100 Years Standing Up for American Enterprise

U.S. CHAMBER OF COMMERCE

Statement of the U.S. Chamber of Commerce

ON: "Accounting and Auditing Oversight: Pending Proposals and Emerging Issues Confronting Regulators, Standard Setters and the Economy"

TO: The Subcommittee on Capital Markets and Government Sponsored Enterprises

DATE: March28, 2012

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance – is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 115 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

Chairman Garrett, Ranking Member Waters and members of the Capital Markets and Government Sponsored Enterprises subcommittee. My name is Tom Quaadman, vice president for the Center for Capital Markets Competitiveness at the U.S. Chamber of Commerce. The Chamber is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector and region. I appreciate the opportunity to testify before the Subcommittee today on behalf of the businesses that the Chamber represents, which are investors themselves in our economy.

We are here to discuss the current issues facing the accounting profession and accounting and auditing standard setting.

Effective financial reporting and internal controls are an important priority for the U.S. Chamber of Commerce and one of the reasons why the Chamber established the Center for Capital Markets Competitiveness in 2007. In order for businesses to grow over the long-term they need to be able to access capital in financial markets domestically and abroad. The conveyance of reliable and relevant financial information to investors is an important part of that capital formation process.

Similarly, businesses are investors and active market participants themselves. Companies must mitigate risk through derivatives transactions and raise cash to ensure continuity of operations and accommodate growth. As active participants in the debt and equity markets, companies, like other investors, must have access to reliable and relevant financial data that facilitates efficient analysis and decision-making.

Therefore, the work of the Financial Accounting Standards Board ("FASB"), Public Company Accounting Oversight Board ("PCAOB"), and the Securities and Exchange Commission ("SEC") to ensure usable, reliable, and relevant financial reporting are critical to our free enterprise economy.

If the United States is to create the 20 million jobs that it needs to revive the economy over the next decade, financial reporting must play its crucial role of accurately, reliably and efficiently reflecting relevant economic activity. Some advances have been made in improving accounting and auditing standards. But unfortunately, over the last two decades, we have also seen ill conceived initiatives. Some of these were not just bad policy. They were efforts to redirect accounting and auditing standards to advance agendas rather than providing investors and businesses with useful information.

Dialogue between regulators, the accounting and auditing professionals who prepare financial data and the investors who use and rely upon it—including American business—is critical to keeping changes and refinements to auditing and accounting standards on track toward serving their vital purpose. The Fair Value accounting crisis was brought about, in part, by a lack of communication between FASB and the business community. A lack of dialogue deprived FASB of useful information and critical facts. Consequently, this led to flawed standards that prevented financial reports from realistically measuring economic activity.

In this context, the Fair Value accounting crisis was merely a symptom of a larger communications problem—one for which we think FASB has taken efforts to correct through regular and meaningful dialogue with stakeholders. However, we are concerned that the PCAOB is currently facing a similar communications challenge.

To elaborate, we have worked with Financial Accounting Foundation Chairman Jack Brennan and FASB Chairman Leslie Seidman to facilitate continuous on-going communications regarding standards development and other issues of importance to accounting. I believe that these communications have been helpful and fruitful during this critical phase of the FASB convergence projects with the International Accounting Standards Board ("IASB"). The objective is not to create standards that pick winners or losers in our free enterprise system, but rather to insure that the standards are reflective of real world activities and provide investors and other users of financial reports with the relevant, reliable and useful data needed to make informed decisions and compete on a level playing field.

Are all of our concerns addressed in these communications? Of course not. Are there bumps in the road? Yes. For instance, we believe that a reversal by FASB and IASB of current lease accounting standards could dramatically spike costs for companies and weaken a leasing market worth trillions of dollars. Yet, we continue to work with FASB to solve the problem. By giving stakeholders their voice in the process, FASB has developed a level of trust that insures a collaborative partnership to share relevant facts to inform the development of standards. This benefits everyone and ensures that the evolution of accounting and auditing standards remains focused on its specific role in our system of free enterprise.

