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Remarks of Randy Fletchall
Chairman, AICPA

Good morning! Welcome to the 35th National Conference on Current SEC and PCAOB Developments, sponsored by the American Institute of Certified Public Accountants.

It's a pleasure to be with you here today and to be sharing this message with those of you watching through video conference in New York, Chicago, Houston, San Francisco, and London.

Many thanks to David Follett, the conference chair, to other SEC Regulations Committee members, and to the AICPA staff who assist in planning this event. This conference is a special event: one that is such a tradition for so many of us, one that each year we make certain to mark on our calendars because the content is rich, our regulators and standard-setters are here to provide the most current insights just before year end, and we get the chance to reconnect with many friends and colleagues.

I am honored to again this year be here as the AICPA representative to kick-off the conference.

A year ago I said that I hoped the preparers, investors, standard-setters, regulators, and auditors at the conference would focus the dialogue on how we could improve the reliability, relevance and timeliness of reported financial information. I said that many people were discussing the need to tackle the complexity that has built up in the U.S. financial reporting system over a period of years. I spoke about the potential for principles-based standards and the harmonization of U.S. and international standards to reduce complexity in our financial reporting. And I spoke about

initiatives to modernize business reporting and to using technology such as XBRL in the delivery of financial information.

But not in my wildest dreams did I think as I stood here that we would see the significant developments that have occurred during 2007, or that we would be on the precipice of even greater, farther-reaching change in 2008. Today I want to talk about the potential for great change in our financial reporting system and the pace of that change. Some real challenges face us – but the opportunities are so significant and so exciting.

Complexity

All of us know that the world in general and the business and financial worlds in particular are far more complicated than they have ever been.

The bricks and mortar, vertically integrated business model of a U.S.-based company that sold “things” that was so prevalent not that long ago has been replaced by globally-based businesses that today sell ideas, delivery channels, and intellectual property, and do so by moving electrons literally faster than the speed of light. Today human capital is at least as vital as financial capital, natural resources, and plant and equipment.

And these changes are themselves rapidly changing. A business process, practice, or product that once would have lasted for a decade or more, today is subject to almost constant revision.

For example, the operating system for your computer, your cell phone, and your way of searching for information have all changed substantially in recent years. How much have they changed?

Just a decade ago you probably didn't know what an operating system was, didn't have a cell phone, and were still using the Yellow Pages because you thought that "Google" was the strangest name you had ever heard of for a business.

Thus, we must cope with a considerable amount of complexity that is simply unavoidable. It has been, and will continue to be, the job of CPAs, both preparers and auditors, to make sense out of the dramatically changing and increasingly complex financial world and to transform what might otherwise seem like chaos into clarity and transparency for investors and the capital markets.

We somehow have to take the shorter life cycles of a company's products, services, and intellectual capital and make that understandable when compared to the bricks and mortar world of the past. We have to find ways to communicate the growing value of an entity's human resources, customer service, and goodwill; to determine the effects of the faster pace of technological innovation on such concepts as depreciation and useful lives; and to evaluate elaborate business strategies, complicated business transactions and ownership structures, and sophisticated risk management techniques.

And, because of the speed at which information is desired, the increasing number of users of business and financial information, and the wide variations in the financial sophistication of investors, we have to communicate the information faster and in a more transparent and understandable manner than ever before.

This is not just a far cry from the days when the value of a business was primarily based on the cash in the register at the end of the day; it's at the other end of the universe.

Our challenge is quite clear: Common wisdom assumes that complexity discourages transparency and that a transparent system must disclose more detail. That typically leads to even greater complexity as increased regulations and standards are adopted to guide the reporting of the additional information. And the natural tendency for some investors is to believe that more data is always better, which can result in even further complexity. And that is particularly the case when the additional disclosures are quite lengthy, often boilerplate, overly legalistic, and fail to communicate important information clearly and effectively. But some of this complexity in our financial reporting system is avoidable or can be minimized if we actively and determinedly take steps to do so.

