Deloitte Fireside Chat VIII:
International Convergence

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James McKinney: Good afternoon and welcome to today's Deloitte Fireside Chat, broadcast live on www.sechistorical.org. I'm James McKinney, Tyser Teaching Fellow at the Robert H. Smith School of Business at the University of Maryland and moderator for today's program.

The Deloitte Fireside Chat Series is made possible through a partnership between Deloitte LLP and the SEC Historical Society. Deloitte is a brand under which tens of thousands of dedicated professionals and independent firms throughout the world collaborate to provide audit consulting, financial advisory, risk management and tax services to selective clients.

The SEC Historical Society shares, preserves, and advances knowledge of the history of financial regulation through its unique virtual museum and archive at www.sechistorical.org. The virtual museum and archive celebrates its 10th anniversary this year and has welcomed more than one million visitors. Both the museum and the Society are independent of and separate from the U.S. Securities and Exchange Commission and receive no public funding. The Society is grateful for the sustained and generous support of Deloitte LLP in making the Deloitte Fireside Chats possible.

Since its debut in 2009, the Deloitte Fireside Chats have become the authoritative series on current issues in financial regulation of interest to the accounting and auditing professions. Past broadcasts, all available in the Deloitte Fireside Chats section under Programs in the virtual museum and archive, have addressed such topics as the role of professional judgment, principles verses rules-based accounting, responsibility for preventing and detecting financial reporting fraud, and the role of the SEC in accounting standards setting. Last month, Mark Peecher of the University of Illinois moderated an excellent discussion on how the profession looked at the Sarbanes-Oxley Act. I would encourage those listening to today's program to access the previous chats in both audio/mp3 and edited transcript formats at their convenience after the broadcast.

Today we will look at convergence with international accounting standards. Joining with us today are Robert Herz, a former Chairman of the Financial Accounting Standards Board and retired senior partner with PricewaterhouseCoopers LLP. He was also an original member of the International Accounting Standards Board. Also with us today is Joseph Ucuzoglu of Deloitte LLP, a former senior adviser and professional accounting fellow in the SEC Office of the Chief Accountant.

Before we begin, I would like to state that the views of the presenters are their own and do not necessarily reflect those of Deloitte LLP or the SEC Historical Society. The Society selected me to moderate the program. I am a current member of the Museum Committee. I worked with the presenters to determine the topics and questions that will guide the content of our discussion.

One of the hallmarks of the Deloitte Fireside Chats is that it is an interactive series. Visitors to the virtual museum and archive are encouraged to submit questions for the chats. We've received a number of questions for today's discussion and I will be using them for the broadcast. So let us go ahead and begin this discussion. Bob and Joe, convergence with the international financial accounting standards has been a topic of discussion for many years. More recently in July 2012, we've had the release of the SEC final staff report that discussed the work plan for IFRS convergence. So, I guess the question is, to start out: How did we get to where we are today?

Robert Herz: Well Jim, it's been something of a forty year journey and a continuing journey. I won't go through all forty years, but forty years ago was about when the FASB was founded and it's also when a group called the International Accounting Standards Committee was also founded. Of course our standards here in the U.S., U.S. GAAP, are derived from the FASB and predecessor bodies and supplemented by the SEC. The International Accounting Standards Committee, or IASC, was founded originally to promulgate standards that could be used by companies in countries where they didn't have their own standard setter, and so those standards by and large codified different existing practices in different parts of the world. So if you looked at one of their standards, it might have alternatives, one of which was U.S. GAAP-like, another one might have been more like UK accounting principles. That kind of did okay until the fall of the Berlin Wall and the globalization of capital markets that followed. Starting in the '90s there was a move to try to make those standards, I'll call them, more capital markets suitable. Ultimately, it led to restructuring of the IASC into a fulltime, more professional body called the International Accounting Standards Board that in some respects was a little bit like the FASB and its parent organization the Financial Accounting Foundation, in some respects a little bit different in terms a size of the membership, but the IASB adopted the existing IASC standards and then went forward. Europe decided to adopt those standards wholesale for its listed companies in 2005 and many other countries around the world have since followed.

