

Securities and Exchange Commission Historical Society
Oral History Project
Interview with Robert Herz
Conducted on March 11, 2011, by James Stocker

JS: This is an interview for the SEC Historical Society's Online Oral History Archive. I'm James Stocker. Today is March 11, 2011. I'm talking today with Bob Herz. Good afternoon, Bob.

RH: Hi, James.

JS: To begin with, let's talk about where you were born and where you grew up.

RH: I was born in New York City, in Lenox Hill Hospital in June 1953.

JS: How much did you weigh?

RH: I believe it was something like seven pounds and ten ounces.

JS: Did you grow up in New York?

RH: We lived in New York City until I was about two. Then we moved to Maplewood, New Jersey, which is the sister town to South Orange, New Jersey, where you're doing this interview. We moved back to Maplewood in 1980 and then from there to this house, in South Orange, in 1984, so a good part of my life has been around here.

JS: How did you get from Maplewood, New Jersey, to Manchester, England, to study accounting?

RH: I was living in Maplewood when I was fourteen. My father came home one night and told my mother and me that we were moving to Buenos Aires, Argentina. We lived in Buenos Aires until I was more or less eighteen. I went to high school there. I went to an Anglo-Argentine school. The English part of the day the courses were like an English public school. I ended up taking what are called "O levels" and "A levels," which are kind of like the English university entrance exams. That led me to college in England.

JS: What did your parents do?

RH: My father was a commodity trader, a pretty well-known one, and eventually rose through the ranks in larger commodity trading corporations. At the time, he was with a company called Bunge, who were very big in Argentina. They were much into more than commodity trading there. They owned a lot of the base industry there, and had a very big operation there.

JS: While you were in Manchester studying, did you study the American, as well as the British systems of accounting?

RH: While I was at university, I read economics and that is what my degree is in. I did take

some accounting courses and I wouldn't say they were specifically American or British. They were on accounting theory and managerial accounting and the like. I started taking more accounting courses towards the end of my three years in college, because the recession of 1973-74 hit and I was told that the best job opportunities were in accounting, not in economics.

JS: Did you have any particular influences while you were there?

RH: Yes, I did. There were three accounting professors there that were all pretty well known. The head of the department was a guy called Bryan Carsberg, who is now Sir Bryan Carsberg. He later went on to be the Secretary General of the old International Accounting Standards Committee, and is a very well known English figure. Two of the other professors there were John Arnold, who later became the dean of the Manchester Business School, and, in particular, there was a professor there, **Tony Hope**. I still maintain relationships with all these folks. They really kindled my passion for accounting.

JS: Someone suggested that I ask you for a picture of your time in England, of you with long hair, for the SEC Historical Society archive. Are there such pictures?

RH: Yes, here's one. Here's a picture of me and my wife, coming off a plane, I think, in Spain around that time. It's kind of the John and Yoko picture. (Laughter.)

JS: I was going to say, that's not John, is it? That's great. From university, how did you decide to come back to the United States?

RH: I joined Price Waterhouse in Manchester, England, after university and I was there for about four years. I got qualified as an English chartered accountant and my long-term sweetheart, my wife, Louise, we got married. Anybody who lived in England during the seventies knows that it was hard to make ends meet. I think at the time I was earning – being a qualified accountant, this was now 1978, when I got married – I was now not only a chartered accountant, but I think I was either a supervisor or assistant manager. I think I was making the princely sum of about £5,000 a year, which maybe would have been about \$8,000. Most of that went to taxes, because the taxes were very progressive.

After a lot of discussion, I convinced Louise that the U.S. was the land of opportunity. I think at the time similar jobs were getting paid two or three times that amount and had lower taxes. I went to Price Waterhouse and asked for a transfer, and eventually they came up with Miami, Florida. So we transferred to Miami, Florida. I guess the reason they did that was because I speak Spanish, from my days in Argentina.

JS: How long did you spend in Miami?

RH: Only about nine months. The reason was that Florida has rather strict professional licensing requirements, because of the issue with retirees settling down there. Being an English chartered accountant, they would have required me to not only take the CPA

exam, which would've been fine, but essentially to redo my college education. After some soul searching, I decided that was not the best course of action.

Unfortunately, Price Waterhouse down there would not facilitate another transfer for me to another state. My preference was the Northeast, because that's where I came from. I wrote a few letters and fairly quickly got a job with Coopers & Lybrand, in Boston.

JS: What year was that?

RH: That was the beginning of 1979.

JS: So you went over to the competition.

RH: I went over to Coopers, yes.

JS: How long did you stay there?

RH: I was in the Boston office of Coopers from about February of 1979 to about October of 1980. I took the CPA exam, because in Massachusetts they recognized my English college education. I got the Gold Medal in the state of Massachusetts, the highest score. I also got the Elijah Watt Sells Award nationally on the CPA exam. I got a lot of job offers all of the sudden because of that.

One of the job offers, interestingly enough, was from the FASB. I was about to take the job at the FASB, but a couple of partners in the Boston office took me under their wing and said, "Well, if you want to do that kind of work, the alternative would be to transfer to the Coopers & Lybrand national office in New York City. You could follow the FASB and the SEC and write guidance to the practice, write books and all sorts of cool stuff."

After talking about it with my wife, we decided I would stay with Coopers. At that point, Louise was pregnant with our first child, our son, Michael. We decided to relocate back to my hometown of Maplewood.