In recent years, as rules have become more complicated and voluminous, preparers and auditors have had a harder time determining whether they are in fact meeting the requirements of each and every rule in all possible interpretations.

This does not serve investors well. Our system does not work efficiently when fewer and fewer preparers and auditors are confident they are getting to the correct application of the accounting standards. It does not work well if the system depends too much on scarce accounting policy or National office resources.

Detailed rules are intended to ease implementation and to promote greater consistency in reporting. But while increasingly detailed instructions result in “compliance,” that compliance can come at a severe cost: the lack of transparency and understandability.

This didn’t happen overnight or by design, and is no single body’s fault. Decades of increases in the volume and complexity of requirements have resulted in disclosures that even the most knowledgeable users, let alone average investors, have trouble understanding.

Mere simplification is not the answer because we cannot make simple what is complicated. But we should, and indeed must, make complicated information more understandable to investors. To accomplish this objective, we need to tackle the areas of complexity in our financial reporting process within our control.

After much discussion about the need to reduce complexity, including remarks by SEC and FASB officials at this conference the past two years, in June of this year the SEC established its Advisory Committee on Improvements to Financial Reporting, which is being chaired by Robert Pozen. The AICPA is very excited about the work of this advisory committee, which has been charged by the SEC with examining the U.S. financial reporting system to identify ways to improve it by both reducing unnecessary complexity and making information more useful and understandable to investors. This advisory committee is working diligently to develop a set of recommendations by August 2, 2008 and even earlier if interim recommendations emerge.

For many years, the AICPA and its members have been lending the CPA profession's voice to improving financial reporting. From the AICPA Special Committee on Financial Reporting, which is better known as the Jenkins Committee, to the Enhanced Business Reporting Consortium, to our longstanding and current efforts to promote the development of and convergence with international accounting standards, the profession has been committed to improving financial reporting. Many of our members are involved with the advisory committee and we stand ready to assist the advisory committee in whatever ways we can contribute to these very important efforts over the next several months to reduce unnecessary complexity.

Convergence and Use of International Standards

The use of multiple standards can introduce additional complexity, particularly if the standards are quite different. The AICPA has been committed to harmonization and convergence efforts, and to continuing its longstanding role as a leader in such endeavors.

The AICPA was a founding member of the International Accounting Standards Committee, which was the predecessor to the current International Accounting Standards Board (the IASB), and it was one of the first organizations to recognize the need for international convergence of accounting standards. Since 1973, the AICPA has continued to advocate for convergence, supporting the efforts that have been made by the IASB and FASB. In our view, as business and finance have become increasingly global, the need to harmonize U.S. GAAP with International Financial Reporting Standards (or IFRS) has been a virtual prerequisite to reducing complexity and increasing understandability.

The pace of developments in the recent months regarding the use of IFRS has been rapid. In November, the SEC announced the revision of its rules to now accept from foreign private issuers financial statements prepared in accordance with IFRS as published by the IASB without reconciliation to U.S. GAAP. In addition, the SEC has just received comment letters on its concept release on allowing U.S. issuers the option to prepare financial statements in accordance with IFRS and has scheduled roundtables this week and the following as next steps in considering the use of IFRS in the U.S.

Given the increasing globalization trends, the AICPA supports the goal of a single set of high quality, comprehensive accounting standards to be used by public companies in the preparation of transparent and comparable financial reports throughout the world. We support giving U.S.

companies the option to prepare financial statements in accordance with IFRS as an important step toward achieving that goal.

We also believe that, as we move towards a single set of globally accepted accounting standards for public companies, changes need to occur in the U.S. auditing, regulatory, and legal environments, and recently have testified to that effect before the U.S. Senate.