Now since about ten years ago, the FASB and the IASB at the encouragement of the SEC and other global regulators and capital markets participants have been working together to try to bring about more convergence between the two sets of standards, which are really the two sets of widely accepted standards around world's capital markets. That program has proceeded in different forms over that period. I think the question has become now though, with the encouragement of G20 leaders, whether or not we should get to a single set of standards across at least the major capital markets in the world and, to that end, the SEC over time has been, in principle, endorsing that idea, but also trying to make sure that it fulfills its mandate: protection of U.S. investors and capital markets. So, the last iteration, I'll let Joe weigh in about some things that happened when Joe was at the SEC of great import, but the last iteration was that the SEC in 2010 asked their staff to do a thorough examination of the IASB, its operations, the quality of the standards, the level of consistency of implementation and enforcement of the standards around the world, the level of understanding of those standards among U.S. participants, particularly investors, and a variety of issues that might be encountered if we were to start moving towards those standards to replace U.S. GAAP, or at least to be incorporated into our accounting system. That report you reference was the report that the SEC staff issued in July 2012 with their findings, a lot of detailed findings. I don't think any of them were particularly earth-shattering, but from the viewpoint of capital markets participants in other parts of the world I think the surprise and maybe a little bit of disappointment or frustration was that the report from the SEC staff did not have any recommendation to the Commission on how to proceed on this important issue. Moreover, in the forward to the report it was made clear that the Commission felt that it might need to do further work in order to decide how to proceed on what is a very important threshold issue for our reporting system and capital markets.

James McKinney: Joe?

Joseph Ucuzoglu: I do think that we should recognize at the outset what a real privilege it is to have Bob here with us. There is truly no individual in the world who is more eminently qualified to speak to these subjects, so it should be a phenomenal discussion. At the outset of the conversation, we really have to focus back on the original objective that was set out to achieve. It's an objective that's very hard to quibble with: this idea that we ought to have one set of accounting standards applied consistently by corporations throughout the world. It's motherhood and apple pie, the ability to facilitate cross-border capital flows with optimal efficiency to allow investors to compare financial performance on apples to apples basis. It just makes so much sense and if one was going to go about trying to achieve that objective, it's natural that you might first look to, going back a decade, the set of standards that really formed the backdrop for the most advanced capital market system in the world. U.S. GAAP really has been the gold standard of financial reporting for many, many decades. So, this idea that we would go about converging the existing body of international literature with the U.S. GAAP in existence at the time, and not just make them equal for the sake of being equal, but take the opportunity to improve upon both so what we came out with at the other end was a better set of standards in the interest of the investors, again, made perfect sense.

What you're seeing come to fruition now are just some of the difficulties and complexities in actually achieving the objective that, frankly at an objective level, most people agree upon. Bob hit on a few of those and we'll get into it some of the details during this conversation. It is important to keep in perspective we've made a lot of progress, a lot of good has in fact occurred and it's not like there is no usage in the U.S. capital markets of IFRS today, in fact, those companies domiciled overseas that do trade on U.S. exchanges and are registered with the SEC, so-called foreign private issuers, are permitted to use IFRS without reconciliation to U.S. GAAP. That was a phenomenon that was brought about five years or so ago. So, IFRS is being used in the United States and it is being relied upon by U.S. investors. Now the question is: how do you get that last step and is it advisable in the interests of U.S. investors to actually allow U.S. domiciled companies to prepare financial statements in accordance with IFRS and are we working through, as a country, the complications and issues associated with making that final step? What you're seeing, candidly, is a little bit of impatience and fraying of nerves overseas, because if we put ourselves in the shoes of other countries... no other countries had the privilege of sitting at the table conducting all of its projects on a joint basis with the IASB. The U.S. has and so, as a result the U.S. has had an outsize level of influence on the standards being crafted by the IASB. Yet, we haven't committed to use this stuff and so it's not an unreasonable question for one to ask, if you were going to have this level of influence, you ought to perhaps make some demonstrated commitment to adopting this stuff yourselves. And so we're seeing some of that dynamic play out in the last few months.

James McKinney: Let’s go ahead and talk about these standards. When comparing the process issued by the International Accounting Standards Board with the financial accounting standards as issued by the Financial Accounting Standards Board in the United States and the processes surrounding their adoption, what do you believe has worked out well and what do you believe has not worked out as well as originally hoped?

Robert Herz: I think there's a lot of learning. First, let me say that I think the processes of both boards are high quality, they're open, they're transparent, they're thorough, they're engaging of constituents and unlike some other legislative type processes or rule setting processes if you observe a FASB meeting or an IASB meeting or a joint meeting between the two boards I think people are surprised at how much active discussion there is between the board members to try to understand the issues and get to solutions. So I think they're both very, very good processes.