JS: You stayed then in Maplewood until you made senior partner?

RH: Well, I was at Coopers in the national office as a manager. Then I was in the New York office as a manager. I made partner at Coopers & Lybrand in 1985. I was at Coopers through the merger with Price Waterhouse and PwC until July 1, 2002.

JS: So you were still there in the mid-nineties too, when Coopers & Lybrand was under investigation by the SEC for the auditing independence rule?

RH: Yeah, that was actually after the merger. It was after the merger and I was there. I was the head of the national office by that time. I was on the board of partners. I was one of the people, the many that they subpoenaed lots of records for and went through the

records . I think they found a number of violations, but by and large, they weren't that serious. A lot of them were people tripping over particular rules.

There were some serious violations, particularly what sparked it off originally, in the Tampa, Florida office. There were some things that I found fairly distasteful. By and large, after the SEC did a fairly extensive investigation of the firm and the partners, they didn't find many more violations. Actually, my recollection is that because of that and maybe some other things, it led to some rewriting of the personal independence rules.

JS: Were you active in the AICPA during your early career?

RH: I've been a very proud and longstanding member of both the AICPA and the Institute of Chartered Accountants in England and Wales. I'm a fellow of that. In the nineties, I became the senior technical partner of Coopers & Lybrand, and by virtue of that you get much more active in a lot of professional activities. That, for me, included joining and then becoming the chair of the AICPA SEC Regulations Committee. I was on the SEC Practice Section Executive Committee of the AICPA. I was on the AICPA's Council, its governing body, as well, for a few years and various other activities with the AICPA.

JS: While you were on the SEC Regulations Committee, what issues did you work on there?

RH: Well, the role of the Regulations Committee is to interface between the profession and the SEC staff, particularly on SEC filing matters. And so, we would provide informal

guidance that was not official GAAP or official SEC guidance, but we would help on practice issues. There were a number of those.

One thing I do remember was during part of my term as chairman of the Regs committee. The chief accountant was Lynn Turner. Lynn and I had been colleagues at Coopers & Lybrand going way back to the national office, as managers, back around 1980 and 1981, then extending for many years. There was an issue related to how valuations of in-process research and development projects were being done in business combinations in purchase accounting. Lynn asked me to organize a group to provide guidance on that and that group eventually became a much larger AICPA effort, that provided very significant guidance in that area.

JS: Did you work on the issue of stock options at that time?

RH: No. When I was in the national office of C&L, in 1994 and 1995, the FASB was working on that issue at that time. So that was one of many things that we were covering, the people that worked for me were covering. But , I can't say I directly worked on it, no more than any other issue.

JS: So in that position, you weren't directly interfacing with the FASB at all?

RH: I don't recall. I remember that the firm did a study for I think the Financial Executives Research Foundation on the impacts of valuing stock options across various industries. I

had some involvement with that effort.

JS: You also served on the Emerging Issues Task Force.

RH: I did.

JS: When was that?

RH: That was probably 1996 to 1999.

JS: What sort of issues did you work on there?

RH: Let's get out the book and see.

JS: That's a good idea. Bring back some old memories.

RH: So let's go. There are lots of fun issues here. Here's one, "Accounting for Equity Instruments that are Issued to Other than Employees for Acquiring, or in Conjunction with Selling, Goods and Services," which is an issue dealing with accounting for stock options granted basically to suppliers. "Debtor's Accounting for Modifications or Exchanges of Debt Instruments." There's lots of them here. "Implementation Issues in Accounting for Leasing Transactions Involving Special-Purpose Entities." I'll just pick out a few more. Accounting for Business Combinations Involving Physicians Practice

Entities. Each year there were probably fifteen to twenty different EITF issues.

JS: So they were different from year to year. Did they involve changes in the economy, what they called at that point in time "the New Economy," which is not so new anymore?

RH: For example, the first one on issuing stock options to suppliers, that was clearly something gaining more prevalence in the New Economy, particularly out in say Silicon Valley, where if you rented your premises, sometimes you gave the lessor stock options. Other suppliers, you'd give them stock options. There were those kind of new economy issues. There were issues relating to deregulation of the electricity industry and telecommunications industries. So some of them did and some of them were old industry-type issues.

JS: Were any of them issues that popped up later, when problems emerged at Enron and other companies?

RH: There was an issue relating to the accounting for energy contracts. I can't remember which issue that might have been. We might have to look to the index as to whether or not I was actually on the EITF at that time, but it was sometime around that time. Accounting for derivatives trading activities or certain types of derivatives trading activities. That did come up again, in the wake of Enron and other things, when I was in my early years at the FASB.

JS: How much of your time did your service on the EITF take up? You're still working at your other job at this time.

RH: Oh, you know this is by recollection: I think it was probably 10 percent, something like that.

JS: So it was fairly significant. But you still also found time to co-author a book during this period?

RH: Yes, most of that was done in 1999 and 2000. You're referring to *The ValueReporting Revolution: Moving Beyond the Earnings Game*. I became increasingly involved with and intrigued by the whole area of reporting on key performance metrics, value drivers of business and the like, and the extent to which that could be used both from a managerial perspective and also to improve the information set going to the investing public.

Earlier in my career, I had done many what we called "acquisition reviews" for both strategic and financial buyers. People were buying other companies or making big investments in other companies. When you did those reviews, you didn't just focus solely on the financial statements, but you often focused on these non-financial items, the key risks and opportunities, what were really driving the success of the business, and how to measure that and the like .

