Benefits to Investors in U.S. Securities or the U.S. Economy

One of the most important policy initiatives facing the auditing profession is the SEC's consideration whether to permit or require U.S.-based companies to use international financial reporting standards. On the timetable imagined, such a move would present significant implications for the auditing profession, including for example significant training costs. The larger firms have, to an extent, embraced the need to prepare for the shift and have begun the training initiative. But smaller firms today are far behind, and the move itself may further separate large firms from smaller regional firms competitively. That concerns me, as does the potential effect on investors in U.S. securities.

IFRS has been touted to investors as offering comparability; at the same time, in the competition for market share among the world's stock exchanges, some have praised IFRS's openness to manager discretion as a selling point. In my view, promoting comparability of financial reporting across companies is a noble goal, and well-worth pursuing on an international basis. But ultimately IFRS can't deliver on both promises because they are at odds with each other. Because I don't believe the current initiative will lead to more comparability, I think it should be reconsidered.

A. The Myths Associated with the Current IFRS Initiative

To explain how I've reached this view, I want to take some time today to unpack the arguments in support of the initiative. As I've hinted, it is based on a set of assertions that, when explored, turn out to be myths. They are –

- that the current initiative promotes convergence of IFRS and GAAP, a long-standing goal endorsed by the Sarbanes-Oxley Act;
- that IFRS are superior to GAAP, because they are principles-based;
- that switching to IFRS will enhance comparability of financial reports;
- that IFRS will improve investor protection; and
- that the IASB's standards-setting process is adequately protected from influences unrelated to the quality of standards.

1. The Current Approach Undermines Efforts to Converge U.S. GAAP and IFRS

First, let's look at how the current initiative affects the effort to converge IFRS and GAAP, including the effect of recent regulatory actions already taken. The FASB and the IASB have pursued a strategy of convergence for several years. The joint FASB-IASB projects have been designed to foster comparability

between two vastly different reporting systems, by taking the best of both sets of standards and improving them still.

At the same time, standards-setters must be mindful of the environment in which their standards will be applied. In the U.S., we face unique risks from financial reporting failures. We have the highest personal investment rate in the world, with more than half of U.S. households investing their savings in our markets. We use such investments to provide for retirement more than any other country. And a significant portion of our population is approaching retirement.

The standards-setters' jobs are to fashion standards appropriate for their respective environments, build on each other's ideas when it makes sense, and promote comparability in as many aspects of reporting as possible. We have measured progress on convergence by looking to the SEC's requirement that non-U.S. companies reporting under IFRS reconcile their financial reports by disclosing net income and equity as it would have been reported under U.S. standards. What gets measured gets done; the reconciliation not only measured convergence, it drove it by exposing differences.

And then politics entered the picture. Ostensibly intending to promote convergence, political forces shifted convergence off its course. On April 30, 2007, the U.S. and the EU endorsed a Framework for Advancing Transatlantic Economic Integration, as part of a meeting among European Council President Angela Merkel, European Commission President Jose Manuel Barroso, and President Bush.[1] That framework included a commitment to promote "conditions for the U.S. Generally Accepted Accounting Principles and International Financial Reporting Standards to be recognized in both jurisdictions without the need for reconciliation by 2009 or possibly sooner." Shortly thereafter the SEC eliminated the reconciliation requirement from its rules.

Non-U.S. companies applauded the change, but investors generally did not. Studies consistently show that the reconciliation captured value-relevant information.[2] Moreover, research shows that IFRS reporting itself has not yet resulted in convergence with, or comparability to, U.S. GAAP.[3] There may be countervailing political benefits from the bilateral arrangement to eliminate reconciliations in both Europe and the U.S. But no one should mistake that elimination of the reconciliation makes convergence harder, not easier. Without reconciliation, we will know less about whether IFRS and GAAP are converging.

The standards-setters continue their work. But the elimination of the reconciliation signaled a substantial shift in approach. Henceforth, IFRS will be treated as sufficient for U.S. markets, regardless of differences from GAAP. And as the SEC proposed last month, the new strategy would switch U.S. companies to IFRS entirely, effectively eliminating GAAP.

Perhaps the most candid explanation for the new approach was provided by FASB Chairman Bob Herz, who said recently, "We do have the best reporting system, but the rest of the world will not accept it."[4] The truth is that the new approach is not about convergence, but about capitulation. It's an exit strategy. It's not a way of gaining comparability, but a way of getting away from GAAP. It does not address the real challenges we face. And therefore it's not going to take us where we need to go to achieve comparability in financial reporting.

2. IFRS Are Not More Principles-Based Than GAAP

Let's turn to another common misconception – that IFRS are better than GAAP because IFRS are principles-based, whereas GAAP is rules-based. The reality is that IFRS are not more principles-based, they are just younger.