There have been different approaches taken in the history of this convergence effort over the last ten years. We started out with kind of an inventory of what were major differences that were appearing on what were called the Form 20-F reconciliations. The filings by foreign registrants that Joe referenced in the U.S. capital markets and pre-2008, those companies used to have to do a detailed reconciliation between their financials prepared under their local standards including IFRS with U.S. GAAP in terms of net income and stockholders’ equity. That requirement was lifted, but only for IFRS filers in late 2007. So, the early period was to try to identify those major differences that caused these reconciling items and we had a number of projects, some of which came to fruition to eliminate these often very targeted differences. For example, on the FASB side, we changed some of our standards related to inventory costing, to non-monetary exchanges, to voluntary changes in accounting, and maybe one or two others to be in line with the IFRS standards, we thought they were better. On the IASB side, they changed a number of their standards including segment reporting and discontinued operations and aspects of accounting for post employment benefits and some others to come up to the U.S. standard. However, what we thought would be relatively easy exercises sometimes turned out to be much more complicated. For example, that was the case with trying to converge our respective standards on accounting for income taxes and earnings per share. So, with the help of the SEC back around 2005 (the chief accountant at that time was my good friend and former fellow partner Don Nicolaisen), we started to modify the approach to convergence. Don, with his staff, developed what he called a "road map" for lifting the reconciliation, what needed to be done for the SEC staff to recommend to the Commission that the 20-F reconciliation requirements be lifted for foreign filers using IFRS as issued by the IASB. One of the principles under that was that the boards should work together as Joe suggested, not just concentrate on eliminating targeted differences, but maybe you get more bang for the buck by working together in major areas where both sets of standards required improvement, and could be improved. So that has been the main focus of the effort since about 2006 under what's called the Memorandum of Understanding.

Now, some of those projects have been completed, some of those are still very much in progress and some of them are kind of on the back burner. I think it's been partially successful, but I guess you can look at it either as a labor of love or a great challenge to get the common improved standards, not for lack of any effort on behalf of either of the boards, but there are very challenging subjects. And in terms of their existing literature, they were starting from different places and their constituents sometimes therefore think about things differently.

James McKinney: How about, Joe, from the profession's point of view?

Joseph Ucuzoglu: I'd start by observing that there's a significance even to the nomenclature used in asking your question. You referred to IFRS as promulgated by the IASB. That might sound like that's the expectation, but in fact when you look at how these standards are being applied around the world, sometimes what you get is an assertion that somebody is complying with IFRS, when in fact, it's not quite, it's IFRS-like and so..

Robert Herz: It was really not quite "Herz". (Laughs)

Joseph Ucuzoglu: An excellent articulation of the point, and so it's important to read the fine print. If somebody says they're applying IFRS but when you actually look at the basis of accounting disclosed in the financial statements in the auditors opinion and it says IFRS as adopted in XYZ jurisdiction, there may be tweaks: "We kinda like this standard, but we didn't so much like this one," or “We opened it up to a few more options that the IASB actually foreclosed,” and so that's part of the debate occurring now here in the U.S. is to what extent, if we were to move to IFRS, do we just stick to what's been promulgated versus allow for some jurisdictional adaptation. Obviously, jurisdictional adaptation allows for some varying to the unique needs of individual countries, but it tends to distort the ultimate objective of achieving comparability.

In terms of what's worked well in the convergence process, there is a lot that's been accomplished. The naysayer or the critic might point to specific standards and suggest "Well here's the thirteen ways that they're different", but what's more important than focusing on each of the individual nuanced differences is at a concept level are they directionally consistent. Getting agreement on all of the underlying details is very difficult. It's difficult even within the individual boards. If just the FASB is working on a project to get a majority to agree on one hand, or just the IASB is working on a project, similarly, to achieve consensus, let alone now trying to bring the groups together with all the different influences on each of the boards, we ought to take some credit to the extent that the underlying model and the objective from a financial accounting standpoint is to the information that is attempted to be communicated to investors is, in fact, aligned. We have quite a few standards where that has, in fact, been achieved. There is also a benefit to having had the boards working together on some of the most difficult and contentious projects, because when you have each of the boards going off on their own path it opens up an opportunity for what you might call "regulatory arbitrage", where those who don't like the potential new rule essentially engage in a race to the bottom of finding the few areas where the other one has it easier or a less rigorous standard and suggesting "Well, it's not fair for companies within my jurisdiction because now we're placed at a competitive disadvantage. They don't have to do it." Those on the other side similarly find the few areas that they can make the same claim across the ocean and so having a process to work through these issues together really does seek to head off those instances of arbitrage. The last thing I'd say is that, I think there's been a little bit of a misconception developed in common belief around the extent to which the two bodies of literature are all that different. Some say that the IFRS standards are really principles-based, and that the U.S. GAAP is really rules-based. As with most issues, that is a drastic oversimplification. There are many, many rules in IFRS, in some cases

IFRS standards have very detailed rules that don't even exist in U.S. GAAP, and likewise U.S. GAAP is founded upon principles, people to just dream up arbitrary bright lines out of the blue, but there is a very compelling, conceptual underpinning to many of the U.S. GAAP requirements.

In my mind one of the few things that separates the two bodies of literature is time. The IASB has less time to go construct all these rules and fences than the FASB and its interpretive bodies have had, and so give them a couple of decades and we'll see how thick their rule book is. The real issue is if we if we don't like the extent of rules in U.S. GAAP, and the level of complexity that we've come to see, is trying to avoid the exceptions that people ask for, and that's a common phenomenon in both IFRS and U.S. GAAP. What happens is, for well intentioned reasons, folks ask for an exception, standard setter tries to be accommodating and grants it and that leads to a whole new set of questions around who's eligible for it and "How do I ring-fence it so it doesn't get abused" and before you know it, you have four or five times the volume of interpretive guidance as the original standard you started with. That's not something that's unique to U.S. GAAP, that's an issue that, frankly, both boards confront.

