

## **INTEGRITY: Restoring Trust in American Business and the Accounting Profession**

(This document was written by David M. Walker, CPA, Comptroller General of the United States, based on a speech he gave to the American Institute of Certified Public Accountants' leadership conference in November 2002)

November 26, 2002

Our profession, the performance and accountability profession, currently faces a "crisis of confidence" that must be addressed not only for the good of our profession but also for the good of our country and the nation's capital markets. We are not, however, the only ones who are under the microscope as recent events in the private sector have made clear. Restoring public trust and confidence in a manner that can be sustained over the long-term will require concerted actions by a various parties in order to address some very real systemic weaknesses plaguing our current corporate governance, accountability, and related systems.

### **RECENT ACCOUNTABILITY BREAKDOWNS:**

Recent accountability breakdowns in the private sector have come in a variety of forms and bear many names, including Enron, WorldCom, Qwest, Tyco, Adelphia, Global Crossing, Waste Management, Micro Strategy, Superior Federal Savings Bank and Xerox, just to name a few. A recent U.S. General Accounting Office (GAO) report highlighted the increasing frequency and changing nature of corporate earnings restatements. Furthermore, the rapid decline and fall of Arthur Andersen LLP has served as a dramatic lesson that will no doubt be the subject of many books and business school case studies.

Clearly, some of these breakdowns are more complex and harder to understand than others. The WorldCom failure appears to be a simple matter of not following basic accounting principles in connection with capitalizing versus expensing certain items. Although all the facts are not known, it is perplexing how such a basic error involving billions of dollars could go undetected by the auditors. On the other hand, the Enron situation involved complex transactions with a number of parties and a now apparent weakness in current generally accepted accounting principles. Others involved simple matters of greed by corporate executives and inadequate oversight and accountability actions by boards of directors.

### **ARTHUR ANDERSEN LLP:**

Although there are many dimensions to the current challenge, let's start with one of our own: Arthur Andersen LLP (Andersen). Andersen may have been the auditor for more than its fair share of the entities associated with the most recent accountability failures, but it was not the auditor for all of them. In fact, U.S. Securities and Exchange Commission (SEC) data disclosed that until 2001, Andersen generally had a lower rate of earnings restatements for its public company audit clients than did other major

accounting firms. In addition, while Andersen had certain unusual audit related policies and practices that were not widely known by its partners and may not be shared by many other firms, it was hardly a rogue firm in the profession and any assertions to the contrary are not only inaccurate but also inappropriate. Such assertions serve to disparage the reputations of the thousands of Andersen professionals who did their job right every day and to the very end. Such assertions also serve as an attempt to discount the need for meaningful reform to help prevent future accountability failures.

The Andersen story illustrates how a few people can do the wrong thing with catastrophic consequences for many innocent parties. It was not long ago that Arthur Andersen was viewed by many as the premier professional services firm in the world. For years, Andersen had the reputation of “thinking straight and talking straight” and doing what it felt was right in connection with challenging accounting and reporting issues - even if the client didn’t like the answer. From global gold standard to GONE in less than two years! What happened?

As a former Andersen partner who severed all ties with the firm in 1998, I believe that Andersen got caught up with a never-ending quest to grow the top line, grow the bottom line and grow the income of its partners. Stated differently, it was primarily focused on maximizing earnings and not enough on managing risk, including risk relating to its hard-earned and priceless reputation. I observed some of these tendencies during the later stages of my almost 10-year tenure with the firm. These tendencies had not yet reached a critical level and the firm had not experienced a major public accountability failure when I left to return to public service as Comptroller General of the United States in 1998. Evidently these trends became much more pronounced after I left the firm.

During the later part of my tenure with Andersen, I expressed my concerns publicly in several partner meetings and privately to various internal players; however, as someone who had not “grown up” with the firm, I found that my actions to speak up - - especially when my views were not consistent with Arthur Andersen business unit leadership’s preferences - - were somewhat counter-cultural. This was most apparent when I expressed my support for George Shaheen, the ex-Managing Partner of the Andersen Consulting business unit (now known as Accenture), to succeed Larry Weinbach as the Managing Partner of Andersen Worldwide, rather than Arthur Andersen management’s choice of Jim Wadia, Managing Partner of the Arthur Andersen business unit in the United Kingdom. Ironically, it was George Shaheen rather than Jim Wadia who publicly stated his support for modernizing the attest and assurance model for the 21<sup>st</sup> century! This, along with his leadership skills, had a lot to do with my support for his candidacy.

