Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR)

32nd SESSION
4 - 6 November 2015
Room XVIII, Palais des Nations, Geneva

Wednesday, 4 November 2015
Morning Session

Keynote address

Presented by

Russell G. Golden
Chair
Financial Accounting Standards Board

Remarks of Russell G. Golden
Chairman, Financial Accounting Standards Board
United Nations Conference on Trade and Development
International Working Group of Experts
on International Standards of Accounting and Reporting
Geneva, Switzerland
November 4, 2015

Good morning. It's a pleasure to be with you today in Geneva.

I'm honored by your invitation to address this important organization—the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting.

It's the first time that I've had the opportunity to visit with you, and to my knowledge, it's the first time that any chair of the Financial Accounting Standards Board has been asked to speak at one of your meetings. I want you to know how much we appreciate this opportunity—and we very much look forward to continuing our dialogue in the months and years ahead.

In the past few weeks, I've made an effort to better understand the mandate of ISAR. As it turns out, ISAR and the FASB share many of the same goals: acting to ensure comparability in disclosures; promoting increased transparency; and pursuing the long-term objective of international harmonization of accounting and reporting.

Today, I'd like to share my thoughts with you about the critical role that relevant, representationally faithful, comparable, and verifiable financial reporting plays in the efficient and effective operation of capital markets around the world. Put another way, I'd like to talk about the importance of financial reporting that tells the truth.

As a key part of that discussion, I'll outline my perspective on what it takes to develop the kind of high-quality accounting standards that promote high-quality financial reporting—and the consequences we face when we fall short of that goal.

I'll share with you brief descriptions of two projects we are about to complete that are intended to promote much greater transparency in financial reporting—one involves leases, the other credit losses.

Finally, I'll talk about the need for cooperation and collaboration among all of the organizations around the world that play a role in financial reporting—accounting standard setters, audit standard setters, securities regulators and others.

Only by working together can we collectively promote reporting that is more accurate, comparable, and relevant to investors.

Before I begin, let me add my usual caveat—my remarks today reflect my views alone. I do not speak for the entire Board—we only do that after spending an awful lot of time conducting research, listening to our stakeholders, arguing and debating among ourselves, and then voting on final accounting standards.

With that out of the way, let me begin.

The month of October 1929 was a bad one for investors. Fueled by speculation and easy credit, American stocks had been on a nine-year run that peaked on September 3, 1929. On that day, the Dow Jones Industrial Average reached 381. On October 18, stocks went into a free fall. Panic set in on October 28. When the closing bell rang on October 29, the market had lost 40 percent of its value. By November, the Dow Jones average had slipped to 198, helping to usher in the Great Depression, which lasted for more than ten years.

Fast forward seventy-plus years. In December 2001, energy giant Enron filed for bankruptcy, admitting that accounting "errors" had inflated its income by $586 million since 1997. Those accounting "errors" later turned out to be accounting "fraud," through which Enron hid billions of dollars in debt from failed deals and projects.

Seven years later, in September 2008, the U.S. Office of Thrift Supervision seized the assets of Washington Mutual Bank from Washington Mutual, Inc. and placed it into receivership with the Federal Deposit Insurance Corporation. It was the largest bank failure in American history. The action followed a nine-day run on the bank, during which customers withdrew $16.7 billion in deposits.

The collapse was fueled in part by fear driven by the risks and uncertainty associated with potential losses in Washington Mutual's portfolio of mortgage and credit card loans, which generally were made to less credit-worthy customers.

Besides generating headlines, these financial disasters share a common thread. They all resulted—directly or indirectly—from a lack of high-quality financial reporting. As we know, the toll in jobs, wealth, and financial security was devastating.

That's why the reporting of high-quality financial information is critical to the functioning of capital markets.

In the case of the stock market collapse of 1929, that information simply did not exist. In the 1920s, before the creation of the U.S. Securities and Exchange Commission, financial reports often comprised only a statement of profit and loss and a balance sheet. There were few standards. Consolidated financial statements were rarely seen, and sales and cost of sales often were not reported.

The lack of relevant information gave rise to many deceptive and questionable accounting and financial reporting practices. As a result, investors were harmed.

In the case of Enron—and the bankruptcy of telecommunications giant Worldcom the following year—the relevant financial information existed—and should have been reported—but it was purposely hidden from investors through the misfeasance—and malfeasance—of senior corporate executives.