James McKinney: Related to the adoption by different countries, here's a question submitted for this discussion: Have standard setters who propose a single set of global accounting standards considered different cultural influences on the financial accounting reporting process and how that will affect the implementation of a single set of standards from one country to the next, and if so, how?

Robert Herz: I think that's a good question. It is something of the challenge. First, let me say that certainly in different countries there are different laws, tax laws, other types of unique transactions, government rules and the like. They will be accounted for and they may be unique to those jurisdictions. I am a big believer, however, in concepts and principles and I believe that if you start with concepts and derive principles from them, that you can work your way through to largely consistent accounting, even though a particular transaction may only occur in this jurisdiction, or this law only occurs in this jurisdiction, but the principle of how to treat them at a conceptual level and then following through to how that then translates into the accounting, I think you can get a lot of consistency. It's kind of the issues where people say "Okay, we got this transaction, let's just derive an answer for it," without thinking back to what is it we're trying to portray in tying it back to some concepts contributes, in my view, to a lot of the diversity in practice and to a certain extent to the complexity of the rules.

Now, having said that, I would say that there's a lot more work that needs to be done in my view at the conceptual level. Both the FASB and the IASB have conceptual frameworks. Those were developed several decades ago and time has proven that while they provide useful guidance in framing accounting issues, the frameworks themselves are not complete and not crisp enough and not developed enough in certain key areas that you can get that consistency of thinking at the concepts and principles level. I personally think more work needs to be done on that aspect. About 2004, we started to work on improving the conceptual framework, or merging our two conceptual frameworks. We did get to a joint framework statement on both the objectives and qualitative characteristics of financial reporting that is common now, but there are many other areas that need, in my view, more exploration, areas related to measurement in accounting, areas related to disclosure and the like. It's an effort that most people in standards setting would agree with, but it's like a lot of things in life, the important often gives way to the urgent. Starting in 2007-8, all the issues related to the financial crisis demanded a lot of attention of both of the boards and then since then the drive to complete a number of these major joint projects on particular broad areas of accounting has also consumed a good part of both boards' time and attention. The issue of can you get complete consistency in all areas, I think it's going to be a work in process, but I think if you start from common standards, you're a lot better off than if you say "Well, we're never going to get there." It's a continuous improvement exercise

James McKinney: Thanks Bob. Joe?

Joseph Ucuzoglu: I do think the cultural angle is overblown to some extent. If we, as Bob suggested, go back to the underlying economic phenomenon that underlie these transactions, you see a lot of consistency around the globe. Companies hire people, compensate them, produce goods and sell them, taxes get levied by a governmental authority and there are tweaks here and there depending on which country you're in, but at times the cultural difference gets used as kind of an excuse for "I just don't like the answer that's being proposed by the standard setter" and so there is some of that.

There are, though, complications that do have to be taken into account as we move toward, potentially, convergence and adoption of IFRS that are broader than just the technical standards themselves and that's an important point. Whether you call those things cultural or perhaps look at it a little bit more expansively, one of the things that I think the SEC's work over the past few years has brought to life is some of the significant challenges that we do have to work through in the context of the U.S. economy in order to lay the groundwork for a potentially successful implementation, so we can get the standards aligned. Some would say that's actually the easier part. Then how do you go about driving that understanding throughout the system, training up all the CPAs who are already in practice on the new set of standards, embedding this into university curriculum so that the new students coming through the system actually are educated in the new way of doing things, looking at regulatory and contracting regimes. Just as a very simple example that really brings this to life - in the U.S. for tax purposes companies are allowed to adopt the LIFO basis of accounting (last in, first out) which tends to reduce taxes or at least defer them over time in a rising price level environment, but only if there is so-called conformity and they do the same thing for book purposes. You can't have your cake and eat it too, and use the FIFO (first in, first out), which gives you higher income for book and use the LIFO which gives you lower income for tax. IFRS actually precludes the use of LIFO accounting for book purposes, and so if one were to adopt IFRS and comply with that provision it would be impossible to meet the conformity requirement and the all of the sudden there would be a big tax bill incrementally due. Similarly, a lot of contracts and debt covenants are tied to U.S. GAAP. If you all of the sudden change the basis of accounting you might have issues as to how those old contractual provisions will apply, how they might need to be amended to account for some of the differences that exist in IFRS, not to mention, if we were to move to IFRS, how to educate the investor base around some of the differences that they'd be seeing in the financial reporting that they're receiving. So, whether one calls that cultural or not, I do think it's indicative of the fact that there are a broad series of factors over and above the technical requirements and standard that have to get worked through in order to successfully move to a new regime like IFRS.