It was something I was very familiar with from that venue. But how do we get this in a

more systematic fashion into reporting, both to management and, potentially, in public reporting?

JS: The basic criticism of the book seems to be that financial statements are often not worth very much to investors.

RH: Well, I think the thrust of the book is that the information set could be much richer than it is with just the financial information. I don't think it should be taken as discounting the importance of financial information, because one of the things you learn in that sphere is that the ultimate measures are the financial ones. But what's very important is that a lot of these non-financial metrics are often the leading indicators of future financial performance.

So for example, in a service business, the higher your customer satisfaction, the better your sales may be in the future, your ability to cross sell. You'll find also in service businesses that more employee satisfaction tends to correlate with more customer satisfaction, which then tends to correlate with better future financial results. Those are all the kinds of things the book explored.

JS: So it makes the point that financial statements only tell so much about a business.

RH: That's correct.

JS: Do you think that that basic criticism is still valid?

RH: Yes. I think there has been some increased reporting, particularly in some industries, of the kinds of things that were envisaged in that book. But I think it's still got a ways to go. It's something that other parties have commented on many times. The AICPA then took what was ValueReporting and then broadened it into what was called Enhanced Business Reporting. The SEC Advisory Committee on Improvements to Financial Reporting that reported out in 2008 had a number of recommendations in this area, as well. It's still something which I view as an opportunity to improve the information set.

JS: Moving on to the IASB period, how did you come to join the IASB?

RH: That's an interesting story. I was with Jim Leisenring, who at that time was at the FASB. I was with him in Philadelphia in the summer of 2000 at the annual American Accounting Association conference. He said to me, " you know, they're forming this new IASB. I'm thinking of putting my name in for that. It could be real interesting, so maybe you'd be interested in it, too."

I said, "I'm real happy doing what I'm doing right now. I don't want to leave PricewaterhouseCoopers." He said, "Actually, as I understand it, they can take up to two part-time members." So I said, "Oh, really? I started looking at that and talking with a few people and put my name in and was interviewed and was one of the people selected.

JS: Had you previously worked on accounting standards at all or been involved in the accounting standards process?

RH: Well, the Emerging Issues Task Force (EITF) is a standard setting organization. The Regs committee was quasi like that. In heading the national office of one of the major accounting firms, part of that role is developing comment letters and positions on accounting standards and issues. I had also been on the FASB's Financial Instruments Task Force for many years, as well, and various other endeavors related to accounting standard setting.

JS: How familiar were you with international standards when you joined the board?

RH: I had a fair amount of familiarity. In the nineties, Coopers & Lybrand put together some publications on international accounting standards. I was one of the co-authors.

JS: Was that partially because of your education in the U.K. and previous work experience there?

RH: It was definitely a matter of interest, because being an English chartered accountant, I was obviously conversant with U.K. accounting standards. I had, over the years, based upon work I had done abroad, become conversant in many other accounting standards, particularly Latin American ones. Because of my Spanish, I seemed to get pulled into those assignments. I had done jobs in Mexico and other parts of Latin America.

JS: What sort of issues did you work on at the IASB?

RH: I was one of the original fourteen members. We put together an initial agenda. Part of that was a fairly broad effort, going through the existing standards to tighten them up. I was part of a working group within the board looking at those issues. The initial projects also involved the controversial subject of what they called share-based payments, accounting for stock-based compensation, and business combination accounting. There were a few other major projects.

JS: The issue of stock options was becoming fairly important at that time, right? One of the first major issues you worked on?

RH: Yes. The whole board worked on it, and the staff. It was one of the original agenda items.

JS: Did the board have to develop new rules of procedure or anything like that?

RH: It developed fairly detailed rules of procedure. I think to a certain degree, they were taken from what had been developed by other accounting standards setters, including, fairly prominently, what the FASB had in hand.

JS: Do you think the change in the U.S. presidential administration, from Clinton to Bush,

had any impact on the move towards internationalization?

RH: I don't know. I think that the creation of the IASB to replace the old International Accounting Standards Committee was something that had been in the works from about 1999 and 2000. In fact, the creation of the new board was at the end of 2000. Both the SEC and the FASB and its parent, the FAF, I think had a role to play in the creation of that organization, its blueprint and the like, not completely, but to a certain degree .

My own view is that there was a growing realization that the globalization of capital flows, of corporate activity, of M&A activity, of investments, was increasingly leading to the idea of there being a truly international set of accounting standards, and that in order to do that the old International Accounting Standards Committee, which was like a League of Nations of part-time people, needed to be reconstituted.

The IASB was born out of that concept and also out of some of the problems that came out of the Asian financial crisis, in the late nineties. I think it got further impetus in the wake of the accounting scandals in this country. All of the sudden, some began to question that U.S. GAAP is invincible and obviously the best.

JS: You're talking here about scandals of companies, like Waste Management to Enron and WorldCom? Had that already begun to hit, as you were joining the IASB?

RH: Our first meeting was a planning meeting in February 2001. I think Waste Management

had been before that. Enron had not hit, WorldCom, Adelphia, those were yet to come.

JS: How did your experience at the IASB compare to what you expected it to be?

RH: I'm not sure what I expected. You know , it was a wonderful thing, because it was a new organization with a bold mission: to create standards for the world. It brought together some of the leading people in accounting and accounting standards from various parts of the world. I've always been an internationalist, I guess from the age of fourteen on, when I found out I was moving to Argentina.