Andersen is not the only organization to be captured by the siren’s song calling for more money, more money and more money. During the past few years, certain partners strayed from the core values of leadership, integrity, service and stewardship that made Arthur Andersen great and caused me to join the firm in 1989. The result was that a few partners’ actions served to bet the ranch in connection with the firm’s reputation, and they lost the bet!

Although some of Andersen's partners and employees may have violated the law and should be held accountable, the Justice Department's indictment of the firm resulted in the "Big Five" accounting and consulting firms becoming the "Big Four." This served to further reduce competition in a profession of critical importance to the public that had already consolidated from eight to five major global firms. It was more than a little ironic that the Justice Department that opposed the consolidation of the "Big Six" into the "Big Five" caused the further consolidation in the profession. Regardless of the methods and motivations of the various parties, the deed is done, and Arthur Andersen is essentially dead.

I am proud to have been a partner with Arthur Andersen in its glory days, but I'm shocked and saddened by what happened to the firm during the past few years. Clearly, one of the big lessons from Andersen's fall is that it may take years to create a reputation of quality and integrity but that hard-earned reputation can be lost very quickly if there is a real or perceived breach of trust. In Andersen's case, it took decades for Andersen to climb to the top and less than two years for it to decline into extinction. Hopefully, people will take that lesson to heart.

#### **AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS (AICPA):**

Andersen's fall, along with the recent business accountability breakdowns and other integrity failures, has served to adversely impact the public's trust and confidence not just in CPAs, but also in other performance and accountability professionals, corporate officials and a variety of other parties. They have also served to adversely affect public confidence in our nation's capital markets. Many CPAs have also shown increasing concern with recent actions and inactions of our own professional association, the American Institute of Certified Public Accountants (AICPA).

What are these concerns? First, the AICPA's actions in connection with the recent accounting reform legislation and certain other reform related administrative actions have damaged its reputation in government and elsewhere. Some of its external actions may have been designed to serve the economic interests of some of its members but they were not necessarily consistent with the broader public interest, especially in connection with audits involving public companies and public funds. Furthermore, some of the AICPA's recent internal actions have been questioned by its own membership. For example, the membership soundly rejected the Institute's efforts to further stretch the CPA brand name and allow others to benefit from our profession's hard-earned reputation through the so-called "XYZ initiative." Other AICPA actions designed to enhance the value of CPAs to their clients have met with mixed results. In addition, some of these have not been a model of transparency or integrity given delayed disclosures and potential conflicts of interest.

One would expect the AICPA to lead by example in connection with transparency and conflict issues given the role and nature of the profession that it represents. In my view, the AICPA and its leadership must set the standard for professional conduct and be beyond reproach because they represent all of us and, as a result their actions, reflect on all of us.

Clearly, the AICPA's value-enhancement and trade-oriented efforts have dominated its agenda in recent years. Although value-enhancement to the membership is clearly a legitimate role for the AICPA, as a professional association it also has a responsibility to aggressively address a range of professional risk management issues. In my view, not enough has been done to manage the current and emerging risks associated with our profession, especially in connection with modernizing the attest and assurance model and related auditing standards, including the independence standard for the 21<sup>st</sup> century. Yes, some steps have been taken but not nearly enough or as quickly as is called for, given recent events and the vital role that CPAs play in our overall accountability system.

As a result, some are questioning the future role of the AICPA and whether they should continue to renew their membership. I, for one, have renewed my membership. Why? Because I believe that it is better to be an active member who tries to make needed and constructive changes from the inside rather than voting with my feet and simply walking away. I hope that most of my fellow members will agree with me. However, I believe that additional actions by the board and AICPA management will be needed to restore trust and confidence in the Institute over the longer-term.

#### **CORPORATE GOVERNANCE:**

Outside auditors bear varying degrees of responsibility for these recent failures, but they don't bear all the responsibility. Where were the boards of directors (boards) and what was the role of top corporate management in connection with these business breakdowns? What involvement did other key players have in connection with these accountability failures? These and other questions are worth exploring to determine what changes are needed on a going-forward basis to minimize the possibility that these types of events will occur in the future.

In my view, the most critical element that needs to be addressed to help ensure that these failures do not proliferate in the future is the overall governance model for public companies in the United States. Many believe, and I am one of them, that the current U.S. corporate governance model for public companies is not adequate to protect the interests of shareholders and other key stakeholders. Specifically, although most public companies are required to have a board that is comprised of a majority of "independent directors" and certain key committees are required to be comprised solely of outside directors, a closer look reveals that the independence of many boards may be more a matter of form than substance.

