Statement of the U.S. Chamber of Commerce

ON:	**"FOSTERING ACCURACY AND TRANSPARENCY IN FINANCIAL REPORTING"**
TO:	**HOUSE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES OF THE HOUSE COMMITTEE ON FINANCIAL SERVICES**
BY:	**DAVID HIRSCHMANN, SENIOR VICE PRESIDENT, U.S. CHAMBER OF COMMERCE**
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incentive, initiative, opportunity and responsibility.

Testimony before the House Committee on Financial Services
Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

"Fostering Accuracy and Transparency in Financial Reporting"

Testimony by David Hirschmann
Senior Vice President, U.S. Chamber of Commerce

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Good afternoon, Mr. Chairman, members of the subcommittee. My name is David Hirschmann and I am Senior Vice President at the United States Chamber of Commerce, the largest business federation in the world, representing more than 3 million businesses.

I'm here today to present the business community's views on how to improve auditing and accounting practices, insure the viability of the auditing profession, and encourage a greater focus on long-term performance measures to help investors, companies, and the economy.

First, allow me to address the widespread practice of projecting a company's future earnings as a way to inform and guide investors.

In fact, this practice is inherently flawed. Earnings guidance is a precise measurement—down to a penny or two per share—based on subjective forecasts of accrual accounting information that is itself quite subjective in many respects.

Guidance is issued based on forecasted financial statements that principally contain only educated estimates about the value of income, expenses, liabilities and assets, such as pensions, oil reserves, and bad debt, to name just a few.

It used to be that companies were encouraged to "manage" earnings—they would have a few honest, legitimate, acorns in the basement, as the saying goes, to support one or two cents of earnings on a rainy day. As one former auditing executive put it, analysts viewed any CEO who couldn't legitimately, legally manage earnings within a penny or two to meet forecasts as not being in touch with what was happening at a company. But in the current accounting environment, there are no acorns, and anyone who tries to create them is asking for trouble.

Quarterly earnings guidance misrepresents a company's true financial strength and puts pressure on executives to meet quarterly expectations. Companies often sacrifice creating long-term value if it means missing quarterly projections—and that is a disservice to the company and its investors.

Instead of issuing earnings guidance, companies should better communicate their strategies and objectives and come up with alternative benchmarks that will show progress toward meeting their goals.

More communication—not less—between the companies and the investor community is needed, and that is why the Securities and Exchange Commission (SEC) should reexamine Regulation Fair Disclosure (Reg FD). This regulation was passed with the legitimate intention of leveling the information playing field so that a favored analyst or investor would not receive better or more timely information. Unfortunately, in part due to the way this rule has been enforced, it has had the unintended consequence of restricting and reducing communication.

We also support efforts by Chairman Cox to move to clearer and easier forms of electronic communication between companies and investors. Good companies have the advantage when there is an open and level playing field for information. Initiatives like eXtensible Business Reporting Language (XBRL) improve the capability of the market to assess information and reward those companies that are doing well. If we have one note of caution, it is that while numbers are obviously important, analysts and investors should not focus only on numbers and ignore the underlying business fundamentals. XBRL will help everyone to better assess financial statements, but the smart money will still take the time to carefully understand industry factors and long-term strategy.

Let me move to a related area that is of great concern to the business community, and that's the issue of fair value accounting—the concept of developing well-reasoned estimates for certain intangible assets and liabilities and including them on the corporate balance sheets.

There are no doubt, limitless things that could be both estimated and added to financial statements. And, many of them would be consistent with Generally Accepted Accounting Principles (GAAP). However, we can't lose sight of the fact that they are estimates. The move toward fair value accounting should be tempered by a thorough examination of the implications to both business and investors of adding another imprecise estimate to the financial statements.

All investors want to understand the value of items on a company's balance sheet. That is easy when an asset or liability has a readily determinable market value. The problem arises with intangibles and other items for which there really is no market value.

The traditional historical cost approach to financial reporting can lead to out-of-date valuations of certain assets, but it at least had the virtue of being objective and stable. That allows investors and analysts to assess operational trends over time.

The concern is the continuing push by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) to move away from historic values for hard-to-value assets and liabilities. In multiple arenas, companies are being required to develop systems for assigning estimated values to such items—and, thereafter, continually reassess and revalue these items.

These educated guesses then generate risk for companies and their auditors. If someone thinks the guess is wrong, the company will be sued. When the company relooks at the guess, any significant change will create volatility in the financial statements—hurting the stock price and generating more lawsuits. Fair value accounting also puts great pressure on the auditing industry to certify the appropriateness of value estimates.

It is also highly questionable whether investors and other users of financial statements would find fair value estimates of certain assets and liabilities useful in making their own forecasts about a company's future cash flows. These estimates are purely hypothetical and not at all indicative of the cash flows that a company actually expects to receive or incur.

In the end, it is not at all clear that this well-intentioned attempt to give investors better information will do anything other than make financial statements less precise and meaningful for investors.

The world of accounting regulation does not get much attention. However, we have already seen the impact of adding estimates of the value of unvested stock options on the way in which companies, particularly emerging companies, offer stock incentives to rank and file employees.

Now, FASB is considering adding additional fair value estimates to the financial statements on a range of issues to including business combinations and asset retirement obligations.

It would also have a major impact on real world business transactions and operations. For instance, an acquisition or merger that might make good business sense might never come about if all of the future costs of integrating the companies are added to financial statements in the year the merger is completed.

The U.S. Chamber will be asking FASB and the IASB, as they further explore the feasibility and desirability of expanding the application of fair value accounting concepts, to recognize that their efforts may create a perception of accounting precision which may have potentially significant consequences for companies and investors. While the push towards fair value auditing may be theoretically pure, the costs may end up being much greater than the benefits.

Finally, the business community has great concerns about the future of the auditing profession.

In the post-Sarbanes-Oxley litigation and regulatory enforcement environment, auditing firms are under attack from several different parties. Much of this criticism results from the erroneous perception of precision in financial reporting.

Also, there is pressure on auditors to “do more” when conducting audits, and this has resulted in higher auditing fees for their clients. Even as their auditing costs have increased, clients are receiving less overall advice and support from their auditors because of auditors’ fear of litigation or raise questions from the SEC or PCAOB about their independence.

The environment has become even more volatile because accounting principles remain in flux—as I’ve already talked about—as business transactions become more complex.

The cumulative result of all of this is the very real potential for further concentration in the auditing profession. There are now only four major firms serving a large majority of the listed and actively traded public companies in the United States. Further contraction in this profession would threaten its viability and could shake public confidence in our capital markets.

The Chamber has issued three recommendations for fortifying the auditing profession. First, the profession should become insurable against catastrophic litigation. Second, PCAOB standards should be clarified. And, third, we need expansion of and greater competition among the Big Four accounting firms.

For reasons of time, I will not go into detail on how we propose implementing these three goals, but I have provided to the committee the Chamber’s auditing white paper, released earlier this year and would ask that full recommendations be included in the record of this hearing along with this statement.

In conclusion, the United States Chamber of Commerce is fully committed to highly accessible and transparent capital markets, and we will leverage the full resources of the organization to ensure accounting and auditing practices that are necessary for achieving that goal.

Thank you for the opportunity to speak today and I look forward to your questions.