IFRS allow considerable flexibility to choose among multiple approaches to reporting financial information. This makes accounting under IFRS more variable, not more principled. The variability may, in part, reflect the range of uses for accounting in different countries, including calculating taxes and gathering statistics for government analysis, in addition to (and in some places perhaps more important than) communicating financial information to investors.[5] As the IASB sorts out these different goals, I hope it will introduce more comparability in information reported for investment purposes. That would make IFRS more useful to investors, not less principles-based. IFRS would also then be more rigorous, although some might call them more rules-based.

Nor is accounting in the U.S. less principles-based. GAAP may be relatively more detailed, but it rests on a conceptual framework of principles, as well as the fundamental principle of the federal securities laws prohibiting misleading disclosure. Indeed, managers choosing IFRS for their flexibility may be surprised to learn that, in the U.S., compliance with IFRS will be no defense if they have nevertheless misled investors.

The 1969 case, United States v. Simon, is instructive.[6] There, the Second Circuit upheld the conviction of three Coopers & Lybrand auditors for their role in the Continental Vending fraud, rejecting the auditors' argument that they could not be found guilty if the company's disclosures complied with then-existing accounting standards. In a thoughtful opinion by Judge Henry Friendly, one of the most respected jurists in U.S. history, the Court affirmed the trial court's decision that proof of compliance with GAAP was "not necessarily conclusive that [the auditors] acted in good faith, and that the facts as certified were not materially false or misleading."[7] Recently, the Second Circuit reaffirmed this principle in cases involving Bernie Ebbers, the CEO of Worldcom, and the Rigases, who perpetrated the Adelphia fraud.[8]

The Simon ruling led to a proliferation of calls for more detailed accounting guidance, for two reasons. First, the ruling all but invited such requests, by

suggesting the auditors of Continental Vending might have had a stronger legal argument had they been able to point to specific rules or prohibitions addressing the circumstances at issue.[9] Moreover, and even more important in my view, Simon taught preparers and auditors subject to the U.S. federal securities laws that the supposed flexibility of broad principles can be dangerous. This flexibility can tempt management to present a rosier picture than justified, on the ground that the standards don't expressly prohibit the presentation management prefers.

"Tell me where it says I can't do what I want." This is a long-standing refrain in the quarterly dialogue between preparers and auditors. And it will only get louder under IFRS. Indeed, IFRS's "scope for interpretation . . . remains colossal," as one European asset manager has complained.[10] As preparers and auditors in the U.S. have learned from Simon and its progeny, this discretion will set a trap for the unwary if we switch U.S. companies to IFRS prematurely.

3. Switching to IFRS Will Not Enhance Comparability in Financial Reporting

This leads to another claim that in my view is not correct – that worldwide adoption of IFRS will provide comparability and make GAAP obsolete. We need only look to the EU's recent implementation of IFRS to see this. As a recent survey of French institutional investors revealed, even after many European companies were required to use IFRS, they did so in name only, while in fact they continued to report in what the survey called "nostalgic accounting" based on their home country standards.[11] In some cases, the surveyed investors felt the use of such "nostalgic accounting" was encouraged by local regulators.[12]

This is where the two objectives I discussed at the outset – comparability for investors and flexibility for managers – conflict. Calls for U.S. regulators to acknowledge that IFRS are not designed to achieve comparability have already begun. For example, the AICPA has said that "a decision by the SEC to permit an IFRS option should carry with it an expectation by regulators and investors that the use of reasoned, professional judgment *may yield different outcomes in similar circumstances more often under IFRS than U.S. GAAP.*[13]

Comparability is also affected by cultural differences. There is nothing unique about IFRS that addresses these differences to make reporting more comparable. Research by Ray Ball of the University of Chicago and others has explored the connection between standards and comparability of reporting in depth. In their words, claiming that uniform standards produce comparable results is "substantially and misleadingly incomplete, because financial reporting practice under a given set of standards is sensitive to the incentives of the managers and auditors responsible for financial statement preparation."[14] They found "changing manager and auditor incentives is more important than mandating foreign accounting standards."[15] And thus they concluded that "international differences in reporting incentives inherently limit the extent to

which international comparability of accounting information can be achieved through homogenization of accounting standards alone."[16]

Research by Christian Leuz on use of IFRS in Europe reached a similar conclusion. Together with Luzi Hail of Wharton, he examined IFRS statements by European companies and determined that –

> The way in which firms use th[e] discretion [in IFRS] is likely to depend on their reporting incentives, which are shaped by many factors, including countries' legal institutions, various market forces and firms' operating characteristics. As a result, it is not clear that the adoption of IFRS itself materially shapes firms' reporting behavior and hence that it does make corporate disclosure more informative or more comparable.[17]

If IFRS are not going to deliver comparability, then claims that GAAP is obsolete are misplaced as well. As the European asset manager I mentioned earlier put it, "if IFRS do not provide for sufficient comparability, US GAAP might regain popularity because they at least impose the same rules on all issuers!"[18]

4. IFRS May Weaken Investor Protection in the U.S.

For years, investors outside the U.S. have relied on the U.S. regulatory system to make up for weak local regulation. As recently as June 2007, Canada's Minister of Finance Jim Flaherty lamented that "some Canadian investors consider it necessary to rely on the United States to hold companies to account for their actions."[19]

One of my concerns about the current IFRS initiative is that it would circumvent existing investor protections without replacing them with anything even near adequate, given how heavily invested our populace is and how important strong capital markets are to our economy. The link between investor protection and economic growth is well documented. Our tough accounting standards, rigorously enforced by regulators as well as auditors, give investors the most comfort available (albeit insufficient in some cases) that the information they use to evaluate corporate performance is meaningful and reliable.[20] This reduces investors' agency costs, and in turn reduces the cost of capital.

