

**AICPA National Conference on Current SEC & PCAOB Developments
December 11-13, 2006
Washington DC, NY, CA, IL, TX**

**Remarks of Randy Fletchall
Vice-Chair, AICPA**

Good morning! Welcome to the 34th National Conference on Current SEC and PCAOB Developments sponsored by the AICPA. It's a pleasure to be with you here in Washington, DC, today and with those of you watching via video conference in New York, Chicago, Houston, and San Francisco! Many thanks to Jeff Lenz, the Conference Chair, and the other SEC Regulations Committee members and AICPA staff who assisted in planning this tremendous event. I am honored to be here, and look forward to three days of excellent education, insight and camaraderie.

Over the next few days, I hope that this important assembly of preparers, investors and other financial statement users, standard-setters, regulators, and auditors focus the dialogue on how we can improve the communication of reliable and relevant financial information to investors and the capital markets around the world in a timely manner. After all, that is the common purpose that brings us together. Critical to achieving that objective is transparency. An impediment to it is complexity.

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Improving financial reporting and increasing transparency are things all of us support. For many of us, improving financial reporting means making it easier and less expensive in time, effort and money for preparers to create, collect and distribute meaningful information about their companies. It also means providing users with better and timelier financial insight and operational intelligence to make fully informed decisions for investing, seeking or extending credit and numerous other purposes.

To achieve greater transparency in financial reporting, however, we will need to address several issues. One of these is the complexity of our accounting standards. Our accounting standards in the U.S have become unnecessarily complex. But don't mistake this statement to be a criticism of our Financial Accounting Standards Board because as SEC Deputy Chief Accountant Scott Taub said recently "we are all collectively causing the complexity that bothers so many of us." And I completely agree with him.

Here's the question I pose today: Can transparency of the information communicated to investors be enhanced while at the same time reducing complexity? Can we improve the financial reporting

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process by reducing rules and regulations, rather than increasing them?

Can reliance on professional judgment be done with a principles-based system that is rigorous enough to serve the public interest? Yes we can.

One could take the view that a transparent system is one that discloses more and more detail, thereby adding to the regulations and standards that are required to accurately and transparently report them. But a complex system is not a transparent system. On the contrary. Complexity discourages transparency.

As rules have become more voluminous and more complex, preparers and auditors are having a harder and harder time of determining whether they are in fact meeting the requirements of each and every rule, in all possible interpretations. Our system does not work well when fewer and fewer preparers and auditors are confident that they are getting to the correct application of the accounting standards. It does not work well if the system depends too often on scarce accounting policy or National office resources.

More rules and more information, unfortunately, do not add up to more transparency and more clarity.

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Of course, detailed rules are intended to ease implementation and to promote greater consistency in reporting. But, while increasingly more detailed instructions often result in compliance, disclosures are lengthy, are often boilerplate and overly legalistic, and fail to clearly and effectively communicate important information.

Our reporting system didn't become complex overnight. Decades of increases in the length and complexity of requirements have resulted in disclosures that even the most knowledgeable users have trouble understanding.

But it is not easy or even appropriate to solve the problem by mere simplification. Business transactions are more involved than ever. Both public and private companies implement elaborate business strategies, form complicated ownership structures and use sophisticated risk management techniques. We cannot make simple what is complicated. But we can and should try to make information more understandable to investors and creditors.

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Many others are on the same page with this idea. Various SEC leaders have more than once articulated an intent to work toward reducing “the complexity that has crept into our financial reporting process over the years.” Just last year during this very conference here in Washington, D.C. SEC Chairman Christopher Cox, who attended by videoconference, and FASB Chairman Bob Herz both suggested the need for greater transparency in financial reporting. They and several others, including SEC Chief Accountant Conrad Hewitt and FEI President and CEO Colleen Cunningham, have recently reiterated the importance of addressing the complexity issue.

For many years, the AICPA and its members have been lending the CPA profession’s voice to the mission of improving reporting to better meet the needs of financial statement users.