The dramatic improvement in communications with the Financial Accounting Foundation and FASB has made the convergence projects less contentious than they could have been and facilitated world class standards that can help advance capital formation globally. This benefits businesses, investors, and our economy. The increased communication efforts and process to solicit input, facts, and feedback can serve as a model for the PCAOB in improving its processes and the deployment of the resources at its disposal—the majority of which come from public companies.

This is important because the PCAOB appears to have embarked on an agenda that is leading far afield from its specific, but important, mandate to regulate auditors. For example, the concept releases on mandatory audit firm rotation and auditor discussion and analysis have the Chamber concerned that the PCAOB is engaged in mission creep. It is leaving the realm of audit regulation and crossing the threshold of regulating corporate governance, a subject area that has been left to state corporate law and the Securities Exchange Commission. Moreover, the PCAOB should clarify that their recent proposal for auditors to understand executive compensation is for risk assessment rather than trying to regulate corporate governance.

Let's take a look at the history of mandatory audit firm rotation debate:

- Congress, in debating Sarbanes-Oxley, explicitly declined to enact provisions requiring mandatory firm rotation;

- The General Accounting Office has twice reviewed and rejected the need for mandatory firm rotation;

- Academic studies have demonstrated that mandatory firm rotation may harm companies through higher costs and increased incidence of undetected fraud;

- The PCAOB has failed to provide information through the inspections process demonstrating a need for mandatory firm rotation;

- Over 90% of commenter's to the concept release have opposed the concept of mandatory firm rotation; and

- The majority of investors commenting on the concept release also opposed mandatory firm rotation.

The PCAOB's failure to demonstrate any need for mandatory firm rotation – much less a rationale that outweighs the cogent and consistent concerns raised about it by investors, businesses and government entities that have rejected the concept leads us to question why valuable resources, time, and monies are being spent on this project. They can be better deployed for many other worthwhile endeavors. Indeed, statements that this issue will be worked on a year from now open the PCAOB to potential criticism that a predetermined objective exists even if there is no record to support it. A similar zeal to reach a result in the absence of supporting facts or analysis caused the D.C. Circuit Court of Appeals to vacate the SEC's proxy access rule.

Such a result is neither good for the PCAOB nor for financial reporting as a whole.

Last month we wrote to the PCAOB and SEC with concerns that the PCAOB does not have enough dialogue with the business community, and we have proposed the creation of a Business Advisory Group to work with the PCAOB from the outset along the lines of the dialogue that now exists with the FAF and FASB. Such dialogue can prevent concept releases being opposed by 92% of the comments submitted and allow a more constructive focus on workable standards tied to the PCAOB's mission. A wide range of input and discussion can only enhance the ability of the PCAOB to prioritize issues within its purview and address them in a thoughtful and balanced manner.

Other innovations, which we will discuss in greater detail, such as the use of a cost benefit analysis can also assist the PCAOB and stakeholders in determining the importance of issues and the efficacy of proposed solutions in relation to the costs and burdens they impose.

To summarize, for the past twenty years we have seen financial reporting move from one crisis to the next. Numerous studies have been conducted with solutions seldom implemented. Standards have been written, not to reflect economic activity, but in search of a holy grail of purity that is simply unobtainable and sometimes counterproductive to good and lawful economic activity. During this time we have seen:

1. A steady decline in the listing of public companies in the United States; and

2. American companies eschewing the traditional form of public company financing and consciously avoiding the American capital markets to raise capital through private markets.

Despite these indications of serious problems, financial reporting policies in the United States are still the best in the world. But our competitive advantage as the preferred destination for capital formation is eroding. We cannot wait to address the issues and correct the problems if we want to ensure our capital markets remain efficient and attractive for years to come.

The following are among the reforms that need to be taken to retain our primacy:

- **Financial Reporting Forum:** A FRF should be formed and made up of the SEC, FASB, PCAOB, financial regulators, investors (broadly defined), and businesses and its mission should be to identify and propose solutions to problems before they reach the crisis stage. This will also provide a mechanism to allow for appropriate coordination amongst regulators and input from investors and businesses. Congressman Gary Miller had an amendment to create an FRF that became a part of the House passed financial regulatory reform bill. The Miller amendment was stripped out by the Dodd-Frank Conference Committee.