The current IFRS initiative would delink us from our regulatory model, not only by loosening our standards to allow more manager discretion, but also by weakening enforcement. Expressly allowing interpretive discretion weakens the enforceability of a standard. For some, this is a welcome, indeed intended, change. As reported in BNA last month, the Chairman of International Accounting Standards Committee Foundation has stated that, based on his involvement in the initiative, he believes that the U.S. approach to enforcement will change to be more deferential to managers. Asserting that stringent

enforcement is very specific to the U.S. financial reporting arena, he said, "the SEC realizes that [its] attitude should change."[21]

If this is true, I believe it is short-sighted. The SEC's commitment to enforcement, and the development of enforceable standards, is key to preserving investor protection, as well as the low cost of capital that results from robust investor protection.

5. IFRS Are More At Risk from Lobbying and Other Political Pressure than GAAP, Not Less

For the reasons I've explained, IFRS are not inherently better for us than GAAP. Nor will they be in the future, unless the IASB and those charged to oversee it demonstrate an unwavering commitment to protect it from influences unrelated to high quality standards-setting.

Moving to IFRS is often offered as an easier path than facing the weaknesses of our own system. After more than 70 years of experience facing calls for exceptions and carve-outs from industry lobby groups, political forces, and others, U.S. accounting standards are indeed pocked with the scars of compromise. Make no mistake: that is a problem we must confront.

IFRS are not as battle-worn, but they will face the same attempts at influence that the FASB has. They already have, as demonstrated by records uncovered in a 2002 congressional inquiry, which revealed that Enron was evaluating how much influence a $500,000 donation to the International Accounting Standards Committee would have bought.[22]

It is just these concerns that motivated the Sarbanes-Oxley Act's provision on accounting. That provision, Section 108, requires the SEC to determine that a private accounting standards-setter has satisfied certain criteria before the SEC can recognize its accounting principles as generally accepted for purposes of the U.S. securities laws.[23] One of those criteria is independent funding via Sarbanes-Oxley's mandatory fees, which is how the FASB has been funded since 2003.

Another is that the standards-setter considers "the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors." This is an important decisive factor. It shows that the Congress was well-aware of the convergence movement and intended, through Section 108, to establish the approach the SEC should follow to evaluate the IASB and its standards. The IFRS revolution was not, as some would have it, unanticipated by the Act.[24]

Section 108 has largely been ignored in the policy debate. The IASB's funding mechanism does not comply with Section 108. Recently, there has been some discussion about reforming the structure of the IASB. But unfortunately,

this discussion has focused mainly on *establishing* mechanisms to give interested governments influence over standards-setting. One remembers the EU's frustration with its relatively weak tools to shield local banks from having to comply with IAS 39. Whether the influence comes from companies directly or indirectly through their government representatives, this is precisely the kind of influence that should be prevented, not institutionalized.

B. Investors and the U.S. Economy Would be Bettered Served by a Policy that Promotes Comparability, Quality and Strong Enforcement

The current initiative to expand IFRS has momentum, despite these failings. If we paused to look for a better course, even hypothetically, where should we go? In my view, the research I've referred to shows us the way. Here's what it suggests to me we should do.

First, if the goal of IFRS is to establish internationally comparable financial reporting, then we should stop pursuing an agenda of enhancing management discretion and instead write accounting standards in a manner that fosters, indeed requires, comparability.

Second, we need to deal with the debilitating effect we allow lobbying and other political influences on standards-setting to have today. Funding is the start. Whoever sets the standards should be independently funded. If the IASB wants its standards to be considered for use in the U.S., it should present a plan for independent funding for the SEC to consider under the framework set forth in Section 108. And then we need to go beyond funding, and focus on adopting and sticking to national policies of protecting the standards-setter, whether it's the FASB or the IASB, from influences unrelated to the quality of its standards.

Third, we should return to a policy of convergence, not planned capitulation. The focus should be on quality, not speed. Instead of using timetables to drive substantive milestones, we should use substantive milestones to drive timing. To my mind, the best roadmap is the one established by Sarbanes-Oxley itself. We should establish milestones related to convergence such that, when the SEC is ready to determine that IFRS should be treated as "generally accepted" for purposes of U.S. securities laws, no one cares. That is, GAAP and IFRS should be virtually identical by that time, and no training or preparedness milestones should be necessary.