The issues of concern start at the top of the corporate governance pyramid. The CEO of many major public companies also serves as chairman of the board of directors. As chairman and CEO, this one individual has a huge impact on the direction of the company, the role of the board, and the composition of the board. All too frequently, such individuals will have significant influence over who is asked to join the board and who is asked to leave it. Boards are often comprised primarily of internal management officials, high-level executives from other companies, and major service providers to and customers of the company. Interlocking boards are also fairly common. Under such

arrangements, executives from different companies who know each other will sit on each other's boards. Although all these individuals have valuable experience and perspective to bring to the table, they are not well positioned to address all of the key roles and responsibilities of an independent board.

What should public company boards be doing? Under modern governance theory, the board works for the shareholders and the CEO works for the board. But how can this be if the CEO also serves as chairman of the board? Boards have at least three roles that they need to play. First, they should provide strategic advice to management in order to help maximize shareholder value. Most boards have historically spent most of their time on this role. Second, they need to help manage risk, including risk related to attempts to maximize current value at the expense of mortgaging the future. Risk management must also consider the interests of key stakeholder groups, such as employees, customers and the communities in which the company operates. Finally, boards have a clear responsibility to hold management accountable for results. This latter element is a major reason why having a board that is both qualified and independent is so important. Board member qualifications are more than a matter of education and experience, they are also a matter of personal attributes of which integrity is number one. Board independence does not require the elimination of all inside directors but it would seem to call for ensuring that a super-majority of board members are truly independent both in fact and appearance.

Having a qualified and independent board is important but not enough. Boards need to have adequate resources, including having access to their own independent attorneys and advisors when they believe it is appropriate. Board members also must have the time needed to address their various roles and responsibilities. From a practical standpoint, this means that active executives should limit the number of boards they sit on, and all board members need to be comfortable that they can dedicate the time needed to properly discharge their fiduciary responsibilities.

Yes, board members have a fiduciary responsibility to the shareholders that they represent. They must do their best to do the right thing and not breach their fiduciary duties through either commission or omission. After all, it's not just what you do that counts, it's also what you fail to do when circumstances dictate that you should act.

## **EXECUTIVE COMPENSATION:**

Having the right governance structure is of critical importance. It's also important to consider the nature and reasonableness of the incentives provided to top management and board members. Much has been written regarding the meteoric rise of executive compensation in the United States. Various studies have shown how the ratio of executive compensation to average employee compensation has risen to levels of irrationality and levels that far exceed those of other major industrialized nations.

How much is a single executive worth? After all, unlike inventors who should be rewarded for innovation resulting from their personal efforts, leadership of a major public company is a team effort. Despite the assertions of some CEOs, while one key

player can make a difference, it requires a team of talented executives to add shareholder value and manage shareholder risk over time. In some cases, one wonders what some highly compensated top executives were doing to earn their pay given their public statements and testimonies subsequent to the decline of their companies. Certain former Enron and WorldCom executives come to mind in this regard.

It's not just the total amount of compensation but the form and structure of executive compensation arrangements that is important as well. It is well known that the behavior of individuals is affected by the nature of their compensation arrangements; top executives are no exception. For example, some executives may be tempted to accelerate income or expense recognition in ways that will serve to help them maximize their bonus compensation in the current or following year, respectively. Boards and auditors need to be vigilant to ensure that any inappropriate actions are avoided.

Recently, a significant amount of attention has been focused on the structure of "stock options" and the related accounting treatment. Clearly, some amount of stock compensation makes sense in order to tie the interests of the shareholders with the interests of top executives; however, the amount and structure are both important to ensure equity and avoid perverse incentives to maximize value in the short-term at the expense of the longer-term.

There is little question that some abuse of stock compensation has occurred. In a large number of cases, key executives have been granted additional stock options or their existing options have been re-priced (i.e., lower strike price) because of a decline in the market value of their company's stock. Part of the decline may have been due to general market conditions, but it's doubtful that all of it was. In fact, some or most of the decline could have been due to the failure of management to deliver on their promises. The result is that these executives can make huge sums if the stock price rebounds.

Although some have argued that stock option re-loads and re-pricing were necessary to keep their executives, I wonder how many of these executives wanted to give up options or raise the strike price of their options when general market conditions were causing all boats to rise? I don't know of any, but maybe you do! We should not have a heads-I-win and tails-you-lose compensation structure. This situation could be mitigated if companies had qualified, independent, and adequately resourced boards; however, as I noted previously, this is all too often not the case.