- **Materiality for Investors:** The SEC, FASB, and PCAOB should develop standards of materiality for investors, as well as the scope of outreach to the investor community. This will provide perspective on various accounting and auditing issues such as the need for restatements on the one end, while framing the picture for input on the front end of standard setting.

- **PCAOB, FASB, and Regulator Coordination**: A formal, ongoing, and transparent dialogue should be created to consider the auditability of accounting standards. This would allow for the auditing of accounting standards to work in conjunction with standard development. It would also provide for the identification and resolution of issues that arise in practice. A similar process should be created to ensure that regulators have an understanding of standards and that different entities are not working at cross purposes. The era of "not my problem" needs to end.

- **Administrative Procedures Act and Federal Advisory Committee Act**: Recognition should be made that both FASB and PCAOB can have an enormous impact on the economy. Accordingly, FASB and PCAOB should abide by the same rules of procedure as required by the Administrative Procedures Act. In its standard setting activities, it should be required to consider the effects of its proposals "on efficiency, competition and capital formation" as the SEC is required to do and provide meaningful cost-benefit analysis so that it is mindful of the downstream effects of its proposals. Additionally, any advisory groups FASB and PCAOB form should be balanced in representation, open in process and follow the mandates for transparency and open deliberation reflected in the FACA.

- **Formal Pre and Post Implementation Review by FASB:** Standards should be field tested and put through a rigorous process to identify unintended consequences both before and after implementation. This process should include the following:

  1. Establishing a nine month period, following the finalization of the convergence projects, for FASB and IASB to work with all financial reporting stakeholders to identify transition issues and issue an implementation plan;

  2. Establishing an Implementation Issuer Advisory Group made up of large cap, mid cap, and small cap public companies and appropriate private company representation to advise FASB and IASB on the transition issues and implementation plan;

  3. Holding a series of roundtables, in conjunction with the appropriate regulators, for all stakeholders to have a voice in identifying issues and developing an implementation plan;

  4. Committing to procedural transparency through adherence to the Administrative Procedures Act and the cost-benefit analysis required for significant rulemakings, as well as disclosure policies established by U.S. financial regulators in the wake of the Dodd-Frank Act rulemaking;

  5. Consulting with appropriate financial regulators; and

  6. Developing a formal implementation and post-implementation process as proposed by CIFiR.

- **PCAOB Business Roundtables and Formation of Business Advisory Group:** In the coming weeks the Chamber and other trade associations will call upon the PCAOB to hold a roundtable and form a business advisory group to understand the role of companies as investors and their views on enhancing audit quality and other issues under the PCAOB's purview. Such a group should be transparent and follow the standards of FACA.

- **PCAOB Audit Advisory Group:** To provide for current, relevant expertise in the standard setting process and facilitate the identification and resolution of issues that arise in practice, the PCAOB should form an audit advisory group composed of public company auditors.

- **Cost Benefit Analysis**: In developing accounting and auditing standards, FASB and PCAOB must conduct a cost benefit analysis for investors and businesses before moving forward with a proposal. Standards should also show a justification for market efficiency and capital formation.

- **Less Reliance on Prescriptive Rule Making:** Hand-in-hand with the appropriate use of judgment is avoiding a system that is overly prescriptive in the formulation and application of standards and rules. The danger of an ever increasing number of rules and regulations by which audit firms are required to operate and auditors are required to apply has a danger of limiting the perspective of audit firms and auditors by displacing the application of principles and the exercise of judgment. This has the potential to create a system that has a one size fits all approach and check the box mentality that is at odds with the ever evolving dynamics of change inherent in our economy

- **Global Standards:** The SEC, FASB, and PCAOB should work towards the convergence of accounting and auditing standards to create a global system that will benefit investors from around the world. This convergence must create quality standards and should not adhere to a strict timeline to achieve that goal. Additionally, the SEC, and the Administration should continue efforts to achieve the international recognition of inspections.