Finally, we should acknowledge and address counterproductive reporting incentives that will undermine *any* reporting regime. The best way to combat bad incentives is to create a stronger counter-incentive by enforcing the standards. We need to acknowledge that enforcement is the reason for the benefits that companies get from a U.S. listing, *not* a detractor to the supremacy of U.S. markets.

Enforcement comes in many forms. It includes administrative, civil and criminal actions, when appropriate. And it also includes rigorous auditing and regulatory reviews, such as those by the SEC's Division of Corporation Finance. Private enforcement also plays an important role. We need to use all those tools. In doing so, we will give investors more confidence in reporting by both U.S. and non-U.S. companies, helping them improve their cost of capital.

This leads me to the two other initiatives I want to cover. At present, I am concerned that, as we speed toward IFRS, we are *not* preparing to enforce them with strong auditing. Specifically, the PCAOB has proposed placing "full reliance" on inspections of non-U.S. auditor oversight bodies, which among other things would balkanize a significant part of the enforcement of auditing requirements. In addition, there is some talk of reconsidering the PCAOB's decision to develop its own auditing standards and instead deferring in some manner to standards set by an international professional association.

II. The PCAOB's Proposal to Place "Full Reliance" on Inspections of Non-U.S. Auditor Oversight Bodies Is Likely to Reduce Economic Benefits Both in the U.S. and Abroad

Before Sarbanes-Oxley, the SEC's ability to obtain information on audits of U.S. issuers, whether U.S.-based audit clients with foreign operations or foreign private issuers, was limited and strongly resisted by the accounting profession.[25] Without such information, it was practically impossible to enforce applicable auditing standards on such audits, notwithstanding the SEC's jurisdictional authority to do so.

A. Sarbanes-Oxley Gave the SEC and the PCAOB Better Tools to Regulate Foreign Audit Work for U.S. Public Companies

Sarbanes-Oxley changed that situation, at the same time that it dramatically enhanced oversight of U.S. audit work. In particular, the Act requires firms that audit or play a substantial role in auditing the financial statements of U.S. issuers, wherever located, to register with the PCAOB. To date, 876 non-U.S. firms from 86 different countries have registered. Many of these firms are member-affiliates of one of the global accounting networks.

By virtue of registering, U.S. and non-U.S. firms alike become subject to the PCAOB's inspections. Under the Act and the Board's rules, firms that, within a specific time period, have issued, or played a substantial role in issuing, an audit report on the financial statements of a U.S. issuer are required to be inspected within a fixed minimum frequency. Just over 250 of the non-U.S. registered firms satisfy this test.

In my view, better oversight is clearly in the long-term interest of the profession, both here and abroad. But many non-U.S. firms have, at least in the short-term, not been pleased. I guess that's human nature. That displeasure moved certain political forces, particularly in Europe. Some European lawmakers and regulators overtly opposed PCAOB oversight, even of audit work performed for U.S. issuers.

The PCAOB resolved these complaints by adopting a policy of conducting joint inspections in countries where we have a counterpart to work with. In 2004, the PCAOB adopted rules to provide for coordination with non-U.S. oversight bodies, where appropriate. In particular, the PCAOB's Rule 4012 permits the Board to use the work of local auditor oversight bodies in the PCAOB's inspections. In my view, the rule was constructive, and had the potential to enhance our effectiveness, because it allowed the PCAOB to obtain insights from regulators familiar with the local culture and incentives influencing auditors. The rule also recognized that local oversight could take different forms, and have different levels of effectiveness itself. Thus Rule 4012 incorporated a sliding scale, based on the independence and rigor of the local system, for the Board to use in determining how best to work with such entities.

The PCAOB is only in the early stages of conducting the required non-U.S. inspections, whether joint or otherwise. [26] I am nevertheless cautiously optimistic that joint inspections are proving to be beneficial, by providing the PCAOB insights on local cultural challenges and leveraging PCAOB resources.

B. The PCAOB's Proposal on Full Reliance is Likely to Weaken Investor Protection and, In Any Event, is Premature

But in December 2007, the PCAOB proposed a new policy that, in my view, would undermine the benefits of joint inspections, as well as substantially impede the PCAOB's ability to enforce high quality auditing. The new policy would provide for the Board to place "full reliance" on inspections by non-U.S. auditor oversight bodies that met certain criteria.[27]

As a condition of full reliance, the policy would require qualifying oversight bodies to agree to provide the Board certain information necessary for the Board to comply with its statutory responsibilities, such as the oversight bodies inspection findings, if they were otherwise non-public. The policy would also require the other oversight body to participate in joint inspections during a transition to full reliance. After the transition, PCAOB inspectors could periodically observe the other bodies' inspections, including by requesting audit work papers. But the proposed policy statement expressed an intent that such observation would be limited and that requests for work papers would be made only in exceptional circumstances.

