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REPORT
109–565

PROMOTING TRANSPARENCY IN FINANCIAL REPORTING ACT OF 2006

JULY 17, 2006.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. OXLEY, from the Committee on Financial Services, submitted the following

R E P O R T

[To accompany H.R. 5024]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 5024) to require annual oral testimony before the Financial Services Committee of the Chairperson or a designee of the Chairperson of the Securities and Exchange Commission, the Financial Accounting Standards Board, and the Public Company Accounting Oversight Board, relating to their efforts to promote transparency in financial reporting, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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49–006

AMENDMENT

The amendment is as follows:

In paragraph (2) of section 2, strike "to the quality and transparency of financial reporting".

PURPOSE AND SUMMARY

H.R. 5024, the Promoting Transparency in Financial Reporting Act of 2006, requires the Securities and Exchange Commission, the Financial Accounting Standards Board, and the Public Company Accounting Oversight Board to provide oral testimony by their respective Chairpersons (or designees), beginning in 2007, and annually for five years, to the Committee on Financial Services on their efforts to increase transparency in financial reporting and provide more accurate and clear financial information to investors. The testimony will include a report on their efforts to reassess complex and outdated accounting standards; improve the understandability, consistency, and overall usability of the existing accounting and auditing literature; develop principles-based accounting standards; encourage the use and acceptance of interactive data; and promote "plain English" disclosures.

H.R. 5024 was introduced to prompt our regulators and standard-setters to pursue their initiatives to drive greater transparency and reduce complexity in financial reporting. These efforts are integral to the continued growth and strength of our capital markets. This legislation intends to fortify investor confidence by increasing Congressional awareness of the matter. Further, H.R. 5024 stimulates additional levels of investor protection by ensuring financial information is delivered in a more widely usable and practical form.

BACKGROUND AND NEED FOR LEGISLATION

Since the passage of the Securities Exchange Act of 1934, public companies have been required to file financial reports with the Securities and Exchange Commission (SEC). The goal of these reporting requirements is to ensure that the public understands companies' financial condition. Although the concept of periodic financial reporting has remained relatively unchanged since the 1930s, the standards and rules governing the dissemination and presentation of financial information—securities regulations, accounting standards, and auditing standards—have become increasingly complicated. This complexity, in turn, has reduced the usefulness to investors of financial reports.

Public companies file with the SEC four financial statements—the income statement, the cash flow statement, the balance sheet, and the statement of changes in equity. Public companies report their financial statements according to generally accepted accounting principles (GAAP) promulgated since 1973 by the Financial Accounting Standards Board (FASB), an independent standard setter.

As the financial statements alone do not provide sufficient information for a complete financial portrait, the FASB requires companies to provide supplementary information in notes to these statements. In addition, the SEC requires that public companies discuss their financial condition in detail in a section of their annual and quarterly reports labeled, "Management's Discussion and Analysis

of Financial Position and Results of Operation," or "MD&A." The SEC also issues accounting bulletins, concept releases, and regulations establishing and clarifying financial reporting requirements.

In addition to these reporting requirements, auditing standards known as generally accepted auditing standards (GAAS) govern the performance of auditors as they examine public companies' financial statements. Today, the Public Company Accounting Oversight Board (PCAOB), created under the Sarbanes-Oxley Act of 2002 to register and inspect public company auditors, promulgates these standards.

The corporate scandals at the beginning of this century revealed weaknesses in many aspects of our financial reporting system. While many companies were clearly violating financial reporting requirements, for other companies, the complexity of these requirements was, in reality, undermining compliance and led to a number of financial restatements. Additionally, the complexity of financial reporting requirements has made it difficult to detect purposeful violations of the standards. Congress, regulators, and the industry assessed these financial reporting failures and reacted with efforts aimed at strengthening the financial reporting system.

The accounting scandals revealed the weakness of a rules-based accounting system: Companies structured transactions to circumvent "bright-line" accounting rules and succeeded in avoiding any accounting objectives inherent in those rules. Congress, noting the problem of a rules-based system, directed the SEC to study the adoption of a principles-based accounting system. In July 2003, the SEC released this report recommending that the U.S. accounting system gravitate towards developing accounting standards on a principles-based or "objectives-oriented" basis—where the objective of each standard would be clearly stated. This report followed the FASB's October 2002 proposal, "Principles-Based Approach to U.S. Standards Setting," documenting how a principles-based approach might improve the quality and transparency of financial reporting. In July 2005, in its Sarbanes-Oxley Act-mandated report on off-balance sheet transactions, the SEC reaffirmed its support for the adoption of an objectives-oriented financial reporting system. In addition, the PCAOB adopted GAAS as its interim standards and is in the process of revising those auditing standards to meet a principles-based auditing approach.