I found it very good. There were great colleagues. I think we quickly got to work. I think we worked well. It was grueling, though. At that time I was also chairman of a group called the Transnational Auditors Committee of IFAC, the International Federation of Accountants, which was creating standards for the major accounting networks, in the auditing and quality control spheres, around the world. So it was also an international standard setter. I was the chairman of that.

At the same time I was on the IASB, I also had my normal day job of being the chief technical partner at PricewaterhouseCoopers, of being on the U.S. board of PwC, on the global board of PwC, of being the president of the PricewaterhouseCoopers Foundation and some other roles. So, you put all that together, it was kind of challenging. But the standard setting was a labor of love.

JS: Internationalization of financial standards, just the term itself sounds like something that might worry some people, in Washington, for instance. Do you think that the internationalization of accounting standards flies below the radar, to a certain extent, just because it's a technical sphere?

RH: I think to a certain extent, it may have for a number of years. But I don't think at this point, particularly because now the question is before the house and before the U.S. as to whether, how and when we would move to international standards. So for a number of years and with the encouragement of various parts of the government – the SEC, I think the Treasury and a number of people in Congress – we conducted this convergence effort.

JS: Let's move over to that period. So how did you come to join the FASB?

RH: What happened was the then-chairman of the FASB, Ed Jenkins, who was coming to the end of his first term, decided not to seek a second term. After that, it was probably in early 2002 that some people asked me whether I'd be interested. I think people thought, with my international experience and technical background, that I might make a good candidate. I carefully considered it and talked with people at both PwC and at the IASB, who were very supportive. I threw my hat into the ring.

JS: Do you think your service at the IASB helped your candidacy?

RH: I believe so. I had already, by then, had a year-and-a-half of formal standard setting, at

the highest level.

JS: Also perhaps your expertise in internationalization.

RH: Yes, I think that, plus that I had been for many years a senior technical partner at one of the major accounting firms. I'd been on the EITF. But I definitely think that having been on the IASB probably helped that candidacy.

JS: Does the FASB have any problems recruiting either staff members or board members?

RH: Board members, I don't believe so. I believe every time that there's an open position or something coming up, they get plenty of candidates. As for staff, I would say it kind of goes a little bit with the times. Turnover at the FASB has been fairly low and I think that's because the people who go to work there have pride in the mission, like the challenging environment, and like the nature of the work.

But when there's a booming economy, companies, Wall Street, will snatch some of the people. That's where the turnover generally comes from. In the years I was there, we very much broadened out, both increased the number of staff and broadening in terms of background and capabilities of the people. We added people from the investment community, valuation people. We added people with small company backgrounds and not-for-profit backgrounds.

JS: Did the staff increase in size?

RH: Yes, because of the increasing needs in the wake of the scandals, Sarbanes-Oxley and the like, and the whole other dimension of international convergence, we did increase the staff numbers.

JS: So obviously there was a lot going on when you took the position. Did you hesitate at all to take the position because of all the problems that you knew that you would face?

RH: First of all, I've always had a passion for, not just accounting, but the importance of getting good information into the markets. I viewed it as public service and something where I hoped that using my experience and skills, I could add some value, together with my colleagues. Now that said, I got appointed in April of 2002. That was after Enron, but before WorldCom and before Sarbanes-Oxley. So at the time I got appointed, the world was a little different.

JS: Yes, I can see that. I guess you got appointed in April and you took over in July. There was about a two month period there. How did you prepare yourself to take over?

RH: During that period I spent a number of days up at the FASB. I talked a lot with the existing board members, particularly with Ed Jenkins, who was very helpful. He took me around to some of the key parties in Washington, and some other key parties. That was basically it.

JS: Did you anticipate how much you'd have to deal with Washington at this time? Or did you think that you might just spend most of your time up in Norwalk?

RH: I don't know. I probably underestimated that. Again, at that point, although accounting was very much in the spotlight in the wake of Enron and some other stuff , it really did not totally take flight until the WorldCom thing hit, and then the frenetic development of the Sarbanes-Oxley Act in July. The passage of that would change a number of things. The Sarbanes-Oxley Act was very much aimed at trying to improve the whole financial reporting system in the U.S. and deal with some of the issues that had arisen.

JS: Did the FASB provide input into the process that led to the Sarbanes-Oxley Act?

RH: Yes, I believe Ed was consulted. Probably our trustees were involved. After WorldCom, I had some conversations when we had meetings in Washington. But I think a lot of that had been done. My understanding was that Paul Sarbanes had some really excellent staff, the two Steves, they called them, Steve Harris and Steve Kroll. They had already put together much of what became Sarbanes-Oxley , a lot of it , before WorldCom. I think a lot of those discussions had already occurred.

JS: Did the FASB view any of the provisions of Sarbanes-Oxley with concern?

RH: I can only give you my personal views. I was very supportive of most of the provisions.

Of the provisions that touched on the FASB's activities, the major one was a change in the way the FASB was funded, to go from a completely voluntary funding to a mandatory levy, the same way the PCAOB is funded.

There was an interesting period when I got to the FASB, where after the passage of the Sarbanes-Oxley Act, towards the latter part of July of 2002, the FASB could no longer take voluntary contributions from the accounting firms, the AICPA or from Corporate America. But under the Act, the SEC was required to formally redesignate the FASB as a recognized standard setter in order for us to start getting the new type of funding.