Robert Herz: I think that those are very important points. It's interesting that in response to the July 2012 SEC staff report we talked about before, the staff of the IFRS Foundation, which is the group of trustees that has oversight over the IASB, issued a report and an analysis a couple weeks ago on the SEC staff findings and analysis. I think that while they agreed with some of the SEC staff findings, there were others where they tactfully had a difference in view and maybe pointed out different or additional facts, but I think that as I read it there was some diplomatic, but I think strong, wording in the IFRS Foundation staff report to the effect of that many other jurisdictions have gone through this process and encountered similar issues and with political will, and they use the word "political will", they have dealt with it. I think that if you're sitting outside the United States and you see all these other countries somehow dealing with it in varying degrees of success, but some fairly successfully, it's hard to understand why is the U.S so different and so unique. Even though we sitting here in the U.S., we have a very developed financial reporting system. We have other environmental, cultural, regulatory, behavioral type norms in our system. We have much more enforcement, more litigation. We have internal control requirements that all of those challenges, as Joe noted, and contractual requirements which other countries may have dealt with, but those can be very, very, very challenging. It needs to be worked out in a very orderly, systematic, effective way without killing the crew in the process.

James McKinney: We've talked about this a little bit, but why don't we talk about now, for some of the listeners who may not know what some of the approaches the SEC has talked about taking. When we talk about some of the potential approaches that the SEC has discussed possibly taking towards accounting convergence and what are some of the pros and cons of each of those approaches with respect to the various constituents that are affected. Some of the constituents that might be affected are large global issuers, there might be issuers who are primarily based in the United States, there may be private firms in the United States. The approach the SEC takes towards convergence might affect large and international accounting firms, such as Deloitte. Of course, how they approach convergence could affect the smaller audit firms within the United States. And of course the approach the SEC takes will have impact on the regulators to the SEC, PCAOB potentially, FASB, lawmakers and the investing public, so the question is what are the approaches and what are the potential impacts?

Joseph Ucuzoglu: I'll go ahead and start. It's probably important to first look at some of the different motivations of the subcategories that you laid out in your question. Certainly there is more support behind the potential move towards IFRS from the largest companies that tend to do business globally and that's for a couple of reasons. One, there is an efficiency in an economy of scale associated with, I'm just going to state it simply, being able to keep one set of books around the world rather than having to tell each of your 80 subsidiaries to do things a little bit differently. Putting in place one standard process has a lot of appeal associated with it. There's also the benefit for those companies that do operate globally of potentially being able to use a single set of financial statements to raise capital around the world, again going back to that perspective that if we had an ability to compare on an apples to apples basis it would facilitate more efficient cross-border flows. That's at the largest multinational public company end of the spectrum, which you often hear.

The other end of the spectrum, which you might hear from smaller companies, perhaps those that are doing business on a very limited basis or not at all internationally, is essentially "It ain't broke, why fix it?" A lot of costs that they perceive in the switchover, this is certainly still a tepid economy and there're competing priorities for resources and oh, by the way, they don't see the similar benefits that some of the companies that operate globally do, because they don't have subsidiaries around the world that they're worried about having to keep difference sets of books for. They're not looking to raise capital in other jurisdictions. Those are the perspectives you see at the book ends and then you have every gradation in the middle.

In terms of the options there's probably a thousand different permutations, but directionally, I usually think of this in three buckets: one, is that you actually have the SEC just open it up as an option. "Hey, we can't figure this out. It's unclear whether we should scrap U.S. GAAP or not." Why don't we just let companies choose, so if you want to use IFRS we'll accept your financial statements under IFRS, if you want to use U.S. GAAP you're free to continue doing so, and that has some surface level of appeal and those who think "Maybe we'll just let the market sort this out" would advocate that type of an approach. It's difficult though in some respects to take what is right now a contentious policy level debate and effectively put the mess at the feet of investors. So now you just made a policy issue, a difficult policy issue, a difficult issue for investors who are actually faced with having to compare companies even within the same country on two different bases of accounting and then some would suggest if you open it up like that what you have is people picking and choosing. In one industry I get a more lenient standard under the GAAP; in another industry you get a more lenient standard under the IFRS. You'll have a race to the bottom. Then you just have the practical implication of it's hard enough to train a set of accountants in a country on how to get one set of accounting right consistently, what if now, for example, at an audit firm you suggest that half of your clients are going to be on U.S. GAAP and half of them are going to be on IFRS and then how effectively do you think you can manage that to actually train people on what they need to know to do it right here this week and then to actually pick up on the difference when they go out and ought to be doing it differently somewhere else next week. So, that's one approach.

