Tim Bush: Comments.

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Thank you Robert for that introduction. And good evening ladies and gentlemen.

Why did I write "Divided by Common Language? Robert doesn't pay royalties. There were many other reasons.

I work as an investor in equities – over 4 years ago the team identified several avoidable financial reporting issues with certain companies. The common factor emerged as a UK-US dual listing.

Subsequently 3 of these companies discontinued their US listings. One of them was amongst the first to find a way of delisting from the US and the reasons that the company gave were clear; US accounting was cumbersome, and things were altogether too litigious.

Enron and other things then happened. The problems of Enron were so large as to affect non-US markets, the equity risk premium rose everywhere.

There were various remedies. But it became clear that things were not settling down post-Enron and that in some ways the medicine was causing new problems. Not just for the US, as regulatory medicine can have cross border effects. There were particular problems with Sarb-Ox 404.

I took a closer look to see where the US's problems came from. They were not being resolved, and they could be heading our way.

I went to first principles to see why the UK and US differed so much. To see what was going on meant going back to 1933 (the passing of the first US Securities Act) and comparing it with British Law.

British financial reporting is a branch of Company Law, and is legally constructed to be about shareholders monitoring and responding to company performance – British Company Law is founded on the primacy of the shareholder-company relationship. This law assumes that shareholders wish to see their actual investment return for their actual risk borne. The model is one of disclosure and consent. Company Law is based on shareholder focussed disclosure and that law also gives shareholders' strong rights with which to demonstrate consent.

Conversely, the US 1933 Securities Act created Federal capital market regulation to be **instead** of similar corporate governance, because state corporate law was weak. US Federal regulation is based on regulated disclosure for trading securities, actually leaving out matters relating to shareholders and their consent. The SEC as a regulator is a middleman playing to interests other than the shareholder-company interest, because that's the law.

This is limiting and rather odd as it is the share**holder/shareowner**, who bears the residual risk in the capital of a corporation. In a legally advanced culture there is actually a legal loophole at the heart of the matter. Not just any old loophole, but one creating major conflicts.

All of this can create a problem in setting the boundaries and expected quality of financial accounting. Different parties in capital markets have different objectives. Short sellers for example are notionally accounts "users", but don't bear the same risk as the company. Because they hold a negative position in a company their

economic risk is in fact the opposite to that of the company. A framework for governance and financial reporting that plays to a multitude of users, without properly addressing the shareholder perspective, is a recipe for conflicted and confused objectives. Poor accounting may actually suit some parties who are nevertheless classed as “users”.

Enron is a good way to illustrate some issues in practice. Enron essentially did three things:

> it used “mark to market accounting”, in plain English counting chickens before they are hatched.

> and second it used “off-balance sheet” financing, in plain English not showing your shareholders’ how much debt you’ve got behind your income.

> and third, it privately pledged unissued Enron stock as collateral for these hidden loans, instead of taking a visible charge on Enron’s assets

None of these things, separately or together, were permissible under UK Company Law. Yet Enron’s accounting had passed the tests of US GAAP on these things. Also in the UK, pre-emption rights, are a consent issue. Requiring shareholder consent for share issuing would have foiled any private pledging in the first place.

The philosophy driving the law and SEC regulation has rubbed off onto US GAAP. The overarching **<u>shareholder</u>** perspective also missing in substance from the required overall outputs of US GAAP. The guiding securities laws don’t unambiguously require it, and US GAAP for over 25 years has followed the indistinct and more theoretical concept of capital market “users” instead. Accounting has got confused with analysis.

US accounting has become so interlinked with the theoretical pricing of “securities” for “users”, that real company performance and real monetary position is becoming obscured by second and even third degree factors. Far more complex, abstract and conflicted. What is not very clear, for the best of companies and the best of accountants, is then policed as if it were an exact science.

Ironically, the 1933 Act was directly based on the prospectus sections of the 1929 British Companies Act. But only those sections. Once one realises that limitation of law is at the heart of the US system, lots of things become clearer.

So that’s the background to why I wrote “Divided by Common Language” It was intended to be helpful, and certainly not parochial or protectionist.

London is not utopia, and does require market regulation, but this is proportionate because it is addition to strong company law based on disclosure and consent. There is less ambiguity, and far less litigation. Litigation is a last resort not first port of call. Litigation differs too because the loser pays both sides’ fees.

CEOs are less imperial, boards are more collegiate. There is also collegiate representation in all of the market regulating bodies, making the regulatory system work. Nationality is not a bar. Nor is being a securities lawyer **<u>the</u>** key requirement to being a regulator. The accountancy profession is altogether more confident.

The Takeover Panel draws from Industry, the ICAEW, and investor groups.

The Financial Reporting Council is again a collaborative body

The FSA is collaborative, and not run by the legal profession.

However, we do now have the matter of accounting convergence between the IASB and the FASB. Mr McFall's House of Commons Treasury Committee flagged concerns about aspects of this convergence 4 years ago. Convergence is still not going down very well in many quarters.

Enron type problems have still not been fully resolved by the FASB, and the IASB is now moving towards the FASB's indistinct "users" based model and theory.

Even FRS5 the UK standard, created by David Tweedie that successfully dealt with off balance sheet debt, is not matched by IFRS. A company using FRS 5 for a clearer portrayal of its affairs might be hauled over the coals. FRS 5's best practice is now potentially illegal. And it is good companies complaining the most.

Accounting convergence, post Enron now looks like an example of the emperor having no clothes, but instead of telling him, others seem to be taking off their own clothes instead.

However, the European Central Banks are concerned. So are investors and finance directors. On the IASB/FASB conceptual framework, even David Tweedie disagrees with his own IASB board, and he's the chairman of it. Hardly confidence building. This is not what the IASB promise was about. Quite the opposite in fact.

That said. I think that US Treasury Secretary Paulson and the Committee on Capital Markets Regulation may be beginning to get some answers. London is a very good place to begin to look at for ways of reform for the US, because key Eastern markets, Hong Kong, India and Singapore - which are also competing with London and New York - use the same British derived company law.

To summarise:

the UK and US are different. And regulation is becoming a fault line.

the differences go straight back to 1933.

we should look to promote the benefits of collegiate methods of running markets.

I hope my work has been useful. I hope this roundtable helps things too.

So, if I may, I will pose three questions to carry to the Roundtable:

1. **Do the regulators recognise that an approach of collegiality and stronger rights in law might make for more effective, self regulation?**

2. **Have Accounting Standard setters really resolved accounting problems, 5 years on?**

3. **Are American corporations prepared to accept that the good have nothing to fear, and that stronger governance in substance, is a proveably workable trade to less regulation and less litigation?**