There was a gap of many months there, while the SEC was doing other things, like helping to put together the PCAOB, in the wake of the scandals. My recollection was that, and I don't think the issue was ever in doubt, but it became kind of interesting as the funds dwindled for a period of time.

JS: Did that cause any actual budget gaps?

RH: No, it never got to the point where the organization was ever as I recall it out of money. It was just a matter of changing gears, so to speak.

JS: Other than Sarbanes-Oxley, what other issues did you deal with at this time? For instance, I know that the FASB began to look at a principles-based approach to accounting standards.

RH: The Sarbanes-Oxley Act asked the SEC to conduct a study on the merits of a principles-based system of accounting in the U.S. I, having been from the land of principles-based accounting, my early training in the U.K., the home of much more higher level principles-based accounting; it sort of intrigued me because I was used to that from being in the U.K. But my many years of experience in the U.S. also told me that we might have some issues implementing that kind of system in the U.S.

When I got there, it was one of the many things I discussed with my colleagues and we adopted a three-pronged overall strategy of strategic objectives. One was improvement of the standards and improvement of the standard-setting process. Second was simplification of the process and standards. The third was international convergence. The way I looked at it was that if we did it correctly, or if we had some luck, then all three could go hand-in-hand.

JS: So tell me about the plans of the organization to undertake a codification of accounting standards.

RH: That was one of the ideas around simplification, in that if you look at what was then U.S. generally accepted accounting principles, it was over 2,000 individual pronouncements that had been issued by the FASB and its predecessor bodies, going back fifty, sixty years, issued by the AICPA in various forms, issued by the SEC in staff releases and Commission releases, and issued by the EITF. They were all written in slightly different

forms and somewhat connected, but not completely connected.

For example, if you look at the abstract of an EITF issue. Say the abstract is two pages long. The first page-and-a-half may be references to other pieces of GAAP that somehow are loosely related to this issue. I'd been fairly vocal on this subject, even in the *ValueReporting* book. It seemed to be a system that was becoming increasingly unwieldy, that made it difficult to comprehensively research an accounting issue.

JS: The *ValueReporting* book had a chapter entitled, "Inside the Exciting World of Accounting Standards," that talked about how complex it was.

RH: Yes, it did. I wrote those words about how complex the current system was. So in the discussion at the FASB and folks at the FAF, we came across – it's not a genius idea – the idea of codifying it all came up.

JS: Had this been discussed at all before you took over?

RH: Not to my knowledge. But you know, then again it might have. Something could have been discussed fifteen years before. No one was around anymore. But it was something that we discussed and tried to wrestle to the ground.

JS: This was basically your baby, then?

RH: I guess if I'm good at anything, it would be saying, "Here's a big problem. Here's kind of an outline of a broad solution." Then I'd turn to others and say, "Make it so."

JS: Sounds like the quality of a leader.

RH: Yes, I guess. We discussed it and then at the time, Larry Smith joined the FASB in the position of director of technical application and implementation activities. Larry was an experienced national office partner from KPMG. I basically turned to Larry and I said, "Okay, Larry, I'll help you, but this is your baby."

We came across a good stroke of luck. The fellow who had developed the Arthur Andersen accounting research platform, a guy called Tom Hoey, in the wake of the collapse of Andersen, was available and we grabbed him. And he was probably the best guy in the world, at a more detailed and project management level, to get this done. But it was a massive undertaking . It was almost like a national public works project.

JS: How many people did you have working on the project?

RH: I'd say over the course of the project there were hundreds. Maybe at the height of it there might have been a hundred different people, what were called mappers and authors and program developers. It was a multi-year project and took an awful lot of project planning, a lot of oversight, a lot of love and care, and a lot of help, not only for the people that we got to be mappers and authors and who we'd pay, but then we had review

teams from the accounting firms and companies. A lot of people volunteered time and effort to help with this project. That's why I call it the accounting version of a national works project.

JS: I can see that. Was there any opposition at all within the accounting industry to this? Or was this just something that everyone thought was a great idea?

RH: I think most people thought it was the right thing to do, that there was a problem and that this would make sense. As it went along, specific aspects of it and how the codification was written, there were some people who said you should've done it this way or done this or that. I think there's still some people, I call them the old timers, like me, that are just familiar with the books in their old fashioned type of way. My understanding from talking with a lot of people – I've been on a lot of campuses – is that the students really love it. It's much better than the old system.

JS: A little easier to work with. How did this work with the internationalization of accounting standards? On one hand you're codifying the existing standards, but on the other hand, one of your goals is to change the standards?

RH: Yes, two other goals were improving U.S. GAAP and converging. So you're replacing existing sections and the FASB continues to do that. Right now they're working on a number of major projects with the IASB to come up with a common standard. That then replaces a whole section of the codification. The new common standard becomes the

new part of the codification.

I think it's also made, from the U.S. point of view, some aspects of the convergence process easier, because at least we know everything in U.S. GAAP that we're dealing with. Before, as part of the standard setting, trying to figure out on a major project every piece of literature that might be touched was an enormous exercise. Even our staff sometimes didn't always get everything in front of them immediately.

JS: Let's talk a little bit about the internationalization of accounting standards. At the beginning of your term as chairman, how did the positions of the SEC and the FASB line up on internationalization? Were you both in support of it?