Others advocate kind of a "pick a drop dead date" which many jurisdictions have in fact gone with. Essentially, on January 1, 2018 we're going to take all the U.S. GAAP stuff and throw it out the window. Instead, everyone's required to comply with IFRS as of that particular date, and if you take that approach, you certainly achieve consistency, but it doesn't dispel of the concerns around costs. You still have some people who have concerns around whether we take what's been thought of as the gold standard of financial reporting for many decades here in the U.S. and would we really be well-served to scrap it overnight. Along with the concern around just to what extent are we ceding jurisdiction over a matter for which we have a very important national interest, so even under the current regime where standard setting is largely delegated by the SEC to the private sector, the FASB. The SEC still maintains what you might call an override. If they think that there's a standard it's problematic. They certainly have a level of influence and are able to make that point of view known and if they think there's an area where GAAP hasn't caught up to the needs of investors they can just go plug it with the issuance of, for example, a staff accounting bulletin. So if you really wanted to move to IFRS cold-turkey you get into a lot of questions around how much tinkering would the SEC be allowed to do. What happens to the body of literature that the SEC his superimposed on GAAP and is that all of a sudden go away?

Then finally, you have what we seem to be gravitating towards, which is more of an endorsement based approach, where we continue the legacy of convergence, albeit in a little different form, but rather than moving overnight to a different basis of accounting, we work toward a directional alignment as the IASB takes up new projects. The U.S. incorporates those into the body of GAAP, perhaps looks at the existing body of IFRS and where possible incorporates that in place of existing U.S. GAAP requirement, so that again, I think Bob used the term "continuous improvement". We don't throw the whole thing out overnight, but we work towards an objective of becoming more and more aligned and through that endorsement process and picking up the new things that the IASB puts forward, maybe it takes many, many years and maybe you never actually get to exact symmetry, but at least you move toward a state where they're very, very similar.

Robert Herz: I think Joe's done a very good job of outlining different possible approaches. I think another one that some people would advocate, but I don't think it's likely to be practical going forward, is that the two boards would just continue to work together, developing new standards together. I think it seems like the period in which we had that very strong joint working relationship and Joe said before almost a "unique" partnership and position, may be drawing to a close because of the IASB now having to cater to a good part of the world has lots of competing demands and other standard setters in countries say "Why not us?" and the like. So, new modes of working together, how to continue to get greater alignment are the things that people are thinking about including, as Joe said, some kind of endorsement approach over time. That could range anywhere from the type of process that I'm familiar with in certain countries like Canada where they did pick a date, 2011. They announced that in 2006 and then went through pretty intensive and rigorous process to compare all the differences between their existing standards, which were many cases U.S. GAAP-like, with IFRS and seek input and the like. They then essentially endorsed the entire body of IFRS *en masse*. Going forward, they have an endorsement process for new IFRS standards. That is one end of the endorsement approach. Another one would be a more gradual, maybe partial, type approach, mainly based on standards that are newly issued standards or standards that seem to have better relevance and shown proving to be better than the existing U.S. GAAP standard, but over time to, as Joe said, get more closely aligned. All these things are essentially in the lap of the SEC. The SEC has the jurisdiction over those kinds of issues, but it is a very important policy question. One in which one can understand, although the folks abroad seem quite frustrated at this point. That is something that we do need to consider strongly. I personally believe the time has come for the SEC at least to get clear on where they'd like to head.

Joseph Ucuzoglu: Frankly, the devil will be in the details. It's easy to talk conceptually about an endorsement mechanism, but then the question becomes, "What's the threshold? What is the bar that is to be applied in deciding whether to endorse the standard that comes out of the IASB?" If you put in a relatively low threshold, for example – "You should have a strong bias toward accepting what they do and only in the instance that it is of grave danger to the U.S. capital markets you should reject it" - you'll get one outcome. Versus, if you say "Use your judgment" – if this is kind of the same standard that you would have come up with if you'd done it yourself then you should adopt it, but if you would have done differently yourself, don't adopt it," - you'll get a very different outcome. If you have a higher bar, like the latter that I described, the concern is that we already see there are fissures forming between the viewpoints and some of these contentious projects between the U.S., FASB and IASB. So, if when they're working together at these levels of disagreement are manifesting themselves, it stands to reason that there would even be more concern when the projects are not being constructed jointly as to whether the FASB would be so inclined to endorse the project at the end, which probably makes all the more important having robust processes in place so that the IASB is receiving real time input, not just from the U.S., but around the globe. I have found that no matter what that particular subject may be, at the end of the process somebody is much more likely to accept the outcome if they were along for the journey and felt like they had their say than if they're just having something dumped on their lap at the end and saying "You ought to essentially adopt it as your own."

James McKinney: So what do you think the FASB's future role would be in these sorts of models? It sounds like you're saying that FASB might have some sort of endorsement role. What happens to the FASB funding model and how does that interact with the International Accounting Standards Board?