In the case of Washington Mutual, depositors panicked in part because of their uncertainty over the size of the potential credit losses embedded in the bank's portfolio of mortgage and credit card loans. When they lost confidence, they withdrew more than 9 percent of the bank's deposits over a nine-day period.

From these examples, I draw two important lessons:

First, the principal goal of accounting standards should be to promote truth-telling in financial reporting. Capital markets should pick winners and losers based on merit. But the markets can perform that function only if they have access to truthful and accurate financial reporting.

Second, the work of setting accounting standards is an important part of the process of promoting high-quality financial reporting. However, accounting standard setters are only one of many groups ultimately responsible for the quality of financial reporting. As I mentioned earlier, others include audit standard setters, and securities regulators. To promote high-quality, truthful and relevant financial reporting, all of us need to work together.

Let me talk about truth telling first.

Companies, not-for-profits, governments, and other organizations use accounting standards as the foundation upon which to provide users of financial statements with the information they need to make decisions about how well an organization or government is managing its resources.

That information is used to decide how to invest capital and where to lend money.

So it stands to reason that the information must be clear, concise, comparable, relevant, reliable—and truthful.

Greater transparency results in better capital allocation—investors and lenders make better-informed decisions about how to invest their money and what risks they are willing to accept.

Better investing decisions inspire greater confidence in the markets, which ultimately strengthens our economy. In the end, it represents a "virtuous" cycle.

Without clear accounting standards and an open, independent process for creating and improving these standards, financial information would be more opaque, and capital markets around the world would function less efficiently. That, in turn, would drive up costs for all sectors of the economy.

What does it take to develop accounting standards that promote truthful financial reporting?

Public debate and transparency are the keystones of the standard-setting process. The FASB's ultimate goal is to foster the delivery of accurate and reliable financial information for the investors who provide capital to businesses and other organizations.

At the FASB, we strive each day to update and improve financial reporting, aided by a vigorous and open exchange of ideas with a broad range of stakeholders.

Through that process, everyone involved in developing high-quality accounting standards—financial statement users, preparers, and auditors, as well as members of the standard-setting board—plays an important role in keeping our capital markets efficient and competitive.

That said, it often is challenging to set standards that meet the needs of a wide range of capital market participants, including investors, preparers, auditors, citizens, donors, and lenders, among others.

Standard setting requires a balance between providing information that is most relevant to users of financial statements with the costs of providing that information.

Perhaps the most important prerequisite for successful standard setting is independence. The standard setter must be free to set standards that most accurately depict financial transactions and the financial position of companies.

A corollary of that rule is that standard setting should be independently *funded*. Financial dependence on those who have vested interests in the outcome of the standard-setting process is a burden that no standard setter should have to bear.

Our job is to provide economically neutral information so investors can make their own decisions. It is not the role of the standard setter to pick winners and losers in the economy. We seek simply to ensure that the playing field is level.

If we were to change a standard to portray a more favorable—but false—economic picture, then accountants would be doing the job of the markets: namely, changing behavior. I can assure that it’s not our role.

Accounting standards must be established in an arena free of bias and free of even the hint of political or business interference.

If investors and other stakeholders ever sensed that standards were being set behind the scenes, or to benefit a particular industry or group, they would lose faith in financial reporting and, by extension, the capital markets.

While our process is designed to circumvent politics, outside forces sometimes come into play.

One example centered on stock options.

In 1993, FASB issued a proposal that would have required companies to expense the value of their stock options. This did not go over well with some companies, especially with tech industry startup companies that used stock options to compensate employees. In a nutshell, expensing stock options would make profits appear smaller.

Also opposing it were all eight of the major accounting firms. Four of the five commissioners at the SEC spoke out publicly against us. SEC Chairman Arthur Levitt also said he could not support the proposal.

In fact, one of the only people who spoke out in our favor was Warren Buffett.

Congress got involved. In the end, we tempered the rule so that companies could either report the cost of options in a footnote, with no effect on earnings, or book them as an expense.

Fast forward to 2001. A series of accounting scandals—including Enron—forced Congress to get serious about reforming corporate practices. The stock options proposal finally made it into GAAP—shortly after Congress enacted the Sarbanes–Oxley Act of 2002. By the way, Sarbanes-Oxley is formally known as "Public Company Accounting Reform and Investor Protection Act."