The SEC and the FASB have recently reaffirmed their commitment to reducing complexity in financial reporting. FASB Chairman Robert H. Herz stated in a December 2005 speech, "We at the FASB strongly support the goal of reducing the complexity of and increasing the quality and transparency of financial reporting. We have taken a number of steps to try to do our part to begin addressing these matters." The FASB intends to revise complex and outdated accounting standards; provide a more solid foundation for principles-based accounting; improve the consistency and usability of the existing accounting pronouncements, including codifying all GAAP by subject matter for ease of use, consolidating all accounting standards-setting, and developing principles-based standards; and continue to cooperate with the International Accounting Standards Board on the convergence of international and U.S. accounting standards. SEC Chairman Christopher Cox has described the SEC's efforts as including moving from long, hard-to-read disclo-

sure documents to easy-to-navigate web pages that let investors more simply find what they want; moving from boilerplate legal vernacular to "plain English" in every document intended for retail consumption; and reducing the complexity of accounting rules and regulations.

In addition, the SEC is encouraging the use of interactive data through eXtensible Business Reporting Language (XBRL), a computer code which tags data in the financial statements. Investors are able to quickly download this financial data into spreadsheets for analysis rather than spend time manually entering the data into a software application. In March 2006, the SEC announced a series of roundtables on the use of interactive data and since 2005 has supported through a voluntary pilot program the filing of tagged financial reports. The SEC believes that the use of XBRL will lead to better quality, lower cost, and more accessible financial reporting. SEC Chairman Cox stated in a December 2005 speech, "I completely agree that XBRL will do for business reporting what bar coding did for product distribution. But I believe its possibilities extend much farther than that." Some supporters believe that the use of XBRL may eventually lead to real-time financial disclosure.

In order to further explore ways to reduce financial reporting complexities, the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises held a hearing on March 29, 2006, entitled "Fostering Accuracy and Transparency in Financial Reporting". The SEC, the FASB, the PCAOB, and financial services industry representatives testified on the importance of a concerted effort to reduce complexity in financial reporting. The SEC's Acting Chief Accountant, Scott A. Taub, testified, "Transparent financial reporting is essential to informed investment decisions by investors and lending decisions by creditors, and to other users of financial statements." Marc E. Lackritz, President of the Securities Industry Association, testified, "The complexity and sheer volume of current accounting literature has become overwhelming even to the most sophisticated professional...Standard setters, regulators, and the private sector have all recognized the benefits that would result from a more 'principles-based' approach to accounting." President and CEO of the American Institute of Certified Public Accountants, Barry Melancon, testified on the merits of XBRL. He stated, "[XBRL] provides major benefits in the preparation, analysis, and communication of business information. It offers cost savings, greater efficiency, and improved accuracy and reliability to all those involved in supplying or using data."

Recognizing the difficulties posed by the increasing detail and volume of accounting, auditing, and reporting guidance, as well as the Committee on Financial Services' duty to maintain oversight of the efforts to ameliorate these issues, Congressman Geoff Davis (R-KY), along with original co-sponsors Congressmen Scott (D-GA) and Israel (D-NY), introduced H.R. 5024, the Promoting Transparency in Financial Reporting Act of 2006.

HEARINGS

On March 29, 2006, the Committee on Financial Services' Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises held a hearing entitled "Fostering Accuracy and

Transparency in Financial Reporting." The following witnesses testified: The Honorable Willis Gradison, Acting Chairman, Public Company Accounting Oversight Board; The Honorable Robert H. Herz, Chairman, Financial Accounting Standards Board; Mr. Scott Taub, Acting Chief Accountant, Securities and Exchange Commission; Mr. David Hirschmann, Senior Vice President, U.S. Chamber of Commerce; Mr. Marc E. Lackritz, President, Securities Industry Association; Ms. Colleen Cunningham, President, Financial Executives International; Mr. Barry Melancon, President, The American Institute of Certified Public Accountants; and Ms. Rebecca McEnally, Director of Capital Markets Policy, Centre for Financial Markets Integrity, CFA Institute.