Robert Herz: The FASB funding model since Sarbanes-Oxley is through a mandatory fee that gets levied on registrants and 40 Act mutual funds just like the PCAOB's annual fee. It's interesting that Sarbanes-Oxley said that any recognized standard setter by the SEC cannot be funded by public accounting firms or by voluntary contributions from companies. So, a question has arisen because the IASB does continue to receive some of its funding from Joe's fine firm and the other firms in the accounting industry and how that would be dealt with. The IASB has increasingly gotten funds through similarly mandatory levy mechanisms in different countries and jurisdictions of the world, whether it's just a kind of mandatory fee, or it's a stock exchange levy, but a big question has been "What about the U.S.?" That is a real question. Should part of the fee that currently goes to the FASB be allocated directly to the IASB? It was less of a question while the two boards have been working together, because it goes into a fungible pot of resources, so to speak, or a common set of resources working on joint projects, but if the boards are not going to operate in the same mode going forward and the U.S. wants to continue being part of the international regime that question of funding arises at those two levels. At the law level as to what to do, and also at the financial level as to what the U.S. contribution to this effort would be.

Joseph Ucuzoglu: Given the law of the land, there is a potential impediment to going into the far end of the spectrum and just recognizing the IASB as the standard setter that is relied upon. You could envision that if that were deemed to be an impediment that perhaps some type of FASB led endorsement process where the FASB is still the designated standard setter for legal purposes might be useful in overcoming that impediment. So, that's the funding side. Then on what actually is the continuing role of the FASB, putting aside the money. We've talked at length about endorsement. I think the real sensitive question on the table is "What else besides endorsement?" Is that the only function? Either rejecting or accepting the new standards or is there going to continue to be an ability of the FASB to take up its own projects to the extent there is. That obviously causes some level of inflamed passions around "Well, are you really using IFRS if you're out crafting your own stuff?", but again, if the construct here is that the U.S. has to ensure that it's protecting investors and there is a concern that perhaps there's a project that's important to the U.S. that is not either being taken up by the IASB or is not proceeded under a timeline that's acceptable in the U.S. Does there still need to be a mechanism for the U.S. to plug some holes?

Robert Herz: I've had the privilege of serving for almost two years now on the Accounting Standards Oversight Council of Canada, which is roughly the analogue to the Financial Accounting Foundation in the U.S. that has oversight over the FASB and the GASB, the Governmental Accounting Standards Board, or to the IFRS Foundation Trustees, which has oversight over the IASB. As I mentioned before, Canada went to IFRS for listed companies and certain other entities starting in 2011, but the Canadian Accounting Standards Board is still plenty busy in the public company arena. It does go through an endorsement type approach for new proposals and standards that are issued by the IASB, getting constituent input, engaging constituents, getting that input, considering it, making sure that the IASB is going through its due process and has considered input and the like and people serving on various IASB advisory groups. Then there's the whole question, beyond the SEC realm, of private companies, not for profits and the like, so what you find is that although the role changes, it certainly does change, the standards setter that I'm familiar with, Canada still has plenty to do.

James McKinney: Great. This is great information. So let's switch topics for our live listeners. As our listeners are probably aware, yesterday we had our U.S. presidential election. President Obama was re-elected. I guess the question is what do you think the potential impact will be on the SEC and on convergence with the re-election of President Obama?

Joseph Ucuzoglu: I did hear that we had an election yesterday (Laughs). I will probably start by observing that convergence with IFRS may not be the number one item on the policy agenda in Washington, and, frankly, that's been part of the problem. Things seem to be progressing at a relatively steady pace, and then the financial crisis hit and priorities changed and we had an SEC that was sidetracked with some other more urgent matters. I think you've seen that phenomenon really continue through this day. It's still unclear exactly what changes may be in store at the Commission level. Clearly the outcome of the election has some influence on the makeup of the Commission. What I would say is without making predictions as to exactly how this plays out, my hope is that as we get into the next year, or in some level of certainty as to who comprises the Commission, that we at least have the environment in which to have a constructive dialogue and in what should be a non-partisan issue, to come up with a mechanism such that the U.S. can send a clear signal to the rest of the world as to what our intentions are, and then hopefully make some progress toward whatever that end objective is that we decide upon.

Robert Herz: I think that's very, very well stated by Joe. I think clearly there are higher priority issues and rightly so. Yet the G-20 group very recently, maybe last week, again encouraged, urged the two boards to complete their convergence effort, at least the current major projects in the MOU effort, and asked for it to be done in 2013. So, it's still on the agenda and on the radar there, but the real question is at what point, given all the SEC's other priorities, including I understand that they are only about a third of the way through promulgating rules under the Dodd-Frank Act. They've got this recently passed JOBS Act, Jump Start Our Business Start-ups Act, where they've got to promulgate some things. There are other priorities in our capital markets and so therefore, it's understandable that they want to focus their attention on those things, but I think that the issue of, "What is the path forward in the U.S.? Is the U.S. going to continue to play? How is it going to play?" are important issues. Certainly the eyes of the world have been on us and continue to be on us, and they certainly would like some, as Joe said, some clarity.