Boards have a responsibility to ensure the reasonableness of overall executive compensation. It's clear that a number of them are not doing an adequate job in this regard. At the same time, the federal government bears some responsibility for the movement to stock-based compensation due to tax changes that limited the deductibility of certain types and amounts of executive compensation. These provisions may have to be reexamined as well.

From a more strategic perspective, there is both a need and an opportunity to forge a realignment of interests between the board of directors and auditors in ways that can help to enhance value and manage risk for shareholders and other key stakeholders. In

theory, auditors work directly for the board of directors and indirectly for shareholders. Yes, audit committees of the board interact with and recommend which audit firm to retain for approval by the shareholders. In the real world, however, top management has much more influence on and interaction with the outside auditors. This must change and under the recent Sarbanes-Oxley accounting reform legislation, some related changes will be required. Importantly, once additional needed corporate governance reforms are made to enhance the independence and capacity of the board, the opportunity to implement the needed realignment will be greatly enhanced.

### **ACCOUNTING AND REPORTING MODEL:**

What about the current accounting and reporting model? We have recently seen how current accounting and reporting requirements are inadequate. For example, the collapse of Enron showed how accounting and reporting for so-called “special purpose entities” (SPEs) is hard to understand, much less defend. Does it make sense for companies to be able to keep significant financial transactions off their books when unrelated parties provide only 3 percent of the related capital at risk? I think not! Although Enron may have violated this 3 percent requirement, the 3-percent level would seem to be way too low in an environment in which we should be focusing on economic substance versus legal form in accounting and reporting as well as attest and assurance matters.

There has also been a considerable amount of discussion and debate regarding the appropriate accounting and reporting treatment for stock options. Strong views are held on both sides of this great debate. From a practical perspective, if stock options aren’t compensation, what are they? In my view, it’s not on the issue of whether they should be recorded as compensation expense; it’s more a matter of how it should be done.

From a broader perspective, I believe that the current accounting and reporting model is not well suited for our 21<sup>st</sup> century knowledge-based economy. Unlike the industrial age in which tangible assets were of great value and importance, in today’s knowledge-based economy it’s intellectual capital that is driving the market value of many enterprises. Intellectual capital is created by the efforts of people. As a result, people represent the most valuable asset in the knowledge age. People are the source of all process improvement, technological innovation, and environmental enhancements. If people are our most valuable asset, then why are people treated primarily as a cost and a liability under our current accounting and reporting model?

What about historical cost? Although it’s nice to know what something costs, it’s arguably more important to know what it is worth! Furthermore, the days when historical financial statements were viewed as being of critical importance are gone. It’s not that they aren’t important, it’s that they aren’t as important as they used to be. Today, it’s important to have access to timely and reliable financial and non-financial performance information. In addition, it’s important to not just know what has happened but what is likely to happen based on key performance indicators, projection, information and sensitivity analyses.

We live in an increasingly inter-dependent world. Our markets are global in nature and no nation, including the United States, can go it alone. And yet, we still lack a set of global accounting and reporting standards that reflects the globalization of economies, enterprises, and markets. We need a set of global standards, and various interested parties need to work together to help make this become a reality sooner rather than later.

These new accounting and reporting standards should not just be global in nature, they should be principle-based rather than rule-based. Current U.S. accounting and reporting standards have become much too complex. Too many players are looking for special treatment and loopholes and are focusing on legal form rather than economic substance. Furthermore, too many professionals are busy checking boxes rather than turning on their brains and using their professional judgment to get to the right answer. We must remember that as CPAs, we get paid for our judgment, so let's exercise it.

New principle-based accounting and reporting standards should be focused on value and risk. Related disclosures should focus more on key performance indicators along with selected projection information and sensitivity analyses. In addition, all disclosures need to be stated as clearly and concisely as possible. Too many public companies' disclosures are written in legal language and are way too long. They seem to be designed more to confuse rather than inform the reader.

Some have recently advocated a three-pronged approach to future financial and performance reporting. The first prong would represent basic reporting applicable to all public companies. The second prong would include key benchmark information based on the company's industry. The third prong would include supplemental information on key value and risk elements affecting the company. I believe that such an approach has conceptual merit and should be explored along with the other key concepts outlined above.