The AICPA will continue to support the efforts of such international organizations as the IASC Foundation Trustees and the International Organization of Securities Commissions to improve the development and application of IFRS. We will be a voice to promote needed changes that are not being addressed by others. But we also encourage the SEC, in particular, to seize the unique opportunity created by the events taking place in the U.S. and focus attention on actions that must be taken and changes that must be made internationally to make the use of IFRS in the U.S. successful. We believe the call to action includes steps related to IASB board and staff resources, independent and sustainable funding sources, a public interest oversight body comprising regulators and other key constituents, and enhanced focus on financial statement users and their input.

We acknowledge that we, the AICPA, will also need to fulfill a number of responsibilities to make convergence a success. These include—

- Continuing to educate our members about IFRS;
- Working with accounting educators, textbook authors, and educational institutions to prepare future professionals; and
- Beginning to incorporate IFRS into the Uniform CPA Examination.

Rest assured that the AICPA will meet its responsibilities.

In addition, the AICPA has supported convergence of auditing standards and our Auditing Standards Board for years has actively participated in the setting of international auditing standards. Our ASB has worked closely with the International Auditing and Assurance Standards Board to achieve a consistent interpretation and implementation of the more recent statements on auditing standards.

We believe that the development of globally consistent auditing standards, along with a harmonization of audit oversight and enforcement regimes, will also contribute to a less complex and more cost-effective financial reporting process.

Respect for Professional Judgment and Materiality

Increasingly over the past few years all of us have been coming to grips with the fact that the detail and volume of our rules-based standards, once applauded by many as the strength of our reporting system, now pose a major challenge to enhancing the quality and transparency of financial reporting.

Standards that are based on broad principles, such as IFRS, rather than rigid rules have enjoyed considerable and growing support within the accounting community and financial markets. Four years ago, the SEC completed a study required by Sarbanes-Oxley that concluded that a shift toward an optimal type of principles-based accounting standards, toward “objectives-oriented” standards, would be beneficial. The FASB has been focused on developing standards that are more principles-based and resisting the cries for answers to every question that might arise.

However, movement toward the use of IFRS in the U.S. will accelerate the need for preparers, users, auditors, and regulators to successfully operate with a more principles-based accounting framework. Indeed, the success of the implementation of IFRS in the U.S. will hinge on adjusting to this change. But currently in the U.S. we generally crave certainty in the form of more detailed rules and specific answers to our questions to protect against the regulatory and legal second-guessing that can be costly, both financially and to our reputations.

Principles-based accounting is difficult because it requires a greater reliance on professional judgment. It requires acceptance and tolerance of the fact that, operating in total good faith, different accountants sometimes reach different conclusions. And it requires transparency so that users can understand the accounting decisions made and the potential effects of other alternatives.

But the regulatory and legal second-guessing of good-faith judgments in the U.S. creates risks for all, diminishes the appetite for some companies to do business here, and potentially challenges the relevance and value of the auditing profession.

There are many contributing causes to the large number of restatements that have occurred in the recent past. Some of the volume of restatements has been positive, providing the capital markets with confidence that additional rigor by preparers and auditors is working. But many restatements have not contributed to increased confidence in our financial reporting process. They either have the opposite effect of undermining confidence or, as has often been the case, of being viewed as “ho hum” and making it more difficult for investors to differentiate and evaluate restatements in making investment decisions.

Clearly one of the causes for the large number of restatements has been the regulatory second-guessing and overturning of decisions reached on complex issues by very competent individuals

preparing financial statements and auditing them after careful, thoughtful analysis. Similarly, differing views on when noncompliance with some aspect of the accounting standards has produced material, rather than immaterial, errors in the financial statements has been the cause of many restatements.

To be clear, preparers must be focused on transparency and auditors must be willing to take a stand on behalf of investors when they believe that clients have not applied the relevant accounting standards in an appropriate manner. And they must have a personal sense of duty that goes beyond the issuer or the audit firm. That culture must flourish. And without a doubt it has to be backed up by systems, processes, governance, independent oversight and discipline. In turn, however, regulators and the legal system must be able to respect good-faith professional judgments—judgments that are rational, well-considered, and documented.

