



**Testimony of  
Robert H. Herz  
Chairman  
Financial Accounting Standards Board  
before the  
Capital Markets, Insurance and Government Sponsored Enterprises  
Subcommittee  
of the  
Committee on Financial Services  
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**Prepared Statement**

Chairman Baker, Ranking Member Kanjorski, and Members of the Subcommittee:

Good morning. I am Robert Herz, chairman of the Financial Accounting Standards Board (“FASB” or “Board”). I want to thank you for inviting me to participate at this very important and timely hearing.

I have brief prepared remarks and would respectfully request that the full text of my testimony and all supporting materials be entered into the public record.

The enactment by Congress of the Sarbanes-Oxley Act of 2002, and subsequent related actions by the United States (“US”) Securities and Exchange Commission (“SEC”), the Public Company Accounting Oversight Board (“PCAOB”), and the FASB, as well as various reforms within the business community, have strengthened the financial reporting system and increased public confidence in reported financial information. However, despite the benefits of those important reforms, we at the FASB, and many others, believe that there is much more work to be done to improve US financial reporting.

In our opinion, the complexity that pervades the reporting system—as evidenced by the volume and detail of accounting, auditing, and reporting standards, rules, and regulations—poses a major challenge to maintaining and enhancing the accuracy and transparency of financial information reported to investors, creditors, and the capital markets. We are concerned that complexity has engendered a form-over-substance approach to accounting, auditing, and reporting, sapping professionalism and increasingly necessitating the involvement of technical experts to ensure compliance.

The complexity has also added to the growing costs and effort involved in financial reporting and is a contributing factor to the unacceptably high number of restatements of financial reports by public enterprises. Moreover, it results in analytical complexity for investors and others seeking to use financial information in their economic decisions.

While some of the complexity is a natural consequence of reporting on diverse and complicated business transactions, there are many other sources of complexity, including:

- The continuing focus and emphasis on short-term earnings,
- The often conflicting perspectives and agendas of market participants,
- An evolutionary approach to standard setting that has resulted in nonconceptually based compromises and inconsistencies over time,
- Regular demands for detailed rules, bright lines, and exceptions driven in part by the fear of being second-guessed by regulators, enforcers, and the trial bar and in part by those seeking special treatments and exemptions,
- Continuing use of accounting-motivated structuring in an effort to obtain form-over-substance results, and

- Resistance to change and slowness in embracing and implementing new technologies and reporting models.

The FASB has recently undertaken a number of measures aimed at reducing complexity and improving the relevance and transparency of financial reporting.

First, the FASB has been systematically readdressing specific accounting standards that are overly complex, are rules-based, and do not result in reporting that properly reflects the underlying economic activity. Major areas the Board is currently readdressing include revenue recognition and accounting for pensions and other postemployment benefits. The Board also recently issued two new standards, and has other active projects on its agenda, designed to improve and simplify the accounting for derivatives and other financial instruments.

Second, the FASB has undertaken a major project to develop and maintain a comprehensive and integrated codification of all existing accounting literature. This project will result in an easily retrievable single electronic-based source for all US generally accepted accounting principles.

Third, the FASB has been actively pursuing several activities directed toward the development of more principles-based or objectives-oriented accounting standards, including a major project to strengthen our existing conceptual framework. That project will provide a more solid and consistent foundation for the development of more objectives-oriented standards in the future. Consistent with our commitment to international convergence of accounting standards, this project, like many of our current projects, is being conducted jointly with the International Accounting Standards Board, whose standards are in use in some 100 countries around the world.

Finally, while the development in the US of eXtensible Business Reporting Language (“XBRL”) has been under the direction of the XBRL Consortium, the FASB has been working with the Consortium and others to further the use of XBRL and other evolving technologies in financial reporting.

As important as all of those measures are, unfortunately, when taken alone, they are unlikely to significantly reduce the complexity that burdens the US financial reporting system. In our view, that will require concerted and coordinated action by all key parties in the reporting system to address the structural, cultural, and behavioral forces that generate complexity and impede transparent reporting.

Recently, we have been discussing issues surrounding complexity with the SEC, the PCAOB, and many other interested parties. As part of those discussions, we have begun exploring the kinds of steps and actions that might be necessary to identify the issues that lead to complexity and to develop proposed solutions and recommendations.

We believe that an initiative involving all key parties would be the most effective means to bring about broad-based improvements to the US financial reporting system aimed at both reducing complexity and increasing the accuracy and transparency of financial

reporting. While such an effort would not be easy and would take time, we believe it is one of national importance.

We look forward to continuing to work closely with the SEC, the PCAOB, this Subcommittee, and all other interested parties to ensure that the US financial reporting system meets the needs of investors, creditors, and our capital markets.

Thank you again, Mr. Chairman. I look forward to the opportunity to respond to any questions.