RH: Yes. My recollection was that the then-people at the SEC, the chairman of the SEC, Harvey Pitt, and the then-chief accountant, Bob Herdman, were quite pro-convergence.

JS: So in October 2002, the Norwalk Agreement was signed between the FASB and the IASB. Can you tell me a little bit about that?

RH: I'd come from the IASB. The section of Sarbanes-Oxley that deals with accounting standards actually has words to the effect that the designated U.S. accounting standards setter should consider, in its standard setting, whether international convergence would be in the interest of the U.S. investing public.

It didn't prescribe detailed procedures for that, but it was clearly one of the things , not the only thing, that the law said the standard setter should do. I obviously had a passion for that subject and as I said at the SEC, the people were pro-convergence.

I think just generally, if you looked at the world at that time, there were two sets of widely-used accounting standards. One was U.S. GAAP, and that was because of the attractiveness of our capital markets and the SEC rule that if you raised money in our country, you had to either use U.S. GAAP or reconcile to it. And because our companies were all over the world, U.S. GAAP had been used by their subsidiaries.

The second ones are the international accounting standards that had been developed by the old International Accounting Standards Committee. They were used in a number of countries by a number of companies. So, if the idea was to get to a truly international set of standards, it made sense for the standard setters that were responsible for those two sets of standards to work together.

JS: So had the major details of this agreement already been worked out before you started?

RH: No, not to my knowledge. (However, I believe there had been discussions between representatives of the IASB and representatives of major national accounting standard setters , including the FASB , about various potential cooperative standard setting activities.)

JS: So what was the drafting process like?

RH: First of all, when I got there I talked about it with my fellow board members, with our trustees and the like. Obviously we had conversations with the SEC folks. We then held a joint meeting with the IASB, full board-to-board, and talked about it there and said, "Okay, let's put together an agreement in principle." The drafting elves got to work and there were various reviews and that's how it gets drafted.

JS: After this agreement committed you to working together, how did you go about deciding what areas of accounting to deal with first?

RH: There were different stages of that. The Norwalk Agreement was an agreement in principle to work together to try to find common solutions and to narrow the differences. The key areas of difference were fairly well known. We started working on some of those. We started holding joint meetings twice a year and having some joint teams and the like.

But from 2002 to early 2006, both boards were busy, not only with that activity. We were having to continue to deal with some of the issues in the wake of the scandals. The IASB was very busy dealing with the impending mass adoption of their standards by Europe in 2005. We were both working together on certain specified areas, but we both also had other things to do.

It was really in 2006 when we issued what was called a Memorandum of Understanding,

which laid out a much more detailed work plan, that the thing began to intensify. That was done really in support of what was called the SEC Staff Roadmap, which had been developed by Don Nicolaisen, then-chief accountant of the SEC and his staff in 2005. That was a roadmap, not to adoption of IFRS in the U.S., but to potentially lifting the reconciliation requirement for foreign filers in the U.S.

One of the requirements was to be able to see evidence of continued progress towards convergence between the two sets of standards. In the wake of that and with the encouragement of the SEC, both boards said, "Okay, what are we going to focus on?" We went through various rounds of discussions internally, with each other and with our various advisory committees, with the SEC and with the European Commission, and with other national standard setters. That's how the list of projects was developed that was put in the MOU in 2006.

JS: What were the first issues that you would work on?

RH: By that time, both had worked on stock-based compensation and business combinations and gotten those pretty close. We then had a list of other major topics, which included financial instruments, consolidations, revenue recognition, financial statement presentation and a number of others. We formed joint teams, so we had a single team operating for both boards, comprised of some people from the IASB and some from the FASB.

JS: Board members or staff members?

RH: Staff members, but each major project also had what are called board advisors, maybe one or two from the FASB and two or three or four from the IASB who could advise the staff as well. Then we started meeting. We went from two meetings a year, full face-to-face, to three meetings a year and eventually, starting in October of 2009, almost every month.

JS: During this process of meetings and negotiations, were you issuing public exposure drafts or getting feedback from stakeholders?

RH: Yes, the process on major projects is really a three-stage process. The first stage is to issue either a discussion paper or an invitation to comment, which says broadly, here are the issues, here's the overall approach we think might make sense. Please give us comments. In the next stage, the board would get the comments back, maybe even hold roundtables and then based upon all that, start working towards an exposure draft, which is a more concrete proposal, almost like a draft standard. During that period, on a lot of these projects we were first issuing discussion papers and then exposure drafts.

JS: From your perspective, does the increasing internationalization of accounting standards call for stronger regulation, because there are going to be different standards?

RH: Let me answer it this way. The ultimate goal, I believe, is to get common, high quality

financial reporting across the major capital markets of the world. Common, high quality financial reporting. A necessary, but not sufficient condition for that is having common, high quality standards. It starts with the standards, but getting good reporting by no means ends with the standards. In order to get common, good reporting across the world you also need good implementation by the companies, you need strong auditing and you need good regulatory review and enforcement. All those aspects need to be in place in order to get to the end goal.

JS: Were there ever any worries that actions, say by Congress, would upset these efforts to move towards convergence in international standards?

RH: There are always concerns that our independent, objective standard setting process could be derailed or overridden by political forces, whether that was just trying to do a standard on a U.S. basis or a standard together, internationally. During my tenure at the FASB, there were two notable instances. One was the whole episode on accounting for stock options, which was really the second time around for the FASB. The IASB was acting on that. It was in front of the FASB. It was an issue that we believed needed dealing with in the U.S., in order to improve the accounting standards, but it was also important from a convergence point of view.