I dissented from the proposal. Among other reasons, few if any countries spend as much on – or devote as much intensity of effort to – enforcement of financial reporting and auditing as the U.S. does. Indeed, based on what I've seen, I am concerned that some countries may have established oversight bodies not so much for their own purposes, such as to strengthen investor protection locally, but rather to persuade the PCAOB not to conduct inspections directly. These new entities while perhaps a positive development nevertheless, tend to have extremely low budgets and be understaffed. As I described earlier in the context of accounting, research shows that variation in local enforcement intensity can dramatically affect reporting quality. Yet the proposal would effectively balkanize inspections of audits, undermining a key mechanism to enforce consistency and quality in reporting.

Moreover, unfortunately many countries still cling to a self-regulatory model. For example, the European Commission recently announced new guidance to member states on how to implement EU requirements for auditor oversight.[28] That guidance expressly provides that "[p]rofessional associations should be allowed to assist in inspections" by EU oversight bodies.[29] This is a disappointing development, which I suspect will make international cooperation more difficult and less effective.

The proposal also fails to explain how non-U.S. oversight bodies could be expected to check for compliance with U.S. standards and rules, including many important reforms unique to U.S. securities regulation, such as the internal control audit and tough auditor independence rules. As confirmed by comment letters received on the proposal, including letters from the very oversight bodies that would be relied upon, it's not realistic to think that non-U.S. authorities will have the ability or inclination to enforce such U.S. requirements.

III. Convergence of Auditing and Related Professional Practice Standards to Standards Set by the International Federation of Accountants Is Unlikely to Benefit, and May Harm, Investors in U.S. Securities and Other U.S. Economic Interests

At the same time that the PCAOB has been considering leaving inspections to local regulators, there has also been talk about whether to converge U.S. auditing requirements to standards set by a professional body of accountants called the International Federation of Accountants. IFAC is a federation of national professional bodies, like the American Institute of CPAs in the U.S., which provide member accountants and firms a range of services including accounting and auditing professional education, peer review and other professional oversight, accounting advice, and lobbying, among other things.

IFAC itself has no legal authority. But it does convene accountants and others to write best practice standards that may be used by firms and adopted, to varying degrees of modification, by national bodies that do have oversight

authority, or even governments. Among its committees, IFAC has assembled the International Auditing and Assurance Standards Board to write auditing standards. All of the international audit firms serve on the IAASB, and each professes to have incorporated the IAASB's standards in their respective global audit methodologies.

The accounting profession's efforts to develop standards through the IAASB have been constructive. In particular, the initiative has provided firms an opportunity to share lessons learned. In addition, as IOSCO has recognized, it has provided developing countries a base of standards they would not likely have the resources to produce on their own.[30] But they are by no means a substitute for enforceable standards for developed securities markets like the U.S. This is why I am troubled by the recent push to consider replacing U.S. auditing standards with IAASB standards in the U.S., or converging U.S. standards to the IAASB standards.

Unlike the IFRS debate, there are no beneficial policy objectives to be achieved by permitting auditors to establish their own requirements.[31] In financial reporting, it may be worthwhile to pursue uniformity as a means of achieving comparability of financial statements across companies, but that doesn't hold true in auditing. As I've explained, auditing is a key element of enforcement of applicable financial reporting requirements, and enforcement is our only tool of consequence to create economic benefits through improvements in financial reporting. There's no analogous benefit in being able to compare audits, though. Rather, the only goal is to have the highest quality audit that is cost-effective.

Moreover, the IAASB's standards are not appropriate for use in a regulatory context. By design, they are of limited enforceability. The standards themselves are drafted as rather vague principles; specifics are relegated to a section called Application and Other Explanatory Material. But the standards expressly provide that those materials are "not intended to impose a requirement."[32] And although some jurisdictions have pointed to ISAs as applicable to local audits, ISAs have no enforcement record in any country.

As in the case of the PCAOB's proposal to confer "full reliance" on local oversight bodies' inspections, in my view, relying primarily on the profession to set its own standards would weaken the effectiveness of audits at enforcing high quality financial reporting in our markets.

IV. Conclusion

Notwithstanding the pressure to blend with the rest of the world, we should not overlook the reasons why our financial system is different. For one thing, our economy is unique. We are a wealthy country, but compared to other wealthy countries we have a very low savings rate. Nevertheless, we put significantly more pressure on our savings, by relying on personal savings for retirement and

other expenses covered by government programs in other countries. U.S. capital markets thus serve a purpose that is fundamentally different from others in the world, in that they provide for formation of capital, and ownership, by dispersing minority interests widely, among millions of individual savers who are dependent on the preservation, and growth, of their investments for their livelihoods.

Other markets, even large ones, rely predominantly on funding by governments or private entities that hold significant blocks, and thus have monitoring and engagement powers that would not be practical in our system. But in a dispersed ownership model such as ours, strong securities regulation is necessary, not only to protect investors, but also to promote efficient capital formation. Securities regulation does this by reducing investors' agency costs – that is, the risk that, because investors do not have direct access to police management, management will use invested funds poorly or even for its own private benefits. This in turn reduces the cost of capital investors would demand to compensate for those agency costs. We have the lowest cost of capital, *because* we have the strongest system of investor protection in the world.