The AICPA and its members also have formally researched, discussed, and debated this issue. From the AICPA Special Committee on Financial Reporting, which became known as the Jenkins Committee, to the Enhanced Business Reporting Consortium, which I will discuss later, the profession has been seeking solutions.

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We've continued to work with other organizations to promote transparency, comparability and ease of understanding. We are eager to work with other organizations now on improving the reporting process, increasing transparency, and reducing complexity. Let me share with you a few areas of focus.

Principles-based Standards

One of the risks of today's rules-based standards is that they may unintentionally encourage the structuring of transactions in a manner that complies with the rules primarily to achieve a desired financial reporting result. That's clearly not the intent of the standards, and transparency is reduced if the economic substance of transactions is not reported.

But the greater risk of today's rules-based standards seems to be that their complexity makes it difficult to properly apply each and every one of them. As a result, we continue to experience too many misstatements arising from misapplication of the standards, and the often accompanying restatements, despite the well-intentioned efforts of skilled, knowledgeable accountants.

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Standards that are based on broad principles rather than rigid rules enjoy considerable and growing support within the accounting community and the markets. The detail and volume of our rules-based standards that were long lauded by many as the strength of our reporting system now are viewed by many to pose a major challenge to enhancing the quality and transparency of financial reporting. Even Congress weighed in by requiring the SEC in Section 108 of the Sarbanes-Oxley Act to, and I quote, “conduct a study on the adoption by the United States financial reporting system of a principles-based accounting system.” The SEC completed that study in July 2003, concluding that a shift in the standard-setting paradigm toward an optimal type of principles-based accounting standards, or an “objectives-oriented” approach as defined by the SEC, would be beneficial.

Principles-based accounting is nonetheless a tricky business, because it requires a greater reliance on professional judgment than on interpreting detailed accounting standards. It requires the exercise of good judgment and respect for it. It requires acceptance and tolerance of the fact that different preparers and auditors will sometimes reach different conclusions in good faith. And it requires transparent disclosure

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such that users are able to understand the accounting decisions made and the potential effects of other alternatives

And we will have to be careful about conceptualizing “principles-based” at too high a level, because there are valid concerns about losing comparability, which is one of the key factors in the usefulness of financial statements. “Principles-only” would not be sufficient, and adequate implementation guidance should always be provided. Because, as others have said wisely, “even good disclosure does not make up for bad accounting.”

Harmonization

In the international arena, efforts to harmonize U.S. GAAP with International Financial Reporting Standards will also help to reduce complexity and increase transparency. Multiple standards can introduce additional complexity, particularly if the different standards are quite different.

The need for harmonization is becoming increasingly clear. The world has become a global marketplace, with national boundaries becoming increasingly irrelevant in accessing capital and creating

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wealth. This means that even CPAs in smaller companies or in smaller audit firms in the U.S. will find themselves needing to be familiar with international standards.

The AICPA is committed to continuing its longstanding role as a leader and key player in these endeavors.

The AICPA was a founding member of the IASB's predecessor body, the International Accounting Standards Committee, and it was among 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 IASB's and the FASB's efforts.

In addition, the AICPA's Auditing Standards Board has actively participated in the setting of international auditing standards. In the last several years, the ASB has worked with the International Auditing and Assurance Standards Board to achieve consistent interpretation and implementation of the more recent statements on auditing standards. And it has developed a plan for convergence of auditing standards. The development of globally consistent auditing standards, along with a harmonization of audit oversight and enforcement regimes, would

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contribute to a less complex and more cost-effective financial reporting process.

Enhanced Business Reporting

Another AICPA initiative is focused on the fact that the existing financial reporting model hasn't fully kept up with the times and the resulting need for a modern business reporting model that appropriately includes the communication of non-financial information and the intangible assets that have become increasingly significant components of a company's value.

Management teams clearly recognize the importance of measuring such intangible assets and other non-financial aspects of business performance. They use these measures to successfully manage their businesses.

Research shows that only 25% of an entity's market value can be attributed to accounting book value. The remaining 75% is based on value drivers such as strategy, product innovation, people and customer loyalty. Research also tells us that only about one-third of the value

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drivers generally associated with industry sectors are disclosed in public filings.