#### **ATTEST AND ASSURANCE STANDARDS:**

Although the accounting and reporting model needs to be updated, in my view, the current attest and assurance model is also out of date. The current model relies heavily on an auditor's expression of an opinion on historical cost-based financial statements after year-end. For public companies, audited financial statements generally are required to be filed with the SEC within three months of the company's fiscal year-end. This report has some value but it is not as valuable as it once was.

More needs to be done to enhance the scope and improve the timeliness of various attest and assurance services and related reporting. More also needs to be done to address the continuing "expectations gap" regarding what auditors are doing in connection with the detection of fraud and internal controls, and to audit through electronic information systems rather than around them. In this regard, Texas A&M University has recently formed a new Center for Continuous Auditing involving a consortium of over 12 leading universities and others to help address these issues.



Currently, outside auditor reports are not required to provide any level of assurance with regard to key internal controls. Such controls are critical to determining the reliability of interim reporting and various ongoing assertions by the company throughout the year. Importantly, opinion level of reporting on internal controls over financial reporting will be required by the Sarbanes-Oxley accounting reform legislation that was passed in July 2002. It is designed, among other things, to enhance oversight of public company auditors in light of recent accountability failures.

However, the current audit-reporting model does not provide any level of assurance regarding key risk and value-based performance and projection information that are important to a wide range of stakeholders. We also need to take steps to do so in conjunction with the needed enhancements to the current accounting and reporting model.

It's important to enhance the scope and timing of any related audit reports, but it's also important to ensure that firms are both qualified and independent to perform such audits. Contrary to assertions by some, independence is more than a state of mind. Auditors must be independent both in fact and appearance in order to be credible. In my view, current AICPA independence standards do not adequately ensure the independence of auditors who provide certain non-audit or consulting services to their audit clients. As a result, the GAO issued new independence standards applicable to audits of federal departments and agencies and entities that receive federal funds, and the Sarbanes-Oxley legislation limited the ability of auditors of public companies to perform certain non-audit services for their audit clients.

The Sarbanes-Oxley provisions were based in large part on GAO's new independence standards. Importantly, GAO saw the need for a change in this area and we began the process to make related changes long before Enron and other recent business failures came to light. Although GAO took a lot of heat in being out front on this controversial issue, in part due to recent events, we're getting a lot of accolades now!

During the past decade the AICPA and many accounting firms put too much emphasis on how they could grow their top line, bottom line, and earnings through pushing non-audit/consulting services and not enough time modernizing attest and assurance services that represent the franchise for CPAs on which the public relies. This must change, and recent events are likely to force both the accounting profession and the firms to place much more emphasis on their core services. At the same time, many major accounting firms are spinning off the portions of their consulting practices that pose the greatest potential independence problems.

In my view, auditors should be able to provide some consulting services to their audit clients, but there are certain services that would clearly be inappropriate for them to provide. Specifically, under the GAO's new independence standards auditors must not violate two basic principles. First, auditors should not perform management functions or make management decisions. Second, auditors should not audit their own work when the work involved is material to the subject matter of the audit. These principles are

simple, straightforward, and timeless in nature. We also need to take this type of approach in connection with key accounting/reporting and audit issues.

As I noted earlier, the board and the auditors should have a strategic alignment of interests. Furthermore, for any system to function effectively, there must be incentives for parties to do the right thing, adequate transparency to provide reasonable assurance that people will do the right thing, and appropriate accountability when people do not do the right thing. This strategic realignment and convergence of interests between the board and the outside auditors would help to achieve these objectives.

### **LEGAL, FINANCIAL AND OTHER ADVISORS:**

A variety of outside players other than auditors have been involved in and bear differing degrees of responsibility for some of the recent business failures. Attorneys, investment bankers, consultants and other advisors have played major roles in structuring or engineering business transactions in order to achieve not just a desired business result but also a desired accounting and reporting result. In some cases, this has resulted in changing the form of certain arrangements in order to meet the minimum technical requirements of any related accounting and reporting requirements while coming close to the line of what is legal. Some might call this aiding and abetting.

Many advisors try to help their clients meet a short-term value-oriented objective. However, in doing so they must remember that short-term gain can come at a huge long-term cost if the transaction unravels or otherwise comes under close regulatory review or public scrutiny. Such was clearly the case in connection with certain recent business failures.

Several companies have used such aggressive approaches to deal with a variety of tax issues and other matters. For example, a number of major multi-national companies based in the United States are trying to have their legal headquarters located in another country for tax reasons. Typically, companies and their advisors try to minimize the visibility of such techniques in order to avoid public criticism. Sometimes they succeed, and sometimes they don't.

