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In the brief time that I have to testify, I would like to offer the perspective of someone who wears the proverbial "two hats." That is, first I would like to offer the perspective of someone whose instruction material touches on many of the issues that are central to the debate about the process that promulgates accounting standards and firms' adherence to those standards. Later, I would like to offer the perspective of the researcher who has attempted to document the economic benefits of increased disclosure and greater transparency.

With regard to pedagogy, it is at least a partial indictment of the financial reporting process that one of the most popular elective classes in the Wharton MBA program is an accounting class whose chief purpose is to discuss how firms gerrymander their financial statements to conform to the letter of various US-Generally Accepted Accounting Principles (US-GAAP), but not necessarily the spirit. Further, one of the most popular executive education programs sponsored by Wharton is one in which the financial reporting peccadilloes of firms are brought out into the open and put forth for ridicule. Many of the instructors at Wharton are sensitive to the concern that in regaling students with tales of financial reporting chicanery, we may also be promoting this behavior on the part of our graduates. In our conceit, we rationalize our way around this dilemma by arguing that in any accounting Armageddon, it is important for our students to be better armed than the students from our peer institutions.

In short, viewed from the rarified air of academe, the accounting standard setting process appears structured in such a fashion as to produce the occasional accounting debacle. Industry and financial groups, and their auditors, sponsor a private sector agency, the Financial Accounting Standards Board (FASB), to offer accounting pronouncements and guidance from which the very same corporations and their auditors will either benefit or suffer. In other words, it is a process that, at best, seems fraught with moral hazard problems and, at worse, results in accounting opinions that appear to pander to the worst aspects of corporate America. These problems are only exacerbated when auditors who lobby the rule-making process in behalf of their corporate clients are then asked to implement the rules. In an environment like this, should we have expected anything less than the occasional Enron/Andersen misadventure?

Part of the problem in the rule-making process is the failure to be guided by two broad principles: 1) wherever practical, all publicly traded firms should be required to adhere to a regime of full and fair disclosure; and 2) wherever effective control is exercised over an entity, financial results of that entity should be fully consolidated into the controlling firm. Unfortunately, all too often in the rule-making process corporations through their lobbyists appear to employ a variety of self-serving arguments to circumvent these principles. This problem is further exacerbated by the fact that the rule-making process itself seems more absorbed in the detailed minutiae of accounting transactions than in the economic substance of the transactions. Opponents of the recognition of substance employ these arcane debates to frustrate rule making at all levels. No better example of this exists than the treatment of employee stock options.

But from a research perspective, the real tragedy of recent financial reporting deficiencies is the failure of all representatives in this debate to recognize the clear and obvious economic benefits of increased disclosure and greater transparency: lower costs of capital for firms, increased liquidity for firm equities, greater participation in the capital generation process by the public, etc. Recently, contemporary accounting research has attempted to document these benefits. While somewhat nascent, this research nonetheless is consistent with prevailing notions that increased disclosure is beneficial to the capital generation process. Commitments to increased disclosure on the part of firms do indeed result in lower costs of capital, increased liquidity, etc. The research results are clear and compelling, and buttress traditional claims that greater transparency enhances access to capital markets.

But if contemporary research can document the benefits of increased disclosure, why do publicly listed corporations not embrace it to the fullest extent? One rationale for less than full disclosure is that disclosure may require disseminating information about a firm's proprietary business model, management expertise, technology, etc. This, in turn, may work against the interests of a firm that reports publicly, and to the benefit of firms that compete against it. To the extent to which these competitors are based outside the U.S., or report under accounting standards other than US-GAAP, this provides powerful political leverage for less disclosure. But in a sense, a call for greater disclosure is no different from a variety of welfare arguments. While full disclosure and full consolidation may lead to both winners *and* losers in capital markets, indisputably increased disclosure serves the greater good.

In short, the thought with which I would like to leave the committee is that the rule-making process be governed by an ideal of full and fair disclosure, and full consolidation. Perhaps stated differently, arguments in favor of anything *less than* full and fair disclosure, and full consolidation, should require a high burden of proof. While full and fair disclosure and full consolidation will not eliminate failures that result from fraud, flawed business models, and/or unexpected industry and economic downturns, they will work to ensure that the failures are not the result of reporting systems that give firms and their managers unwarranted discretion to obfuscate an entity's overall financial condition.