There would be a cost to regulating like everyone else. Lessening the rigor of our system won't attract more companies; it will only make other countries' markets more attractive by comparison.[33] Such a change would be detrimental both to investors, by reducing investor protection, and to the companies that tap our markets for funds, by increasing the cost of capital. In my view, it would also be detrimental to intermediaries, including the financial services industry generally, as well as to the long-term interest of auditors. A consistently robust system of policing is the best counterweight we have to the conflicts and perverse incentives that can damage, and spectacularly have brought down, pillars in our financial system.

It's easy to listen to the conventional wisdom today about fears that regulation may hurt American competitiveness. We've learned time and time again, though, that succumbing to such claims does not help our economy, but imperils it. As baby boomers move into retirement, we have more at risk each year. It's more important than ever that we challenge our thinking to be sure our policies work in the long run. Thank you for this opportunity to contribute today.

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[1] Bush, G. W., A. Merkel, and J. M. Barroso. 2007, Framework for advancing transatlantic economic integration between the United States and the European Union, *available at* http://www.whitehouse.gov/news/releases/2007/04/20070430-4.html. Among other things, the framework focused on the integration of financial markets and stated –

> In light of the considerable differences that exist between financial market structure and regulation on both sides of the Atlantic, and given the consolidation underway globally and transatlantically in this sector, we resolve to take steps, towards the convergence, equivalence, or mutual recognition — where appropriate – of regulatory standards based on high quality principles. In

particular, we resolve to maintain the existing informal Financial Markets Regulatory Dialogue.

[2] *See* J. Ciesielski, *IFRS & GAAP: The Urge to Converge*, The Analyst's Accounting Observer Vol. 17, No. 4 (March 2008) (finding that differences between U.S. GAAP and IFRS can be "wide, permanent and potentially misleading," that IFRS provides companies opportunities to present "new, improved earnings," and, specifically, in more than one-third of the cases studied, IFRS resulted in median decreases in earnings and equity of 8.7% and 2.2%, respectively); Gordon, E.A., B.N. Jorgensen, and C.L. Linthicum, 2007, Are IFRS-U.S. GAAP Reconciliations Informative?, working paper presented at the EAA Annual Congress, Lisbon 2007 (""US GAAP-reconciled income is incrementally informative in [the period studied, 2004 to 2006], suggesting that discontinuing reconciliation of IFRS to US GAAP result in less useful financial statements for valuation purposes"); Testimony of Teri Lombardi Yohn, before the Subcommittee on Securities, Insurance and Investment of the Committee on Banking, Housing and Urban Affairs, U.S. Senate (Oct. 24, 2007) (surveying academic research on the convergence of IFRS and GAAP and concluding that "the elimination of the required IFRS - U.S. GAAP reconciliation is premature (at this point in time) and will cause U.S. investors to possess a significantly diminished set of relevant information for investment-related decision making"); Donna L. Street, "International Convergence of Accounting Standards: What Investors Need to Know," at 13-15 *available at* http://www.cii.org/UserFiles/file/resource%20center/publications/International%20Convergence%20White%20Paper%20(Final)%2011-14-07.pdf.

[3] *See* Elaine Henry, Steve W.J. Lin & Ya-Wen Yang, *The European-U.S. GAAP Gap: Amount, Type, Homogeneity, and Value Relevance of IFRS to U.S. GAAP Form 20-F Reconciliations* (October 2007) (finding that differences in net income reported under IFRS and U.S. GAAP remain significant); Hughes. S.B., and J.F. Sander, 2007, Are IFRS and U.S. GAAP Converging? Preliminary Evidence from Three European Union Countries, working paper, University of Vermont; *see also* David Jetuah, *Citigroup Lays Out IFRS-U.S. GAAP Gulf*, Accountancy Age (Aug. 30, 2007) (reporting Citigroup analysts' conclusion that differences between IFRS and U.S. GAAP "could well result in investors and/or analysts coming to different conclusions about the financial position and performance of the business depending on the GAAP used").

[4] Sarah Johnson, "Goodbye GAAP," *CFO Magazine* (April 2008), at 54 (quoting Bob Herz).

[5] *See* Hughes, J. "Blueprint of change fosters revolution," *Financial Times* (Sept. 10, 2007).

[6] *See United States* v. *Simon,* 425 F.2d 796 (2d Cir.1969) (upholding district court's refusal to grant auditors' request for jury instruction that they could not be found guilty of securities fraud if the financial statements in question were in compliance with GAAP).

[7] *Id.* at 805-06.