In my view, too many people today are trying to structure transactions and other business dealings so they are technically acceptable rather than doing what is right. It is time for people to realize that things like the law and accounting and reporting standards represent the floor of acceptable behavior and not the ceiling! Values like integrity, morality, compassion and stewardship represent higher callings that more people should strive to achieve. In the end, we all need to be more responsible for our actions and inactions. The simple rule is, if in doubt about what to do, then check it out both from a technical and value oriented perspective. If still in doubt, don't do it! It's not worth betting your reputation or the reputation of your organization. Just ask the former partners and employees of Arthur Andersen.

Wall Street firms are subject to these same tendencies. They also have certain conflicts in connection with their investment banking and brokerage operations that need to be

addressed just as independent auditors do in connection with their consulting services. The independence and objectivity of stock analysts reporting is also a matter of concern. The SEC and several states are looking into these issues. Hopefully, Wall Street will take voluntary steps to address these issues before it is forced to act.

In the final analysis, attorneys and other advisors need to keep in mind that their actions can have an adverse affect on their reputations as well as the public. Given the lessons from Arthur Andersen's fall, they need to keep this in the forefront rather than the back of their minds.

### **FEDERAL REGULATION AND ENFORCEMENT:**

The primary federal regulator in connection with financial accounting and reporting for public companies is the Securities and Exchange Commission (SEC). The SEC promulgates and enforces the registration requirements dealing with public companies. The SEC has vast responsibilities and finite resources. As a result, they need to constantly look for process improvements and technological enhancements to leverage their finite resources to maximize their effectiveness. In light of recent events, a consensus has emerged that the SEC needs significant additional resources to help ensure that it can do its job properly.

Although the SEC has the authority to issue certain accounting/reporting and auditing standards for public companies, it has historically relied to a great extent on certain self-regulatory bodies to help maintain trust and confidence in our nation's capital markets. For example, it has historically relied on the Financial Accounting Standards Board (FASB) to set generally accepted accounting principles and the AICPA's Auditing Standards Board (ASB) to set generally accepted auditing standards. In addition, other parties such as the major stock exchanges play a role by imposing various requirements for companies to attain and maintain their listings.

While self-regulatory approaches can and have worked in various situations, there are certain instances in which it is unrealistic for them to work as effectively as needed in order to adequately protect the public interest. One example of this is in connection with what type of non-audit or consulting services that outside audit firms can provide to their audit clients and still maintain their independence. History has shown that the present self-regulatory structure has not been adequate in this regard. There is too much of a tendency for self-regulatory structures to rationalize how the provision of a broad range of services can add value to the client and does not present an independence problem. This has clearly been the case in connection with the AICPA's current independence standards.

Another area where the current self-regulatory structure has proved to be inadequate is in connection with the AICPA's self-disciplinary function. The process usually takes too long, and in the final analysis, the most severe sanction the AICPA can impose is expulsion from the Institute. Since CPAs are not required to belong to the AICPA in order to conduct public company audits, the most severe sanction would only serve to save the CPA some dues without any other practical effect. This is clearly ineffective!

While the state boards of accountancy have the ability to impose much stiffer sanctions, including revoking a CPA's license to practice in a state, these boards have not exercised this sanction very frequently.

While I believe that it is not always desirable to have the government intervene, at times it is necessary in order to protect the public interest, especially when others who could act fail to do so. Recent examples include actions taken by the Congress, the SEC and the GAO to address areas of concern that each felt warranted government action. Hopefully, government intervention can be minimized in the future; but for that to occur, others must take steps to address serious public interest issues before they reach crisis proportions. If they fail to do so, I have little doubt that government will eventually act.

From an enforcement perspective, the SEC has certain civil enforcement powers that it can use to address violations of the nation's securities laws. In some cases its sanctions are adequate, but not always. Most corporate officials, board members and professionals are people of ability and integrity who try to do the right thing. At the same time, every country and sector has "bad actors" that take short cuts and push the envelope to achieve a desired result. Many of these players tend to be arrogant and believe that the end justifies the means. In addition, as we have seen in the case of various derivatives transactions involving Enron, Qwest and Global Crossing, sometimes bad actors join forces to help achieve their goals. To effectively deal with these types of individuals, civil sanctions must be strong enough and targeted enough to discourage potential bad actors from doing things that harm others. Too many existing civil sanctions are imposed directly or indirectly (through company paid premiums on officers and directors insurance) on the company and ultimately the shareholders. In this case, shareholders can pay twice for the sins of others.