Years later, Arthur Levitt publicly admitted that his failure to support the FASB on stock options was the single worst decision that he made during his tenure as chair of the SEC.

We are committed to doing our best to make sure that the FASB and the standards we set meet the needs of all of our stakeholders, not just some of them. And we do everything we can to ensure that process remains independent of undue political influences, because then—and only then—can we set standards that produce economically neutral information.

Standards that provide an objective view of a company's financial position enable investors and other users to make the best-informed decisions possible about the allocation of their capital, and second, allows our capital markets to operate as efficiently as they can.

We currently are working to solve some accounting problems where accounting in the past has not told the whole truth.

Since 2009, the FASB, along with the International Accounting Standards Board, has been working on a project to improve guidance for accounting for financial instruments—including loans.

An important component of that project was to develop a more forward-looking "expected loss" approach for recognizing credit losses, in response to lessons learned from the financial crisis of 2008. During the crisis, many believed that existing "incurred loss" model of accounting led to financial reporting that provided too little information, too late.

Because the existing impairment model delays recognition of the credit loss until the loss is probable (or has been incurred), many have argued that the model fails to alert investors to expected credit losses in a timely manner.

The new standard, which we expect to issue in its final form in early 2016, features a "current expected credit loss"—or CECL—model. The CECL model uses a single "expected credit loss" measurement objective for the allowance for credit loss.

It requires the balance sheet to reflect the net carrying amount of a financial asset (net of allowance for credit losses) at the amount an organization expects to collect.

The CECL approach considers more forward-looking information than is permitted under current Generally Accepted Accounting Principles, or GAAP.

When credit losses are measured under current GAAP, an organization generally only considers past events, including historical loss experience with similar assets, and current conditions in measuring the incurred loss. The proposed amendments of the CECL approach would broaden the information an organization is required to consider in developing its credit loss estimate so it can reflect the net carrying amounts of the financial assets at the amount expected to be collected.

The FASB believes this model is responsive to feedback received not only throughout the course of the project, but to the feedback received from the Financial Crisis Advisory Group and other stakeholders that expressed concerns over the weaknesses in current GAAP and IFRS at the very beginning of the project.

Another project through which we are trying to improve the information that is reported to investors is our leases project. The leases project was added to the FASB's joint agenda in response to concerns from investors and other financial statement users—as well as the SEC—about the lack of transparency relating to material lease obligations that today are reported off-balance sheet. Following the Enron bankruptcy, the SEC staff in 2005 identified leasing as a form of off-balance sheet accounting that needed to be addressed.

The objective of the new leases standard—which we expect to issue by the end of this year—is to increase transparency and comparability among organizations that lease assets, by recognizing the assets and liabilities that arise from lease transactions.

The FASB lessee accounting model continues, like today, to account for two types of leases. One type of lease (the capital lease) will be accounted for in substantially the same manner as capital leases are accounted for under existing GAAP. The other type of lease (the operating lease) will be accounted for in a manner similar to operating leases under existing GAAP, except that lessees will recognize a lease liability and a lease asset for all of those leases.

The new leases standard will represent a significant improvement to financial reporting, but also will be a change for many companies and organizations. For that reason, it was important to the FASB to ensure it was appropriately considered. The stakeholder feedback we received on our first leases proposal—issued in 2010—caused us to revise some of our conclusions.

In developing our revised 2013 proposal, the Board conducted extensive field work with U.S. stakeholders, including small group meetings with approximately 100 stakeholders to discuss, among other things, the costs and relevance of various lease accounting models under consideration.

During 2012 and 2013, individual Board members and staff participated in more than 50 meetings, panel discussions, webcasts, and in-person seminars with a wide variety of stakeholders. These provided the Board with information about the costs and operationality and the related benefits of the proposals.

Based on what was learned during the extensive outreach we performed when developing the standard, it appears that lenders already count off-balance sheet lease liabilities when making their credit assessments. In its 2013 and 2014 outreach with investors and analysts, the FASB found that the majority of those consulted already make adjustments to a lessee's reported balance sheet to capitalize operating leases when operating leases are significant to the lessee, and in fact, often capitalize larger amounts than would be recognized in accordance with the forthcoming guidance.

