Testimony of Edmund L. Jenkins
Chairman
Financial Accounting Standards Board
Before the Subcommittee on Commerce, Trade, and Consumer Protection of the Committee on Energy and Commerce
February 14, 2002

Prepared Remarks

Chairman Stearns, Ranking Member Towns, and the Members of the Subcommittee:

I am pleased to appear before you today on behalf of the Financial Accounting Standards Board ("FASB" or "Board"). I have brief prepared remarks, and I would respectfully request that the full text of my testimony and all supporting materials be entered into the public record.

The FASB is an independent private-sector organization. We are not part of the federal government and receive no federal funding.

Our independence comes from the fact that our seven-member Board serves full-time and that we are required to sever all financial ties with our former employers. We are funded primarily through the sale of our publications and to a lesser extent through private donations solicited by the Trustees of a not-for-profit foundation, the Financial Accounting Foundation. Manuel H. Johnson, former Vice Chairman of the Federal Reserve Board, currently chairs that foundation.

Our mission is to establish and improve standards of financial accounting and reporting for both public and private enterprises. Those standards are essential to the efficient functioning of the capital markets because investors, creditors, and other consumers of financial reports rely heavily on credible, transparent, and comparable financial information.

Because the actions of the FASB affect so many organizations and are so important to the efficient functioning of the capital markets, our decision-making process must be open and thorough. An open and thorough process is essential for ensuring both the credibility and quality of the resulting standards. The standards in the US are generally recognized as the highest quality standards in the world.

The FASB has no authority to enforce its standards. Responsibility for ensuring that financial statements comply with accounting requirements rests with the officers and directors of the reporting entity, the auditor of the reporting entity's financial statements, and for public companies, the United States Securities and Exchange Commission ("SEC"). It is also important to understand that the FASB has no authority or responsibility with respect to auditing, independence, or scope of services matters. Rather, our responsibility relates solely to establishing financial accounting and reporting standards.

The FASB does not know many of the facts relating to Enron's financial accounting and reporting. Enron, however, publicly acknowledged in its November 8, 2001, Form 8-K and November 19, 2001, Form 10-Q filings with the SEC that its financial statements did not comply with existing accounting requirements in at least two areas. Those failures resulted in financial statements that materially inflated assets and net income and materially understated liabilities in 1997, 1998, 1999, and 2000. The February 1, 2002, Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron suggests that Enron's financial statements included other violations of existing accounting requirements. One such reference in the report states:

> Enron's original accounting treatment of the Chewco and LJM1 transactions that led to Enron's November 2001 restatement was clearly wrong, apparently

> the result of mistakes either in structuring the transactions or in basic accounting. In other cases, the accounting treatment was likely wrong, notwithstanding creative efforts to circumvent accounting principles through the complex structuring of transactions that lacked fundamental substance. [page 5]

I want to assure you, Mr. Chairman, Ranking Member Towns, and all the Members of the Subcommittee, that consistent with the FASB's mission and due process, the Board is prepared and committed to work with the Subcommittee, the SEC, and all other constituents to proceed expeditiously to resolve any and all financial accounting and reporting issues that may arise as a result of Enron's bankruptcy.

Attachment 4 to the full text of my testimony provides a detailed listing of the FASB's extensive existing guidance relating to accounting and disclosures of related party transactions, special-purpose entities ("SPEs"), and off-balance-sheet financial arrangements.

The Board has active projects under way in over a half-dozen areas that will propose significant improvements to existing requirements, including a project to improve the accounting for consolidations, and a project to improve the guidance for determining the fair values of financial instruments. With respect to the project on consolidations, which the FASB has struggled with for far too long, the Board plans to issue a proposal on an expedited basis in the second quarter of this year that will resolve some of the more common issues encountered by some entities in present practice, including issues relating to consolidation of SPEs.

The Board also understands the concerns that some, including SEC Chairman Harvey L. Pitt, have raised about the speed of our standard-setting activities. As described in detail in the full text of my testimony, the Board has begun pursuing a number of projects and activities focusing on improving the Board's efficiency and effectiveness without jeopardizing the openness and thoroughness of our due process.

The FASB and the accounting standards we issue, however, cannot alone sustain the transparency necessary to maintain the vibrancy of our capital markets. Other market participants also must carry out their responsibilities in the public interest. Those participants include reporting entities, auditors, and regulators.

Reporting entities that seek to access the capital markets to finance their needs are responsible for preparing their financial statements and presenting those statements to investors and other consumers. Those entities must apply the accounting standards in a way that is faithful not only to the language of the requirements, but to the requirements' clear intent. Seeking loopholes to find ways around the language or intent of the standards obfuscates reporting and harms investors and other consumers by creating information that is not transparent and that is not a true reflection of the economics of the underlying transactions.

Auditors are required to examine a reporting entity's application of accounting standards to determine that the requirements have been fairly applied. They too must ensure that not only the language, but also the stated intent, of the standards are followed. They must not accept facile arguments by a reporting entity's management that the financial statements are acceptable just because the language of the standards does not explicitly prohibit an inventive reporting technique or methodology that is intended to hide information from unsuspecting consumers. The primary responsibility of auditors is to the investing public who do not have the benefits of the same level of access as auditors do to the underlying facts about an entity's operations and transactions.

Finally, regulators, principally the SEC, also have an important role to play. The SEC's responsibility is investor protection. Through its oversight and enforcement activities it must also seek to ensure that reporting entities provide information consistent with the language and intent of the relevant standards. The SEC must also ensure that auditors, in accordance with accepted auditing standards, have properly and thoroughly examined and certified the reporting entity's information.

If anything positive results from the Enron bankruptcy, it may be that this highly publicized investor and employee tragedy serves as an indelible reminder to all of us that transparent financial accounting and reporting do matter and that the lack of transparency imposes significant costs on all who participate in the US capital markets.

Thank you, Mr. Chairman. I very much appreciate this opportunity and would be pleased to respond to any questions.