James McKinney: I will ask this of Joe, very briefly, one of the questions that someone had posed was: What do you think the impact of this convergence might be on the PCAOB and its auditing standards, if any?

Joseph Ucuzoglu: At the most fundamental level the auditing standards are essentially constructed to set up the regime by which the accounting information that companies produce is audited, and so to the extent the rules change around how the numbers get computed, that has some collateral effect on the auditing standards. That's the obvious. There is clearly a level of regulatory coordination here in the U.S. amongst, for example, the PCAOB, the FASB and the SEC, and so there will have to be some new normal constructed in the event that now the IASB takes on a more primary role and the FASB, perhaps, in this type of an endorsement model, in order to maintain that level of regulatory co-ordination amongst those bodies, and then from the standpoint of the auditing standards themselves, you know, just like this path with respect to convergence of accounting standards, is as Bob said, you can really trace this back forty years. It is a journey. There's no doubt that we will see a long journey as folks consider the prudence of trying to reconcile the auditing standards that apply around the world. Then, at the most basic level, there is a shared objective of regulators around the world to produce auditing standards that result in high-quality, verifiable attestation, and so that kind of backdrop and that desire for global coordination and global regulatory harmonization will absolutely continue forward.

Robert Herz: Earlier in this conversation, we talked about principles versus rules, and Joe quite appropriately said the kind of portrayal that IFRS is principles based and U.S. GAAP is this bunch of unconnected rules and checklists and the like, is not quite right. But what is true, and Joe also mentioned this, too, is that in U.S. GAAP - we do have much more guidance in a lot of areas. And so there're places to go to and we've had a much more active interpretations activity over the years. And so the question becomes if we were to go to IFRS, would it require, on the one hand, more implementation guidance or, on the other hand, if we're not going to have that then there's going to be perhaps more judgment needed and how in terms of applying that judgment from the auditors point of view or from the PCAOB’s perspective of looking at what the auditor did, does there need to be some changes in approach, mindset, things like that.

Joseph Ucuzoglu: I think that's probably an excellent connection point to a past program that we’ve done on the virtual museum and archive around the use of professional judgment and if you're going to go to a system that has less detailed rules, you need some robust framework in which to guide either a preparer’s or an auditor’s exercise of that judgment. Sometimes professional judgment is misinterpreted as "you can select any alternative" when in fact it ought to be anything but that. It ought to be the process of kind of a rigorous evaluation of what ultimately winds up in the highest quality form of reporting to investors.

James McKinney: So we're running out of time. We are drawing to our conclusions. This has been an excellent discussion - very interesting. Do you have any thoughts on where we go from here - a brief summation?

Robert Herz: I suspect that a number of the listeners here are either students or maybe accountants early on in their professional career, and my advice to you would be: you don't need to learn all the detailed rules of U.S. GAAP or IFRS, but learn the thinking and the concepts behind them. The standards and the rules are going to change over time, clearly, but if you get the concepts and the thinking behind it, you'll be in good shape.

Joseph Ucuzoglu: That's the best piece of advice I could give. I will say in terms of next steps on movement towards international standards – look, I opened up by saying that the concept makes perfect sense and that everybody would agree upon it, but the concept also makes perfect sense that the entire world would use the same measurement system and we haven't even been able to get folks to universally adopt the metric system. And, so this isn't about necessarily trying to boil the ocean. It's as Bob very well said, it's about continuous improvement and continuing to get better over time and not feeling like we haven't achieved the objective simply because we haven't gotten all the way. This will be a continuing journey.

James McKinney: Great. Bob and Joe, thank you so much for sharing your experiences. This has been a wonderful discussion. I think we have gained much greater insight into the international convergence process. We'll see where we go from here. Thank you for your insights into this complex and continuing topic.

Today's program will be an important addition to the museum's collection of materials and information on accounting and auditing. The broadcast will soon be available in audio/mp3 format in the museum and an edited transcript will be added later. I would like to encourage you to visit The Richard C. Adkerson Gallery on the SEC Role in Accounting Standards Setting, when it permanently opens in the museum on December 1. I've had the opportunity to look at these materials myself, being on the Museum Committee, and they're really great materials for students and for historians and for those in the accounting profession. This is the first museum Gallery on an accounting or auditing topic and has been curated by George P. Fritz, retired partner with PricewaterhouseCoopers, LLP and a consultant to accounting and auditing standard setters. Bob conducted an oral histories interview as part of the building of the Gallery and several of the Deloitte Fireside Chats will be linked to the Gallery.

On behalf of the SEC Historical Society, I would like to thank Deloitte LLP for its generous support and its assistance in making this program possible. Thank you for joining us today. Good afternoon.