So, while some industries have argued that increased transparency about lease obligations would potentially create a less favorable economic picture of certain companies, this outreach shows that lenders, investors, and analysts already are making those judgments.

As I mentioned earlier, accounting standards are an important element—but not the only element—required to promote high-quality financial reporting. We need honest companies, we need honest auditors—and we need watchful regulators—to make the system work. The standards themselves can only go so far. Every participant in the capital markets has a role.

In the United States, those participants include the Securities and Exchange Commission, which has the authority to enforce the rules related to financial reporting in the United States. They also include the Public Company Accounting Oversight Board—the PCAOB—which was established by Congress following the Enron and Worldcom scandals to regulate the auditors of U.S. public companies.

At the FASB, we regularly meet with the Office of the Chief Accountant at the SEC, and with our counterparts at the PCAOB, to ensure that we are working together to promote more accurate and more transparent financial reporting. We also meet regularly with banking regulators and all of our major stakeholder groups to share information and trade points of view on important issues related to financial reporting.

On the international front, the same rule applies. Reducing global differences in financial reporting is dependent on more than simply reducing differences in financial accounting standards. Significant differences continue to exist in the auditing and enforcement of financial reporting in jurisdictions around the world. Therefore, broader or more complete convergence of financial reporting cannot be accomplished through financial accounting standards alone.

For example, international securities regulators have developed a well-established and effective model for fostering cooperation and collaboration among their organizations. It's called IOSCO. The International Organization of Securities Commissions—IOSCO's formal name—has as its mandate the protection of investors; ensuring that markets are fair, efficient and transparent; and the reduction of systemic risk.

IOSCO is governed by a board of 33 securities regulators from around the world, and is recognized as the global standard setter for the securities sector. Through a collaborative process, IOSCO develops, implements, and promotes adherence to internationally recognized standards for securities regulation. It works intensively with the G20 and the Financial Stability Board on the global regulatory reform agenda.

International cooperation and collaboration among standard setters also is important. For more than a dozen years, we have been working cooperatively and collaboratively with the International Accounting Standards Board to reduce differences between GAAP and IFRS. More recently, we've also begun to meet with other national standard setters from Europe, the Americas, and Asia to discuss issues of mutual interest.

The work that the FASB and the IASB have accomplished since they began collaborating under the Norwalk Agreement in 2002 represents a major success. To date, the FASB and the IASB have converged their views on major standards covering revenue recognition, business combinations, non-controlling interests, stock compensation, and fair value measurements. The Boards also have produced converged standards on borrowing costs, segment reporting, nonmonetary exchanges, inventory accounting, joint ventures and accounting changes.

Even in areas where the Boards continue to have some differences – leasing and credit impairment, for example – they have agreed on key principles: Most lease obligations should be reflected on the balance sheet; and we should base impairments on expected losses rather than incurred losses. That is all good news.

Let me conclude with a few observations about what we've discussed today.

We are committed to doing our best to make sure that the FASB and the standards we set meet the needs of all of our stakeholders, not just some of them. And we do everything we can to ensure that process remains independent of undue political influences, because then—and only then—can we set standards that produce economically neutral information.

Standards that tell the truth provide an objective view of a company or government's financial position and enable investors and other users to make the best-informed decisions possible about the allocation of their capital. That enables our capital markets to operate as efficiently as they can.

Accounting standards are an important component—but not the only component—of high-quality financial reporting. Companies, auditors, and regulators all have an important part to play.

The concept of balance is the common denominator. We try every day to ensure that our standard-setting boards make decisions that balance the competing interests of the users of financial statements—investors, lenders and others—with those who prepare and audit financial statements.

The process is not always pretty–but it always is open and transparent, and center stage for everyone to see.

Not everyone is happy with the result. But if people feel they have been part of the solution, they are more apt to buy in to the process and the product.

Which brings to mind a famous observation from a legendary European political figure. He was talking about democracy. But I think it equally applies to our standard-setting process as well, for many of the same reasons.

"It has been said," said Winston Churchill, "that democracy is the worst form of government – except for all the others that have been tried."

At the FASB, we keep trying to improve the process. We look forward to working with all of you in this room to keep improving the process.

Thank you for your time.

#####