[8] *See United States* v. *Ebbers*, 458 F.3d 110, 125 (2d Cir. 2006) ("If the government proves that a defendant was responsible for financial reports that intentionally and materially misled investors, the [securities fraud] statute is satisfied. The government is not required in addition to prevail in a battle of expert witnesses over the application of individual GAAP rules."); *United States* v. *Rigas*, 490 F.2d 208, 221 (2d Cir. 2007) ("Even if Defendants complied with GAAP, a jury could have found, as the jury did here, that Defendants intentionally misled investors.").

[9] Specifically, the *Simon* opinion said:

> We do not think the jury was also required to accept the accountants' evaluation whether a given fact was material to overall fair presentation, at least not when

> the accountants' testimony was not based on specific rules or prohibitions to which they could point, but only on the need for the auditor to make an honest judgment and their conclusion that nothing in the financial statements themselves negated the conclusion that an honest judgment had been made.

U.S. v. *Simon*, 425 F.2d at 806.

[10] *See* Investor Perspectives on IFRS Implementation (December 2007), at 48, *available at* http://www.afg.asso.fr/upload/3/Fichier735.pdf. Interestingly, in the same survey, two staff of the French securities regulator opined that:

> There is little doubt that sooner or later regulators or the competent courts will be required to clarify certain positions. It is perhaps a little idealistic to imagine that the standards will remain principles-based indefinitely. There will always be complicated situations for which the market will require arbitration that will then take on status as jurisprudence, i.e. rules.

Id. at 21.

[11] *See id.* at 7.

[12] *Id.* at 30; *see also* Naomi S. Soderstrom & Kevin Jialin Sun, "IFRS Adoption and Accounting Quality: A Review," 16:4 Eur. Acct. Rev. 675 (2007) ("[C]ross-country differences in accounting quality are likely to remain following IFRS adoption because accounting quality is a function of the firm's overall institutional setting, including the legal and political system of the country in which the firm resides.").

[13] Testimony of Charles Landes (AICPA) in a Hearing on International Accounting Standards: Opportunities, Challenges, and Global Convergence Issues, Before the Subcommittee on Securities, Insurance, and Investment of the U.S. Senate Committee on Banking, Housing and Urban Affairs (October 24, 2007), webcast *available at* http://banking.senate.gov/public/index.cfm?Fuseaction=Hearings.Detail&HearingID=a96cc028-3b6d-4996-b849-768e83af35fc.

[14] Ray Ball, Ashok Robin, and Joanna Shuang Wu, "Incentives Versus Standards: Properties of Accounting Income in Four East Asian Countries," 36 J. Acct. & Econ. 235, 236 (2003).

[15] *Id.* at 259.

[16] *Id.*

[17] Christian Leuz and Luzi Hail, Report to AFM on Capital Market Effects of Mandatory IFRS Reporting in the EU: Empirical Evidence (October 2007), at 17, *available at* http://www.afm.nl/corporate/default.ashx?DocumentId=10519.

[18] *Id.* at 49.

[19] Speech by Hon. Jim Flaherty, Minister of Finance, to a Conference on Securities Law Enforcement at Toronto, Ontario (June 27, 2007), *available at* http://www.fin.gc.ca/news07/07-060_1e.html. This is a parlous state for those investors, for some researchers have found that "even in an environment like the U.S., differences in underlying institutional environments can significantly affect reported results." *See* Mark Lang, Jana Smith Raedy, and Wendy Wilson, "Earnings Management and Cross Listing: Are Reconciled Earnings Comparable to U.S. Earnings," 42 J. Acct. & Econ. 255-283 (2006).

[20] I discussed research on the benefits of U.S. securities laws, and robust enforcement of those laws, in my background paper for *The Atlantic's* ideas tour in September 2006. That paper is available at http://www.pcaobus.org/News_and_Events/Events/2006/Speech/09-30_Niemeier.aspx. My discussion, and much of the research today, is based on the groundbreaking original work of Columbia University Law Professor John C. Coffee, Jr. His most recent work on the subject is *Law and the Market: The Impact of Enforcement*, 156 U. Pa. Law Rev. 229 (Dec. 2007). In addition, G. Andrew Karolyi of Ohio State University has performed numerous empirical tests of Professor Coffee's theory, the most recent of which are reported in Doidge, C., Karolyi, G.A., Stulz, R., *Has New York Become Less Competitive in Global Markets? Evaluating Foreign Listing Choices Over Time*, Ohio State Dice Center working paper 2007-09 (July 2007), at 8, *available at* http://www.cob.ohio-state.edu/fin/dice/papers/2007/2007-9.pdf.

[21] *International Accounting Trustees Say Principles-based IFRS Would Weaken SEC*, BNA August 27, 2008.

[22] Arthur Andersen partner David Duncan's email was uncovered during a 2002 Senate investigation relating to Enron's accounting practices. Here is an excerpt –

> While I think Rick [Enron's chief accounting officer] is inclined to do this given Enron's desire to increase their exposure and influence in rule-making broadly, he is interested in knowing whether these type commitments will add any formal or informal access to this process (i.e., would these type commitments present opportunities to meet with the trustees of these groups or other benefits).

