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A Word From Accounting's Powers That Be

The mind-set of financial reporting should ideally evolve from "minimum compliance" to "investor driven." This was an overarching theme from preparers, auditors, regulators, standards setters, and users of financial reports who made presentations at the American Institute of Certified Public Accountants' (AICPA) National Conference on Current SEC and PCAOB Developments in early December 2004.

"Are users receiving the information that we would want to have before making an investment decision—and is the information timely, complete, accurate, and transparent?" presenters asked and answered, according to a summary of the conference prepared by PricewaterhouseCoopers (PwC). Our financial reporting framework should continue changing from a "backward-facing, mixed-attribute model" to one that's flexible and dynamic and focuses on fair value, key performance indicators, and forward-looking information, PwC's report said. Standards should be "objectives oriented" and supported by good guidance, and preparers should adhere to the standard's intent instead of "engineering" around it.

Donald T. Nicolaisen, the Securities & Exchange Commission's (SEC) chief accountant, said financial reports should reflect current, past, and future changes so that investors will be informed about the relationship between risk exposures and company performance. Nicolaisen urged preparers, accountants, and auditors to improve the organization of reports, write them in plain English, and avoid boilerplate language. He also challenged preparers to initiate disclosures to obviate more SEC rule making. They should consider SEC rules the floor, not the ceiling, of financial reporting. (Nicolaisen's speech is located at www.sec.gov/news/speech/spch120604dtn.htm.)

Robert H. Herz, chairman of the Financial Accounting Standards Board (FASB), said the Board wants to improve and simplify U.S. accounting standards and achieve international convergence. Herz said he wants the FASB to move toward principles-based and objectives-oriented standards and away from "detailed rules, bright lines, and exceptions." But it's a difficult challenge because Sarbanes-Oxley is making preparers fearful of being "second-guessed by regulators, enforcers, the trial bar, and the business press." That, Herz said, "reinforces the demand" for rules-based standards. (Herz's speech is located at www.fasb.org/herz_aicpa_12-07-04.pdf.) Staff members of the SEC addressed principles-based accounting standards in the Commission's July 2003 report to Congress required by Sarbanes-Oxley (this report is located at www.sec.gov/news/studies/principlesbasedstand.htm).

It was clear from the speakers throughout the conference that internal control reporting under Section 404 of the Sarbanes-Oxley Act is weighing heavily on people's minds, according to PwC's summary. Collectively, everyone agreed that, in the early years of implementing

Section 404, there will be difficulties as issuers and their auditors shine a spotlight on this complex yet fundamental area. For their part, users and regulators said that disclosure of one or more material weaknesses in internal controls shouldn't be a surprise and shouldn't necessarily be a harbinger of severe regulatory or marketplace reaction. But preparers must do their part to foster a measured and balanced response by ensuring that any material weakness disclosures are robust and transparent and provide readers with an understanding of the situation, the potential impacts, and a clear picture of remediation efforts already undertaken, in process, and planned.

Meanwhile, SEC staff reported that they're doing their part to move the eXtensible Business Reporting Language (XBRL) endeavor along. The Commission released a proposed rule, "XBRL Voluntary Financial Reporting Program on the EDGAR System" (www.sec.gov/rules/proposed/33-8496.htm), accompanied by a "concept release" titled "Enhancing Commission Filings Through the Use of Tagged Data" (www.sec.gov/rules/concept/33-8497.htm). The comment periods for the proposed rule and the concept release ended November 1, 2004, and November 15, 2004, respectively. The SEC staff is currently evaluating comment letters that it received in response to the proposed rule and the concept release, developing internal capabilities for receiving and analyzing XBRL-formatted data, and learning more about XBRL.

XBRL promises to enable investors to pore through data more quickly and apply advanced analytics of financial reports more easily. Information that is tagged can be automatically searched, retrieved, and analyzed without errors commonly associated with manual data collection and analysis. Registrants would need to learn data-tagging concepts and related software tools, as well as keep current with taxonomy changes and software advances. At the general ledger level, XBRL would give auditors a tool for enhanced financial analysis, risk assessments, and additional internal control testing.

A number of speakers in addition to Robert Herz discussed convergence of U.S. and international accounting standards and expected the SEC to someday accept financial statements prepared in accordance with international financial reporting standards (IFRS) without requiring reconciliation to U.S. generally accepted accounting principles (GAAP), the PwC report noted. But no one at the conference would predict when that day might come.

Julie A. Erhardt, the SEC's deputy chief accountant, did say investors need to be able to review, side-by-side, financial statements of companies from different countries without the need for a reconciliation of the accounting principles. But the SEC won't rescind its reconciliation requirement for companies outside the U.S. who prepare their financial statements under IFRS until an international financial reporting system is effectively demonstrated. Nor would the reconciliation requirements be relaxed sequentially as convergence is reached for certain standards of financial reporting because users of the financial statements are apt to have difficulty understanding the reconciliation. (Her remarks can be found at www.sec.gov/news/speech/spch120604jae.htm.)

James J. Leisenring, a member of the International Accounting Standards Board (IASB), highlighted the benefits of a single set of worldwide standards: lower internal costs for preparers and users of financial information, efficient allocation of capital in the worldwide economy, and the resulting economic benefits of overall lower costs of capital. Cooperation by capital market participants and the independence and integrity of the FASB and IASB in developing relevant, high-quality standards for financial reporting are critical to advancing worldwide economies, he said.

But there are considerable challenges to convergence, including limited resources, prioritization of joint agendas, preparer and user resistance to change, and political pressure and interference. The politics are considerable, Leisenring said: Accounting standards must be endorsed by the European Commission before they are mandatory and enforceable under EU laws.

PwC's reporting on the AICPA's three-day conference concluded on an upbeat note, saying "There was a cautious optimism running through the speakers' remarks…optimism that the reforms embodied in the Sarbanes-Oxley Act have begun to restore investor confidence; optimism that a younger, technology-savvy class of leaders is emerging and is poised to marry the promise that new tools such as XBRL may hold with the ever-expanding needs of the user community; and optimism that independent directors, auditors, and lawyers—some of the traditional gatekeepers to our securities markets—are focusing on their roles as guardians of the public trust with renewed vigor."

Presumably, if that were the case, more accurate, complete, and transparent financial reporting would follow or, perhaps, lead. ■