To facilitate the development of an enhanced reporting model, in 2005 the work of the AICPA Special Committee on Enhanced Business Reporting culminated in the formation of the Enhanced Business Reporting Consortium, an independent, market-driven, collaboration among stakeholders of business reporting. The consortium's overarching objective is to achieve the right mix of fully disclosed, high-quality information.

The EBR Consortium is developing a best practices, high-level, structured framework for the disclosure of key value drivers, financial and non-financial performance measures, and qualitative information on strategy, plans, opportunities and risks – information that is not covered by the financial statements and notes. This information would provide a tremendous amount of insight about the potential performance of a business, and yet it is not currently disclosed to investors on a regular basis. At the same time, the EBR Consortium is conducting research to serve as the basis for constructive recommendations for simplification of existing reporting requirements.

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The EBR framework development process is important not only in order to enhance the quality of key non-financial disclosures that are made by companies, but also in order to be able to leverage fully the potential of the eXtensible Business Reporting Language (XBRL) for electronic reporting of business information. The EBR framework enables a more robust application of XBRL in the sense that it can serve as the basis for meaningful taxonomies for the non-financial components of the reporting package, such as the narrative portions of Form 10-K, including Management Discussion & Analysis. This is important because whereas U.S. GAAP and IFRS frameworks exist as the basis for the development of XBRL taxonomies for financial reporting, there is no such structured framework for the rest of the reporting package. The EBR framework development process can fulfill this need.

XBRL

XBRL all started about eight years ago with a small-firm CPA in the State of Washington. Charlie Hoffman had an ambitious idea: he wanted to make financial reports easier to prepare and use. Hoffman began developing prototypes of financial statements and audit schedules

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designed in XML, an internet language for defining data. His solution was XBRL.

In 1999 the AICPA Board of Directors voted to fund a full fledged effort to develop the technology. The Institute soon launched an XBRL consortium. Since then, membership has grown to more than 400 corporate and public sector members in 18 jurisdictions around the world.

So one CPA's idea—with the AICPA's support and leadership—is having a major effect on business reporting. Regulators, companies and others are using this technology to facilitate domestic and international investment and credit transactions.

Why the warm reception? Because XBRL has the ability to instantly identify financial data. It makes it possible to precisely and reliably extract information and exchange it with other applications. True comparisons and analysis can be pursued at the push of a button, without re-keying any information. A financial report prepared with XBRL will not only automatically distinguish financial reporting categories such as cash, accounts receivables, and debt, it will also categorize accounting policies and other text-based disclosures. This means that

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amounts, and even reporting strategies, from different software packages can easily be compared and analyzed. It makes it much, much easier for companies to provide data that is valued by the capital markets.

As SEC Chairman Cox has pointed out, XBRL makes virtually every participant in the financial reporting chain more productive. Under Chairman Cox's watch, the SEC has been a big supporter of XBRL. Its voluntary XBRL filing program has convinced many people of the value of XBRL, and the SEC's recent 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 that XBRL has to significantly change reporting in the US.

In Conclusion

Investors and the markets in the U.S. have benefited over the years from a well-developed financial reporting process. But many factors, including the forces of globalization and new technology, suggest that now is the time for all of us to collaborate on an improvement agenda. There are several collaborative solutions that hold the promise

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of providing investors with better and more transparent information, while reducing the complexity that impedes understandability.

The process of change will not be easy. And we must be careful not to approach this as a process that is primarily intended to make life easier for preparers and auditors. In fact, as preparers and auditors, through dialogue and collaboration, we need to focus on understanding, defining, and meeting the needs of investors and creditors for financial and business information. Collaboration in the public interest is the best way to bring these initiatives closer to reality.

We can draw inspiration from the public-interest need. As CPAs, we need to always think and operate and make sound professional judgments with that need – and our obligation to meet that need – in mind. The role we play in the capital markets – and what we do – really matters and we are highly valued and highly respected when we do it right.

Thank you. And I hope you enjoy the Conference.