OPENING STATEMENT OF
RANKING DEMOCRATIC MEMBER PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON CORPORATE ACCOUNTING PRACTICES: IS THERE A CREDIBILITY GAAP?

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Mr. Chairman, we meet today to learn more about problems with corporate accounting practices. Although this matter has attracted considerable media attention in recent months, I have held serious reservations about the reliability of certain corporate accounting practices for some time. These problems could also have potentially serious and negative consequences for our country's flourishing capital markets. After all, if investors cannot trust the reliability of the numbers produced by corporate accountants in audited statements, then they might as well spend their hard-earned money on lottery tickets.

Because of my concerns, Mr. Chairman, I wrote to you last June -- well before the collapse of Enron -- about the techniques used by some corporations in order to meet their quarterly earnings estimates. In that letter, I urged you to convene hearings on the many accounting irregularities that contribute to the problem of earnings management. Included among these practices are the accounting treatment of derivatives, swaps, special purpose entities, goodwill, and stock options.

In my view, we should have also convened this hearing before considering the Corporate and Auditing Accountability, Responsibility, and Transparency Act on the floor of the House last week. Such a hearing would have helped us to develop a more comprehensive piece of legislation. Nevertheless, Mr. Chairman, I am pleased that you have called this hearing today. I believe that we must continue our efforts to guarantee that we maintain the vibrancy of our country's capital markets in the long term. Our work today will begin that process.

Our capital markets are the most successful in the world for one simple reason -- investor confidence. The transparency fostered by the application of the U.S. Generally Accepted Accounted Principles, or GAAP, has played an important role in this achievement. Unfortunately, the failure to implement GAAP consistently has now led to an almost daily discovery of accounting irregularities at American corporations. This evolving situation has also sparked a crisis of confidence that continues to ripple through our capital markets.

We have, however, known about these problems for some time. For example, research published in 2001 by Financial Executives International identified some startling facts. The study found 464 cases of earnings restatements in corporate America over a three-year period, more than the previous seven years combined. It also determined that 156 earnings restatements in 2000 wiped out more than $31 billion in market capitalization. I suspect that when we tabulate these figures for 2001, these two already sizable statistics will grow considerably.

In recent months, the Securities and Exchange Commission has also broadened the scope its inquiry beyond the accounting issues raised by the collapse of Enron to include a laundry list of other potential accounting abuses at some of the country's largest companies. In fact, during the first quarter of 2002, the agency opened 64 new financial-reporting investigations, an increase of more than 100 percent over the cases begun during the same timeframe in 2001.

What factors contributed to this troubling state of affairs? In recent decades, the rules governing corporate accounting have become increasingly complex. Since the early 1990s, for example, the Financial Accounting Standards Board has developed several fair-value measurement, recognition, and disclosure standards. These standards often permit multiple interpretations. Accounting has also evolved from determining the cost of producing and the revenue from selling a good like a screwdriver, to ascertaining the cost and revenue from selling an intangible service like a 25-year energy derivative. These and other developments have helped to make corporate financial statements increasingly impenetrable and confusing.

From my perspective, an effective accounting system must ensure the comparability of financial data from one company to another. Comparability in the data used by investors will allow them to evaluate apples against apples, and oranges against oranges. Improvements in accounting transparency will also facilitate the efficient flow of capital.

Since we assumed jurisdiction over securities issues last year, investor protection and financial literacy have become top priorities for my work on this panel. Investors deserve to have timely financial reports that they can read and understand, instead of annually receiving a Byzantine, incomprehensible document dotted with countless footnotes. The collapse of the Internet bubble and the downfall of Enron have only heightened the skepticism of America's investors about corporate accounting practices. After our hearings to today, we need to work to change those attitudes by ensuring that our public companies return to the basics of accounting and avoid financial gymnastics in their future filings.

In closing, Mr. Chairman, I believe our Committee should comprehensively explore the issues related to corporate accounting practices. This hearing should also help us to alert investors about some of the key accounting issues that could affect their portfolios.