While more meaningful and targeted civil penalties can help to discourage many bad actors, in my view, civil sanctions aren't enough in some cases. You need to be able to issue a few so-called "wide-striped suits" to players who violate criminal statutes. Nothing will focus someone's mind like looking at the world from the inside of a prison cell. In addition, we need to be sure that white collar criminals are not merely detained in so-called "country club" federal prison facilities for relatively short prison terms. The price for criminal behavior must be high for these individuals as well.

#### **PENSION AND SAVINGS PLANS:**

The recent business failures have also served to harm a number of innocent parties, including pension and savings plan participants. A number of defined benefit pension plans lost significant sums as a result of the decline in the value of their holdings in Enron, WorldCom, etc. When defined benefit pension plans lose money the plan sponsor, typically the employer, will ultimately bear the cost of the loss. However, when defined contribution plans, like 401(k) plans, incur such losses, the individual plan participants are directly affected and bear the losses themselves.

Participants in 401(k) plans can be particularly harmed in situations where their accounts are heavily invested in employer stock, either because their employer matches

their employee contributions in the form of such stock or because they themselves make significant investments in their employer's stock using their own voluntary contributions. In these cases, participants risk losing not only their jobs but also a significant portion of their retirement savings if their company files for bankruptcy. This was the case in connection with Enron and certain other business failures. In addition, in the Enron case, plan participants were not allowed to sell company stock in their 401(k) account when the stock price was declining rapidly due to a pending change in plan administrators. At the same time, top Enron executives were free to exercise their stock options, and some did. This inappropriate and un-level playing field was addressed in part of the Sarbanes-Oxley legislation. Some suits are likely in order to attempt to right alleged fiduciary breaches. Additional legislation has also been proposed that would, among other things, give employees the ability to diversify their employer matching contributions out of company stock more rapidly than they can under current law.

### **PAST AND FUTURE ACTIONS:**

A variety of parties have already taken some steps in light of these recent business accountability failures. The New York Stock Exchange is moving to adopt certain changes in its listing requirements relating to governance matters; boards and audit committees are taking their related responsibilities much more seriously; the Financial Accounting Standards Board (FASB) is exploring a principles-based approach to accounting standards and is reconsidering the current accounting and reporting treatment for SPEs and stock options; the AICPA has issued a new fraud detection audit standard and is beginning to assess the need for other enhanced attest and assurance standards but it clearly needs to pick up the pace; the U.S. Congress has passed the Sarbanes-Oxley legislation which included establishment of the Public Company Accounting Oversight Board (PCAOB), tougher independence standards for auditors of public companies, and independent funding sources for the PCAOB and the FASB; the SEC has taken a number of regulatory and enforcement actions and made initial appointments to the PCAOB; various U.S. Attorneys have filed charges against several key players associated with some of the recent integrity and accountability failures; the New York State Attorney General and the SEC are taking steps to address certain conflicts within the investment banking community, and the GAO has taken a number of steps as discussed below.

These actions are clearly steps in the right direction. However, as noted above, additional actions are necessary in order to address several remaining systemic issues. Hopefully, the appropriate parties will take steps to address these issues. If they don't, the government may chose to act again in order to fill any related voids.

### **GAO'S ROLE:**

The GAO is a professional services organization within the legislative branch of the federal government. Our job is to help the Congress discharge its constitutional responsibilities and improve the performance and assure the accountability of the federal government for the benefit of the American people. To do so, we perform a variety of oversight, insight, foresight and adjudicatory functions spanning everything the

federal government does or is thinking about doing anywhere in the world. Simply stated, at GAO we speak truth to power. Power comes in many forms, including the U.S. Congress, various government officials, the press and ultimately the greatest source of power in our democracy – the American people. Today, I'm speaking what I believe to be the truth about how to restore confidence in American business and our profession to each of you. I will continue to speak out on these issues in the coming months.

Among other things, GAO serves as the independent auditor of the largest, most diverse and most important entity on the face of the earth – the U.S. Government. We conduct financial statement, performance and compliance audits of federal entities, and promulgate generally accepted auditing standards for audits of federal entities, and entities that receive federal funds. We also help to promulgate generally accepted accounting principles for federal government entities.

