

U.S. DEPARTMENT OF THE TREASURY

Press Center

Paulson: Financial Reporting Vital to US Market Integrity, Strong Economy

5/17/2007

HP-407

Washington, DC- The Financial Times published the following opinion editorial today from U.S. Treasury Secretary Henry M. Paulson, Jr., discussing the first stage of his plan to enhance U.S. capital markets competitiveness: The Key Test of Accurate Financial Reporting is Trust

By Henry Paulson

Accurate and transparent financial reporting is vital to the integrity of our capital markets and the strength of the US economy. In an address last November, I spoke about the importance of strong capital markets, pointing out that capital markets rely on trust. That trust is based on financial information presumed to be accurate and to reflect economic reality.

Our capital markets are the best in the world and so is our financial reporting system. We must work to keep them that way. On Thursday, the Treasury department is announcing several important steps to ensure we preserve an efficient financial reporting system that provides reliable information, is supported by a sustainable auditing industry, and has enhanced compatibility with foreign reporting standards.

In March, Christopher Cox, the Securities and Exchange Commission chairman, and I co-chaired a conference on capital markets competitiveness. Financial reporting was one of the main topics of discussion.

A strong auditing profession is essential for a well-functioning reporting system. The auditor's role is key: to examine financial statements and express an opinion that conveys reasonable, but not absolute, assurance as to the truth and fairness of those statements. The Sarbanes-Oxley Act of 2002 enhanced financial reporting integrity, including mandating major changes affecting the auditing profession. The act created the Public Company Accounting Oversight Board to replace self-regulation, and mandated auditor independence requirements. As these changes took effect, new challenges arose. We now have fewer major accounting firms, and legitimate questions about the sustainability of the auditing profession's business model.

These new challenges require understanding and solutions. To achieve this, the Treasury has asked Arthur Levitt, former SEC chairman, and Donald Nicolaisen, former SEC chief accountant, to serve as co-chairs of a non-partisan committee to address auditing industry concentration, and to consider options available to strengthen the industry's financial soundness and its ability to attract and retain qualified personnel. Through this public forum, investors, advocates, and companies can present a wide range of views, engage in informed debate and provide recommendations.

In addition to changes in the auditing profession, Section 404 of Sarbox appropriately emphasized the importance of internal controls over financial reporting. However, implementation has proven more costly and burdensome than originally anticipated. Mr Cox, Mark Olson, PCAOB chairman, and their commissioners and board members have sought to improve the application of Section 404. A more risk-based implementation will be a positive step.

Another emerging challenge is the soaring number of financial restatements over the past decade. In 1997, there were 116 restatements; in 2006, there were 1,876, or more than 10 per cent of public companies. Restatements pose significant costs on our capital markets. They have the potential to confuse investors and erode public confidence in financial reporting. Some of these restatements might not be material to investors, and others may simply reflect new accounting standards interpretations.

This volume of restatements reflects, in part, the complexity of our financial reporting system. Mr Cox and Robert Herz, Financial Accounting Standard Board chairman, are to be commended for their efforts to reduce that complexity. To complement this move, the Treasury intends to commission a rigorous analysis of factors driving financial restatements, and their impact on investors and the capital markets.

The increasing globalisation of our markets also means that we must enhance the comparability of foreign company financial statements. Mr Cox's leadership has been instrumental. He has taken positive steps towards the convergence of US GAAP and International Financial Reporting Standards, and eliminating the US GAAP reconciliation requirements for IFRS-reporting foreign companies by 2009.

As the SEC has said, its actions are key steps "toward a future regulatory framework in which IFRS may be used on a stand-alone basis by foreign private issuers and possibly also by US issuers." When fully implemented, this will enhance financial statement consistency and

facilitate cross-border transactions and cash flows.

We will pursue each of these initiatives, and other steps that will be part of the broader competitiveness discussion, to ensure that US capital markets remain efficient, innovative and continue to drive capital to its most productive uses. Our markets must retain the integrity and efficiency that has contributed greatly to prosperity in America and around

The writer is US Treasury secretary