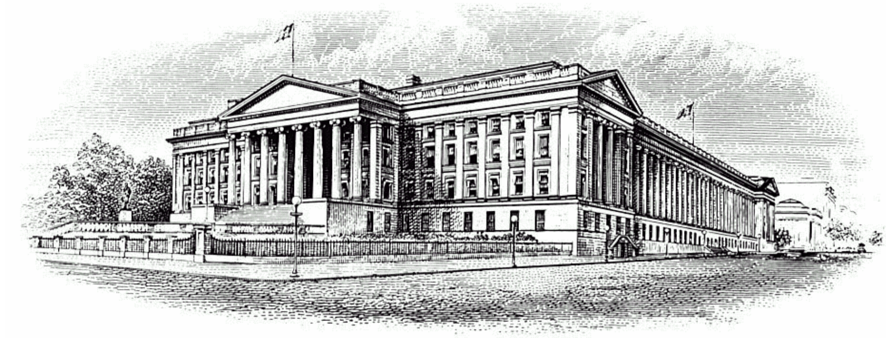

DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

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STATEMENT OF PETER R. FISHER
UNDER SECRETARY OF THE TREASURY FOR DOMESTIC FINANCE
BEFORE THE
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

Thank you, Chairman Oxley and Ranking Member LaFalce, for the opportunity to testify this morning before your committee on reforming corporate disclosure. The President and Secretary O'Neill are emphatic about the need for change.

I would like to describe first the underlying problems in corporate disclosure and second the President's plan for resolving them.

The Administration wants to work closely with Congress and the Securities and Exchange Commission to achieve the objectives spelled out in the President's 10-point plan. Looking at all the proposals now circulating, while there are still some important unresolved issues, there are also a number of areas of broad agreement. I would like to highlight some of both in my testimony this morning. Let me say at the outset that the bill that most closely parallels the President's plan is the Chairman's and Representative Baker's bill, H.R. 3763, the Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002.

The underlying problem

The United States enjoys the deepest, most liquid, and most transparent capital markets in the world. Over the past few months, however, we have learned once again not to take the performance of our capital markets for granted. For investors to price risk properly and to allocate capital to the most promising firms, they must have access to reliable information. Nothing could be more important for the long-run health of our economy and for investor protection.

The quality of corporate disclosures has not kept pace with the growing complexity of corporate finance for at least a decade. While our capital markets have been racing along at 100 r.p.m., our accounting and corporate disclosure regime has been crawling along at 10 r.p.m. The gap has just kept widening.

I am particularly pleased to be here today because for almost 10 years I have been watching this gap grow and endeavoring to close it. In 1994, I joined with other G-10 central bankers to try to update bank disclosures to reflect evolving corporate finance and risk management. I did the same in 1999, that time also with banking, securities, and insurance regulators. Both committees came up with good ideas but not much happened. It is exciting for me to have the opportunity to work with Secretary O'Neill and the President on these issues, and to see this Committee and Chairman Pitt focused on the same problems.

What is driving this gap? The true culprit is an ethic in boardrooms and auditing firms that too often equates GAAP compliance with adequate disclosure. This ethic sets the bar too low. It encourages corporate executives to prepare, and auditors to certify, financial statements that may meet the technical requirements of GAAP but fail to provide investors with a realistic picture of a firm's condition. For our corporate disclosure regime to work, a company's CEO and its auditors must be made accountable for disclosing the information that a reasonable investor would find necessary to assess the company's value (excepting competitive secrets).

The President's plan to restore corporate accountability

The President's 10-point plan is guided by three core principles: first, providing better information to investors; second, making corporate officers more accountable; and, third, developing a stronger, more independent accounting and auditing system.

As the President made clear, and as the Securities and Exchange Commission has recently re-affirmed, mere compliance with GAAP is not enough. Each investor should have access to a true and fair picture of the company, in plain English, and should be promptly informed of critical events that affect the condition of the company. By forcing companies to stop hiding behind technical GAAP compliance and demanding additional disclosure – by re-clarifying what satisfies the law – the President's proposals would raise the bar for what constitutes adequate disclosure.

President Bush directed our attention to CEOs because "reform should start at the top." We believe that CEOs should personally vouch for the veracity, timeliness, and fairness of their companies' public disclosures, including their financial statements. If a CEO or other corporate officer is guilty of misconduct that caused financial restatements, the SEC should force him or her to give back any compensation gained thereby. If corporate leaders abuse their power, the SEC should deny them the right to serve as a director or officer of a public company. And corporate leaders should have to tell investors within two days whenever they buy or sell the company's stock for personal gain.