JS: This was in 2004, right?

RH: This was in 2003-4. You know, during that process, the high technology industry and the

venture capital industry felt very strongly in the importance of being able to grant stock options in order to do their business. That was very, very important to them . So they opposed our efforts to change the accounting, just the way they had opposed it back in the nineties, when the FASB tried it that time.

That led to number of opportunities for me to appear at various congressional committees. At one point in the summer of 2004, the House of Representatives passed, by large margin, a bill that effectively would have blocked the FASB from issuing a standard that required compensation expense (for stock options).

JS: This might be H.R. 3574?

RH: It might be. I don't remember. It was in July of 2004. It passed by a large margin in the House. But we continued on.

JS: So you went to the Hill and you gave a rather strong testimony against this bill?

RH: I went there many times. Between 2003 and late 2004, I must have gone to the Hill five or six times at least, on that subject. Yes, I felt very strongly that it was important that we be able to conduct our standard setting without inappropriate political intervention or override.

JS: Do you feel that you had the support of the SEC?

RH: Yes, absolutely. The key folks at the SEC at that time were Bill Donaldson, the chairman and Don Nicolaisen, the chief accountant, and Scott Taub, the deputy chief accountant. They were all very supportive. I would say they stood shoulder-to-shoulder with us.

JS: So just to go back quickly to internationalization, there was an article in the *Financial Times* on Sunday that quoted a European Commission report that suggested that the United States might lose influence in the accounting world if it failed to adopt international standards. Do you think that could be true?

RH: You know, I don't discount it and I believe that they may feel that way. On the other hand, the U.S. is still the single-largest capital market. It's still the single largest national economy. I believe geo-economic forces will continue to press in the direction that we've been pressing.

To be truly international, it's got to work in the U.S. That doesn't mean that U.S. standards have to be the ones that are used in the rest of the world, because I don't believe that for a minute. I don't think they would work. But it also can't be standards that don't work in the U.S. That's been a whole part of the (convergence) process.

JS: Right, making them work here. In 2006 the FASB issued a new standard on fair value. How did that come about?

RH: That standard, Statement No. 157, did not prescribe any new use of fair value. It was not done to say, "Now you need to use fair value here, there, there, there, there." What it did was provide a common definition of what we meant by fair value, different techniques to get fair values in different situations and a framework for common disclosures about the use of fair value in financial statements. The reason we did that was because there were various definitions and approaches to fair value and there wasn't a good disclosure framework around it.

JS: Was the intention from the beginning just to issue a general standard or did you consider discussing more specific applications?

RH: No, the idea was to issue a more general standard. This gets back to principles versus rules. My view is that a good standard has clearly articulated objectives, sets out clear principles, but then provides enough guidance in an educational way to make people understand what we're talking about and how to approach things.

JS: This gets us up to 2007 and the crisis in the credit and financial markets. After the crisis hit, do you think that some of the backlash from Congress or from the public was directed at the accounting industry?

RH: Certainly from certain parties. People use the word "unprecedented" for the situation and there's some validity in that. We had a situation where we had, for a variety of reasons – not so good, in my view – developed markets in complex asset-backed securities that

were backed by problematic collateral. Those securities had been issued in trillions of dollars and derivatives written tied to those securities. They were all over the world. There were major financial institutions and investment funds and towns in Norway investing in them and the like.

There were markets for those , but when people started to understand the problems behind those, it was a house of cards. Backing all these complicated securities in the end were a bunch of mortgages, mortgages that had often been written on very novel terms and poor underwriting or no real underwriting. When people started to realize that, the credit markets seized up for those.

The accounting rules have long-required that if you're trading those, you carry them at fair value and you mark them to market. But for many other entities, you have to write them down to lower cost to market; you have to impair them. Those rules have been around for a long time. The problem was that the markets dried up, and so valuation became a real challenge from the period of, I'd say mid-2008 through the spring of 2009. So what to do? We had to issue several rounds of guidance to try to help people in that situation understand what was going on, what could be done, and what to look to. It was a difficult situation.

JS: Do you think there's any guidance that could've been issued maybe prior to the crisis?

RH: Guidance did exist. It existed for illiquid securities and for non-financial items. They're

well-worn techniques, based on discounted cash flow analyses and the like. They're used for intangibles. They have been long used for long-dated derivatives and things like that. The problem was that they are labor intensive, and you have got to get a lot of facts. But they are used in situations where you don't have actively traded markets.

Those situations were more confined. They were not all over the place, in trillions of dollars. They also were not imbedded in securities that had highly problematic collateral, and where there was not much underlying transparency around what was in these securities or their current performance. I'm not sure much guidance could've been issued specifically for that. The techniques existed, but getting the data, doing the modeling, making the assumptions became much more intensive and a much broader exercise.

JS: But there were calls for increased regulation of financial instruments and for more stringent reporting by financial institutions, right?

RH: Yes.

JS: For instance, in late-2009, Congress called for the establishment of a financial services oversight body that had the power to change accounting standards. How did the FAF and the FASB react?