Senate Floor Statement of Senator Carl D. Levin (D-Mich) on the Introduction of Legislation to End the Double Standards for Stock Options (Feb. 13, 2002), *available at* http://www.senate.gov/~levin/newsroom/release.cfm?id=209088; *see also* Spiegel, P. and Peel, M., *Enron Considered Influencing Accounting Body*, Fin. Times (Feb. 13, 2002).

[23] Sarbanes-Oxley Act, Section 108(a).

[24] Some have pointed to Section 108(c) of the Act as evidence of the Commission's authority to permit or require application of IFRS. That provision reiterates the Commission's long-standing authority to establish accounting standards of its own. It does not, however, pertain to the Commission's practice of looking to private bodies to establish standards instead. Section 108(b)'s criteria establish, for the first time, a statutory framework for, and limits on, that practice.

[25] By 2000, the need for better access to foreign auditors and their work papers had reached the point of materially impeding the SEC's effectiveness at enforcing applicable accounting and auditing requirements when problems surfaced in the foreign operations of U.S.-based companies or at foreign private issuers. In December 2000, then-SEC Enforcement Director Dick Walker announced his concerns. *See* Richard H. Walker, Remarks before the AICPA National Conference on Current SEC Developments (Dec. 5, 2000), *available at* http://www.sec.gov/news/speech/spch447.htm.

The global accounting firms resisted Dick's concerns, as well as a suggestion by the Commission itself in a 2000 concept release that the Commission consider amending Regulation S-X to require auditor representations that, to the extent it relied on auditors, working papers, or information from outside the United States, the auditor would make the working papers and testimony available to the SEC. See SEC Release No. 33-7801, International Accounting Standards, App. A, Question 20.

There things sat, until Congress passed the Sarbanes-Oxley Act. Section 106 of the Act requires foreign auditors that audited, or played a substantial role in auditing, the financial

statements of U.S. public companies to register with the PCAOB. In addition, Section 106 deems a foreign auditor that issues an opinion or otherwise performs material services on which a registered public accounting firm relies to have consented to produce its work papers to the SEC or the PCAOB in connection with any investigation.

[26] The PCAOB conducted 16 non-U.S. inspections in 2005. All 16 of those reports, based on inspections in Canada and the U.K., have been issued and are available on the Board's website. *See* PCAOB 2005 Annual Report at 23, *available at* http://www.pcaobus.org/About_the_PCAOB/Annual_Reports/2005.pdf. In 2006, the PCAOB conducted 15 non-U.S. inspections, jointly in Canada and the U.K. and independently in five other countries that do not have an auditor oversight body. *See* PCAOB 2006 Annual Report at 8-9, *available at* http://www.pcaobus.org/About_the_PCAOB/Annual_Reports/2006.pdf. Only one report from those 2006 inspections has been issued to-date. The PCAOB continued to conduct non-U.S. inspections in 2007 and to-date has issued six reports on those inspections.

[27] *See* PCAOB Release No. 2007-011 (Dec. 5, 2007), *available at* http://www.pcaobus.org/Inspections/Other/2007/12-05_Release_2007-011.pdf.

[28] *See* Commission Recommendation 2008/362/EC on External Quality Assurance for Statutory Auditors and Audit Firms Auditing Public Interest Entities ((May 6, 2008), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:120:0020:0024:EN:PDF.

[29] Commission Recommendation on external quality assurance for statutory auditors and audit firms auditing public interest entities: Frequently Asked Questions, *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/08/300&format=HTML&aged=0&language=EN&guiLanguage=en.

[30] IOSCO Technical and Emerging Markets Committees, *Survey Report on Regulation and Oversight of Auditors* (April 2005), at 4 ("Auditing standards in current use include both national auditing standards and International Standards on Auditing (ISAs) issued by the International Accounting and Assurance Standards Board (IAASB). National auditing standards are used in most of the TC and ISAs are used more widely in the EMC jurisdictions. Some of the national auditing standards are based upon or derived in part from ISAs."). This report is available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD199.pdf.

[31] In a December 2007 speech to the German Public Auditor Conference, I discussed the history of self-regulation by the U.S. Accounting profession and concluded that the self-regulatory model was, in the long-run, detrimental to the profession as a whole as well as individual firms and auditors. That speech is *available at* http://www.pcaobus.org/News_and_Events/Events/2007/Speech/11-08_Niemeier.aspx.

[32] *See* IAASB, International Standard on Auditing 200 (Revised and Redrafted, adopted June 2008), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards of Auditing," para. A59, *available at* http://www.ifac.org/IAASB/Meeting-Resource.php?MID=0142&type=Updated+Agenda.

[33] *See* Rene M. Stulz, *Securities Laws, Disclosure, and National Capital Markets in the Age of Financial Globalization*, Ohio State Dice Center working paper 2008-13 (July 2008), at 46-47, *available at* http://www.cob.ohio-state.edu/fin/dice/papers/2008/2008-13.pdf.