As the leading performance and accountability organization in the United States and arguably the world, we believe that we have an obligation to lead by example and practice what we preach. We take these obligations very seriously with all of our responsibilities, including those relating to the Congress' concerns regarding the recent accountability failures in the private sector. We held a Corporate Governance and Accountability Forum in February 2002 involving prominent leaders from the public, private and not-for-profit sectors to discuss the recent accountability failures in the private sector and what actions may be necessary to help prevent such failures in the future. This forum served to help inform the GAO's work and other efforts to support the Congress, including our efforts that helped lead to the eventual passage of the Sarbanes-Oxley legislation. We are holding a follow-up forum on December 9, 2002 to discuss what actions have been taken by a variety of parties and those that remain in order to help restore public trust and confidence.

In addition to these actions, GAO has voluntarily decided to express an opinion on internal controls and key compliance issues in connection with our audit of the consolidated financial statements of the U.S. Government and various other federal entities. We are also advocating enhanced reporting in connection with key federal performance and projection information. As previously noted, we published new independence standards dealing with non-audit/consulting services when the AICPA failed to act. We are working with others within the federal government, including the Secretary of the Treasury and the Director of the Office of Management and Budget, to modernize federal financial management and promote expanded performance and accountability reporting. Furthermore, at GAO, we are using the "bully pulpit" and speaking out to encourage others to do their part to help restore public trust and confidence and we will continue to do so.

#### **CLOSING:**

In the final analysis, for any system to work you need to assure that the key people have integrity, that the information provided to key stakeholders is timely and reliable, and that the persons or entities that are providing assurance as to the reliability of any financial and non-financial information are qualified and independent both in fact and

appearance. The importance of integrity can not be overstated, if the key players don't have integrity, not much else matters. In addition, systems should incorporate incentives for people to do the right thing, adequate transparency mechanisms to provide reasonable assurance that people will do the right thing, and appropriate accountability mechanisms if people don't do the right thing. These basic principles are timeless and can be applied to a broad range of professional, business, government and personal issues, including how to restore trust and confidence not only in the performance and accountability profession but also in the broader business community and our nation's capital markets.

I hope that all key parties will take the necessary steps to address any real and perceived problems that serve to undercut public trust and confidence. As recent events illustrate, trust takes years to gain but can be lost in an instant. The performance and accountability profession, and in my opinion, our corporate governance system are at a critical crossroads. As CPAs we must chose the right path. If we do, we will not only regain any lost public trust and confidence in our profession but we can position ourselves to help add value and manage risk in a whole new range of areas that are both needed and which we are well positioned to address a whole new range of performance, projection and compliance issues.

During these challenging times, CPAs must look to what we share in common and how we can help to create the future of our profession. I would suggest that all CPAs regardless of what position they hold or what sector they work in share certain roles, responsibilities and values. With regard to roles, all CPAs are in the business of maximizing the performance and assuring the accountability of their enterprises and areas of responsibility. With regard to responsibility, all CPAs should be mindful of the broader public interest in connection with all their activities. With regard to values, all CPAs share certain basic values such as integrity, objectivity, competence and professionalism.

In my view, we all need to return to a set of core values and timeless principles that can help us to do the right thing, at the right time, all the time. These core values serve as both beliefs and boundaries; beliefs in the form of positive concepts one can be committed to, and boundaries in the form of limits that should not be violated. At GAO our core values are accountability, integrity and reliability. Accountability describes what we do, integrity describes how we do our work, and reliability describes how we want our work to be received. Every world-class organization should have a set of core values, and so should our profession. I touched on these earlier.

In addition to core values, we all need to keep certain timeless principles in mind at all times. First, don't believe what Gordon Gecko said in the film, *Wall Street*. Greed is not good – greed is bad!! Second, remember that the law and other standards set the floor of acceptable behavior and not the ceiling. Don't lie on the floor - reach for the ceiling! Don't just do what is acceptable, do what you think is right! Third, CPAs and other professionals are paid for their judgment. Turn on your brain rather than checking boxes in connection with key accounting, reporting and auditing issues. Fourth, say what you mean, mean what you say, practice what you preach and lead by example in everything

that you do. Finally, remember that your reputation is priceless. It takes many years to build a reputation which can be lost very quickly if you breach the trust that others hold in you. In addition, if you act improperly or fail to properly discharge your duties, you can harm a number of innocent parties. As a result, if it doesn't seem right, don't do it!!

In closing, we all have a stake in the future of our profession and the reputation of CPAs. I can assure you that GAO and I will do our part to practice what we preach and lead by example in our roles, responsibilities and values. I hope that I can count on each of you and others to do the same. After all, the time to act is now! Let's do it!!