RH: Part of the Dodd-Frank Act was the creation of the Financial Services Oversight Council. In the House of Representatives, there was a proposal to introduce an amendment that

would have allowed that council to override both the SEC and the FASB on a particular standard or requirement, in the name of preserving financial stability. The trustees of the FAF quickly reacted to point out some of the dangers around that. I think maybe even more importantly, the investment and business communities, the academic community, the audit community also weighed in very quickly and very strongly against that.

So the final amendment provided that the FSOC can provide input on these matters, but cannot ultimately determine the accounting. I think that's fine. The SEC is a member of the FSOC, but most of the members of the FSOC are from financial services regulators, banking regulators and the like. I think that having the accounting standard setters get good input on those issues is really important. But in the end, I think it's up to the accounting standard setters to determine the appropriate accounting.

The broad reaction by the business and investment community was to say, "You can't do this." It was broad and it was strong, and made me feel real warm about the level of support for the notion of sound standards, independently set.

JS: Tell me about the Financial Crisis Advisory Group.

RH: In late-2008, we held a series of meetings and public roundtables with the IASB. We held roundtables in the U.S., in Japan, and in London, and other discussions. We came to the idea that there were a number of reporting issues or concerns that some people had. Maybe even more importantly, from my perspective, it was clear to me that in the wake

of the crisis, there was going to be another resetting of the whole financial services regulatory regime, in the U.S., globally, and the like. The G-20 were meeting, the Basel Committee, the Financial Stability Board, all of that.

I felt, and I think David Tweedie also felt, that we needed high level, senior, experienced advice, both on these broader current issues related to reporting that were emanating out of the crisis, but also on the landscape. So we put together this committee. We were very lucky. We got Harvey Goldschmid, who had been SEC commissioner, a very wise man, and Hans Hoogervorst, a Dutch financial services regulator to co-chair it. We got lots of other very experienced people from the investment community, like John Bogle.

JS: Is the group still working?

RH: No. It rendered its report in mid-2009. They had a follow-up meeting at the end of 2009 and then that was it. It was an effort to help think through a lot of these issues.

JS: Was there any opposition to the measures that the FASB decided to take, the new standards that they issued, for instance, on things like special purpose entities or credit default swaps or any of those issues?

RH: On the issue of special purpose entities and securitizations, there was some opposition by the securitization industry. They make their livelihood out of that and they're arguing that the revised standards could cripple a comeback in that industry and that securitization is

very important to the U.S. economy. But on any standard, you get lots of input. And some of that input will be, we don't like this standard. Here's why it's wrong. Here's why it won't be good. That happens on almost every major standard. On that one, there were some concerns, and probably some lingering concerns, that it hampers securitization.

JS: On a couple of occasions, it seems that you were willing to criticize executive compensation publicly. How do you feel about that?

RH: Well, I don't know if I was criticizing. Let me put it in context. I think the comments I made were something to the effect that few would begrudge Warren Buffett or Bill Gates their billions, because they have both added a lot of value to our economy and to society. But what I said is what I think rubs a lot of people the wrong way is situations where executives get paid hundreds of millions of dollars and they run a company down. Then to get rid of them, they've paid them hundreds of millions of dollars more. That's, at least, what I found at cocktail parties, the kind of conversation at the time. I'm all in favor of people doing well who do well (Laughter.).

JS: During your time as FASB chairman, you were a frequent visitor on the Hill. On the FASB website, I counted sixteen different times in which you testified before Congress or gave a statement to congressional groups. How do you explain your popularity?

RH: Some of them were in the wake of Sarbanes-Oxley, just reporting to Congress. Financial reporting became an important topic in that era, and still is. So some of them were

periodic reports. Somebody from the SEC, somebody from the PCAOB senior leadership, and we'd go there and report, "Here's what we've been doing." Some of them were those things. A number of them were on the stock option issue. The folks who were not in favor of what we were doing, as is their right, appealed to their elected officials and held us accountable and so hearings were held. I learned to understand and accept that as part of our system. I think there are good aspects to it and sometimes not-so-good aspects to it.

Some of them were held in support of what we were doing. Going back to the stock option issue, my recollection is that the leaders of the Senate Banking Committee at that time, Senator Shelby and Senator Sarbanes, were very supportive of our efforts; had a hearing and understood the importance of it, not only to improve the accounting, but to convergence, and had a hearing in that regard.

JS: Do you care to wager a guess on what year there will be a convergence between U.S. and international standards in accounting?

RH: There's a difference between convergence and adoption of IFRS. If you held me to it, I would say that I believe if we came back here seven or eight years from now, the standards we use in the U.S. will be very compatible with those used in other major capital markets, maybe not exactly the same, but largely the same.

JS: We'll hold you to that, then. Bob, do you have any final thoughts?

RH: People always ask me about the specific things, about challenges, and the like. But as I always say, the thing that will probably last with me the longest, and even now as I look back on particular episodes and standards, what I remember are the people. The wonderful thing that I've had, not only at the FASB and at the IASB, but also in my whole career, whether it was with Price Waterhouse in the U.K., Coopers & Lybrand, PricewaterhouseCoopers, is the opportunity and just absolute pleasure to work with just a ton of terrific people. And I've had the opportunity to meet a lot of interesting people around the world.

There's a picture of me with Prince Charles a few months ago. Those are things, you know, I probably wouldn't have imagined being able to have done by virtue of the kind of work I've done. The work's been interesting, it's been rewarding, and the people have just been great.

JS: Well, thank you very much, Bob Herz. We really appreciate you talking with us. It was a pleasure.

RH: Thank you.

[End of Interview]