COMMITTEE CONSIDERATION

The Committee on Financial Services met in open session on June 14, 2006, and ordered H.R. 5024, the Promoting Transparency in Financial Reporting Act of 2006, as amended, favorably reported to the House by a voice vote.

COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. No record votes were taken in conjunction with the consideration of this legislation. A motion by Mr. Oxley to report the bill, as amended, to the House with a favorable recommendation was agreed to by a voice vote.

The following amendment was considered:

An amendment offered by Mr. Sherman, No. 1, striking certain lines in the findings, was AGREED TO, as modified, by a voice vote.

COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee held a hearing and made findings that are reflected in this report.

PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee establishes the following performance related goals and objectives for this legislation:

> H.R. 5024, the Promoting Transparency in Financial Reporting Act of 2006, requires the Securities and Exchange Commission, the Financial Accounting Standards Board, and the Public Company Accounting Oversight Board to provide oral testimony beginning in 2007, and annually for five years, to the Committee on Financial Services on their efforts to increase transparency in financial reporting and provide more accurate and clear financial information to investors. This bill will prompt regulators and standard-setters to fulfill their initiatives to drive greater transparency and reduce complexity in financial reporting. These efforts are integral to the goal of continued growth and strength of our capital markets, will fortify investor confidence by increasing Congressional awareness of the matter, and will stimulate additional levels of investor pro-

tection by ensuring financial information is delivered in a more widely usable and practical form.

NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the estimate of new budget authority, entitlement authority, or tax expenditures or revenues contained in the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act.

COMMITTEE COST ESTIMATE

The Committee adopts as its own the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

CONGRESSIONAL BUDGET OFFICE ESTIMATE

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

JULY 14, 2006.

Hon. MICHAEL G. OXLEY,
Chairman, Committee on Financial Services,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 5024, the Promoting Transparency in Financial Reporting Act of 2006.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Gregory Waring.

Sincerely,

DONALD B. MARRON,
Acting Director.

Enclosure.

H.R. 5024—Promoting Transparency in Financial Reporting Act of 2006

H.R. 5024 would require the chairpersons of the Securities and Exchange Commission, the Financial Accounting Standards Board, and the Public Company Accounting Oversight Board, or their designees, to testify before the Committee on Financial Services of the House of Representatives on their respective efforts to reduce the complexity of and increase the transparency of public companies' financial reporting documents. The bill would require annual oral testimony in 2007 and in each of the following five years. CBO estimates that implementing the bill would have no significant impact on the federal budget and would not affect direct spending or revenues.

H.R. 5024 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would not affect the budgets of state, local, or tribal governments.

The CBO staff contact for this estimate is Gregory Waring. This estimate was approved by Robert A. Sunshine, Assistant Director for Budget Analysis.

FEDERAL MANDATES STATEMENT

The Committee adopts as its own the estimate of Federal mandates prepared by the Director of the Congressional Budget Office pursuant to section 423 of the Unfunded Mandates Reform Act.

ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

CONSTITUTIONAL AUTHORITY STATEMENT

Pursuant to clause 3(d)(1) of rule XIII of the Rules of the House of Representatives, the Committee finds that the Constitutional Authority of Congress to enact this legislation is provided by Article 1, section 8, clause 1 (relating to the general welfare of the United States) and clause 3 (relating to the power to regulate interstate commerce).

APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of section 102(b)(3) of the Congressional Accountability Act.

SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

Section 1. Short title

This section provides the short title for the bill, the "Promoting Transparency in Financial Reporting Act of 2006."

Section 2. Findings

This section sets forth certain Congressional findings describing the importance to the capital markets of clear and transparent financial reporting. This section further finds that the growing complexity of accounting, auditing, and reporting guidance poses a major challenge, thereby raising reporting costs.

Section 3. Annual testimony on reducing complexity in financial reporting

This section requires the Securities and Exchange Commission, the Financial Accounting Standards Board, and the Public Company Accounting Oversight Board to orally testify before the House Financial Services Committee annually for a period of five years beginning in 2007 regarding their efforts to reduce complexity in financial reporting in order to provide more accurate information to investors. These efforts should include: reassessing complex and outdated accounting standards; improving the clarity and usability of existing accounting and auditing literature; implementing principles-based accounting standards in lieu of rules-based standards;

encouraging the use of interactive data; and promoting disclosures in plain English.

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