What about catching those guilty of fraud? The President has urged the SEC to step up its enforcement against securities fraud. We think existing legal standards are sufficient for this task. Neither the President nor anyone else on his economic team thinks more private litigation would improve corporate disclosure.

Finally, the President believes that we need a stronger and more independent auditing and accounting system. To do this, we need a new, independent private-sector regulatory board, under the SEC's supervision, to develop standards of professional conduct and competence. In addition, the SEC needs to exercise more effective and broader oversight of FASB to ensure that accounting standards are issued more promptly and are more responsive to the needs of investors.

The efficiency of our capital markets rests in part on investors' relying on the independent judgment of outside auditors. The President is committed to bolstering that independence. He is also committed to doing so in measured ways that avoid perverse or unintended consequences.

A strong defense for investors is an active, informed audit committee, and so the President would urge making audit committees more accountable. The President has proposed that the SEC issue new guidelines for audit committees to use in deciding whether a non-auditing service would compromise an auditor's integrity. Audit committees would also report their choice of auditor directly to the shareholders. And the President encourages the SEC to prohibit outside auditors from providing internal audit services to the same client. This would eliminate the largest obstacle to auditor independence.

The President does not support a statutory mandate to rotate outside auditors. A rigid rule like this would impose unwarranted costs on companies and investors. For an outside auditor, just understanding the intricacies of a client's business – like mortgage-backed securities – can take a long time. So does learning about a company's people, processes, and problems. This deep knowledge is in fact the key to effectively reviewing a company's books. It is also why companies often hire auditors to deliver other services such as tax consulting. A rigid rotation rule would erase that intellectual capital every X years, no matter the circumstances. It might also undermine auditor effectiveness by periodically re-establishing auditor ignorance.

Imagine that to stamp out Medicare fraud, the Federal government required all patients to rotate doctors every few years. While this might reduce the risk of financial abuses in some cases, I think most Americans would think this an excessive intrusion into their own judgment about whom they want for a doctor, and an unjustified impairment of their physicians' ability to care for them. The analogy may be imperfect, but the logic is really the same for mandatory rotation of auditors.

Individual companies are of course free to *choose* to rotate. We hope that companies and their auditors will always aspire to best practices, not just avoid breaking the law. If an audit committee judges that in its company's specific circumstances, rotation makes sense, we would applaud. For the same reasons, we would discourage rigid bans on audit firms providing any non-audit services to the same client. As I noted above, the President does favor the SEC's banning combined internal/outside auditing.

The reform agenda I've just outlined focuses on government's role. We can raise the legal minimums that public companies' senior executives must meet. But in a society committed to democracy and freedom of choice, government should not be the only source for setting behavioral norms for CEOs. Legal minimums enforced by fines and penalties will only take us so far. Going beyond that – to ever-improving best practices, more efficient financial markets, stricter ethics for our corporate leaders – is a job for the business community itself.

Required legislation

As I canvass the major bills offered here in the House and in the Senate, I am heartened that we will find a number of spots of convergence. We all want to serve the same goals of better corporate disclosure and improved investor protection. And we all know our corporate disclosure regime is the best in the world, even while we strive to improve it.

The thoughtful bill that you, Mr. Chairman, and Representative Baker have offered is the clearest example of the common ground I see. You have called for a public regulatory organization to police the audit profession that closely resembles the President's proposal, as does your call for real-time disclosure of critical events and insider sales. You would press for fuller disclosure beyond GAAP's limits, such as off-balance sheet items and related-party transactions.

I think we will find common ground on where we will need legislation and where new SEC regulations will suffice. The 1933 and 1934 Acts provide the SEC with tremendous power and flexibility to implement the President's reforms, especially given the substantial consensus between his proposals and the major bills in Congress. If the SEC requires additional resources, the President has said he is open to working with Congress to address that need. And we may find there are specific areas – perhaps the need for a self-regulating organization to police the auditing profession – where legislation may be a useful complement to regulatory action.

One area where the SEC will need new legislative authority is to enable it to administratively bar wrongdoers from positions of corporate trust. Under current law, the SEC must first go to court to bar a director or officer guilty of serious misconduct from serving in such a position again in a public company. The President would urge you to empower the SEC to do so through administrative proceedings (preserving a right of appeal to the courts) – a power much like bank regulators have for bank executives.

We look forward to working with this Committee to find common ground and strengthen our capital markets. I am happy to try and answer any questions you may have.

Thank you.