- **Liability**: It should be recognized that large, medium, and small audit firms are needed, just as our economy needs large, medium, and small financial institutions. However, the unique aspects of the industry and the potential for catastrophic failure because of liability require a serious effort at liability reform, as has been accomplished in other jurisdictions or for other industries here in the United States.

- **Ban Mandatory Audit Firm Rotation and keep the PCAOB focused on its mission:** This is not a matter of auditing regulation. This is a matter of corporate governance outside of the PCAOB's realm. Congress should stop this effort in its track and refocus the PCAOB on its core mission.

The Chamber believes that these reforms would have dramatic benefits and provide a resiliency that was lacking during the financial crisis. All stakeholders would have the ability to provide input to FASB and PCAOB in an open and transparent manner. Standards would be improved and accounting and auditing would be on the same page. The same would be true of the regulators who, with the standard setters, would have a better feel for the overlap and interplay of seemingly disparate yet interconnected disciplines.

Finally, let me discuss the Chamber's positions on H.R. 3503 (the "Westmoreland Bill") and the draft bill banning mandatory firm rotation ("the Fitzpatrick Bill"). We have serious concerns regarding the Westmoreland bill on public disciplinary proceedings. First, the current system is one commonly used for regulatory proceedings—it is the same system that the Federal Elections Commission uses for alleged campaign finance violations. Second, these proceedings affect the auditor and the company. Inappropriate disclosures regarding disciplinary proceedings will impact the equity value of a company, harming shareholder value for investors and a business's capital base. We believe in strong even-handed enforcement and would like to have further discussions with Congress to achieve this goal.

The Chamber supports independent standard setting, however we believe that recent proposals on mandatory firm rotation, audit committee communications and proposals on an auditor discussion and analysis and executive compensation clearly are outside the bounds of audit regulation and entering corporate governance as discussed before. The Fitzpatrick bill reaffirms the line of demarcation, as established in Sarbanes-Oxley, that the PCAOB's jurisdiction is limited to that of an audit regulator, while corporate governance and executive compensation reside with the SEC or state corporate law.

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Auditors would be empowered to use their best judgment to impose integrity and accountability into the system. Global standards and cross-border cooperation will increase the ability of investors to understand a global marketplace, and for regulators to better provide for safety and soundness.

If we want to have transparent financial disclosures, the regulators and standard setters need to be transparent themselves. They need to focus on disclosures that are relevant and rational, and useful to investors, including business. The Chamber urges you to:

- Mandate more rational and efficient procedures at the standard setting bodies with a particular emphasis on improving their transparency and accountability;

- Keep these entities focused on their narrow, but important roles. Do not permit them to become overlapping and redundant bureaucracies that perpetuate a bloated administrative state that stifles the creative energies of its citizenry with excessive red tape;

- Empowering the stakeholders of these entities by ensuring they can engage in meaningful dialogue and get reasoned analysis to support new accounting and auditing standards;

- Address the ominous and growing liability issues that threaten the depth of our auditing and accounting professions.

All of these reforms are critical next steps to aligning financial reporting policy with America's economic prosperity in the 21st century economy.

As you move forward to make these reforms, recognize that the purpose of the financial reporting system is not to eliminate all risk from economic endeavors. Risk is inherent in our free enterprise system. It is a necessary element for innovation and the growth opportunities our economy needs to thrive. While we can try to strengthen the system, we must recognize that rational and enforceable financial reporting policies are designed to help stakeholders evaluate risks through the many different perspectives they may have of it. Such a system properly conceived as a means to an end and not as an end in itself will help spur long-term economic growth and job creation, and the Chamber is willing to work with any and all parties to make that a reality.

I will be happy to take any questions that you may have.

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	**2. Organization or organizations you are representing:**
Tom Quaadman	U.S. Chamber of Commerce
3. Business Address and telephone number:	
[redacted]	
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	**5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?**
☐ Yes ☒ No	☐ Yes ☒ No
6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.	
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