We need to find the right balance. CPAs should be held accountable and wrongdoers should be punished. But we clearly need a system under which good-faith accounting and auditing judgments will be afforded respect by regulators and in legal proceedings.

We understand the Committee on Improvements to Financial Reporting is considering how best to encourage sound professional judgment and improve the consideration of materiality in a manner that issuers and auditors can depend on. We also believe that the U. S. Treasury Department's Advisory Committee on the Auditing Profession, announced in 2007 by Secretary Henry Paulson, should consider the environmental factors in the U.S. regulatory and legal systems that clearly need to be addressed to provide an environment where professional judgment is respected. This advisory committee, which is co-chaired by Arthur Levitt, Jr. and Donald Nicolaisen and includes the AICPA's CEO Barry Melancon as a member, has the very

important charter of developing recommendations by the summer of 2008 on all aspects of the auditing profession, given its critical role with investor confidence in our capital markets.

We strongly believe that success in dealing with these issues will greatly benefit investors and the markets, and that changes are essential to the successful implementation of IFRS in the U.S.

XBRL

Last year at this conference I had the honor of presenting to Charles Hoffman the AICPA's Special Recognition Award for his remarkable contributions to the development of XBRL, which he conceived in 1998. In 1999 the AICPA Board of Directors voted to fund the development of the technology and shortly thereafter launched the XBRL consortium. Membership now includes more than 400 corporate and public sector members in jurisdictions around the world.

Fast forward to last week when the SEC announced the release for public comment of an XBRL U.S. GAAP taxonomy and related instructions for the filing of financial reports in interactive data form rather than text form.

Under Chairman Cox's watch, the SEC has been a big supporter of XBRL. Its voluntary XBRL filing program has contributed to the progress of XBRL for public financial reporting purposes, and its investment of more than \$50 million in XBRL-related contracts to rebuild the public disclosure system and render it interactive is indicative of the potential significance that XBRL has to the future of reporting in the U.S.

The reporting of interactive data in XBRL is becoming a reality

Enhanced Business Reporting

Another AICPA initiative is focused on the need for a modern business reporting model that includes the communication of non-financial information and intangible assets.

As a result of the AICPA's early work, the Enhanced Business Reporting Consortium, an independent, market-driven, collaboration among business reporting stakeholders, was formed in 2005.

The EBR Consortium is developing a best-practices, high-level, structured framework for the disclosure of information not covered by the financial statements and notes, such as key value drivers, financial and non-financial performance measures, and qualitative information on strategy, plans, opportunities and risks. Such information would provide a tremendous amount of insight about the potential performance of a business that is not currently disclosed to investors on a regular basis.

While developments in the EBR framework were less dramatic than other developments in corporate reporting in 2007, we should keep in mind the potential of XBRL for electronic reporting of business information, not just financial information, and such use might take full advantage of XBRL.

In Conclusion

All of this activity in 2007 reflects great strides in moving toward a financial reporting system in the U.S. that is less complex and more transparent than the current state. The stage is set for even

greater progress toward these goals in 2008. And there is reason for optimism that we are eventually headed toward the ultimate goal of a single set of high quality accounting standards in use around the world.

I'm certain that much of what we will discuss in the next three days will deal with the highly technical aspects of this challenge. That's appropriate. We are, after all, expert financial technicians. But I also hope that we will expand our discussion beyond the technical to the practical and political.

The accounting profession and the AICPA need to do in this area what we have always done: take the lead. We must continue to propel these initiatives and clearly communicate their value to investors and the business community.

The bottom line is simple: the time is now. We have already begun to demonstrate that we have the ability to provide investors and the capital markets with better and more transparent information while at the same time reducing unnecessary complexity. And the opportunities to make significant, enduring change are present. It's no longer a dream, or as some might say, a pipe dream. It's a reality.

Thank you. Enjoy the conference.