CPAs (And I'm One) Can Reverse Their Losses

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Last year, a public opinion survey put certified public accountants solidly in the middle of a short list of most-trusted professionals. Thanks to Enron Corp. and Arthur Andersen LLP, we CPAs might be lucky to outrank journalists, lawyers or used-car salesmen in the next survey.

We in the accounting business are fooling ourselves if we think that there aren't more Enrons in the pipeline. Until we fix the problems of auditor dependence on and coziness with clients, Enrons will continue to happen. Our reputations will suffer and, above all, investors' confidence will be shaken.

We can restore trust in the CPA profession, and there are two ways to do that with minimal government intervention, red tape and regulation. One is to make accounting firms work directly for the people with the most to lose -- investors. Let's set up a system by which the stock exchanges would use a competitive process to select CPA firms to audit the financial statements of companies whose stock is traded on their exchanges. That would take auditors off the payroll of the firms they're supposed to be monitoring.

Another measure would be to beef up the strength of the accounting industry's ethics review panel. I have just started my second stint as a member of the ethics committee of the American Institute of Certified Public Accountants (AICPA) and I have seen ethical lapses that resulted in millions of dollars of losses get punished with as little as 16 hours of continuing education. Meanwhile, only state accountancy review boards -- with varying levels of ability, different standards and their own potential problems of cronyism -- possess the power to strip an accountant of his or her license.

Unfortunately, the plan announced Jan. 17 by Securities and Exchange Commission Chairman Harvey Pitt and my own organization, the AICPA, is a collection of cosmetic half-measures. Setting up an autonomous body to oversee ethics enforcement, discipline and SEC practice-monitoring processes is not a bad idea, but it does not address the root causes of the Enron debacle.

Nor is it enough, as many people have suggested, to prohibit accounting firms from collecting lucrative consulting fees from the companies they are auditing. That's only half the solution. Andersen got $27 million in Enron consulting fees in a single year and $25 million for the Enron audit. Take away the consulting fees, and the audit fees are still enough to undermine independence and cloud auditor judgment.

Better to simply end the links between companies and their auditors than to establish new mechanisms to monitor a relationship that naturally lends itself to abuse. Even though in theory the auditors are employed by independent directors representing the interests of shareholders, in reality the chummy relationship between management and directors often glazes over any distinction between them. And the interests of potential investors and lenders have been neglected. If auditors went to work for the stock exchanges, the exchanges could pay them by either billing the publicly traded companies or pooling money derived from a new, small (it would be very small) surcharge to trading transactions. Or both.

Relieved of the fear that they might be dismissed by corporations for being "too tough," auditors could focus on telling investors what they need to know -- and alerting accounting and auditing standard-setters about emerging techniques of dubious propriety. Andersen knew long before Enron's demise that the company's use of special-purpose entities to keep debts and losses off its balance sheets was an "aggressive" accounting treatment. (Translation: questionable or misleading.) It would have been seen as a "disservice" to Enron management, to say

the least, for Andersen to have informed the Financial Accounting Standards Board or the Auditing Standards Board -- which set accounting industry guidelines -- that a new standard was needed in that area.

The new audit process would be more contentious, at least in the short term. But eventually firms would compete on the basis of being "tough but fair." The exchanges would also be able to compete for investors by touting their ability to provide honest audits. The CPA industry would change, too. The 11 largest CPA firms audit the vast majority of publicly traded companies now. The change I propose would probably result in several dozen or perhaps hundreds of firms competing for these audits. In some cases, audits could become less lucrative. In others, where they would no longer be used as loss-leaders to win consulting contracts, audits could become more expensive. But they might actually be worth something.

CPA ethics enforcement also needs an overhaul. The current process was never designed to be the punitive process that the public thinks it is, or that it should be. It was designed to be remedial. It recognizes that accounting is complex and that honest people make mistakes.

In addition, AICPA is a voluntary-membership organization, not a licensing board. The ethics committee lacks subpoena power, and, therefore, effective investigative power. The worst the committee can do is expel someone from the organization. This happens five to 10 times a year, usually in cases when a CPA refuses to cooperate with the committee. But that doesn't affect an accountant's license or prevent him or her from continuing to practice. More typically, when the AICPA ethics committee finds that a CPA has violated professional standards, it orders continuing professional education classes. A CPA found to have violated an accounting standard in connection with a multibillion-dollar corporate collapse, causing massive damage to investors and the public, might receive this sort of minimal sanction. Since all AICPA members are required to get 40 hours of continuing education classes per year anyway, this is not much of an imposition. Moreover, unless a CPA is expelled or suspended from AICPA, punishment or censure by the ethics committee remains a secret.

The deferral procedure is another flaw. A CPA under investigation about ethics can ask the AICPA to defer its investigation until other investigations and legal proceedings are resolved. The ethics committee members, volunteers who are eager to avoid subpoenas, always agree. As a result, accountants who have committed the most egregious ethical lapses -- the ones resulting in SEC investigations, bankruptcy and litigation -- can often continue to practice for 10 years or more after the alleged violation until all the cases are resolved.

The ethics committee should be given the power to revoke a CPA's license to practice. Currently, licenses are issued on a state-by-state basis. While the state accountancy boards can levy fines and take licenses, in many cases investigations are not very rigorous. Accountancy regulation usually falls under a state's department of commerce; a typical investigator may examine a CPA one week and a dog-grooming parlor the next. Understanding accounting principles and auditing standards is not usually a requirement to be a state licensing investigator. Congress should establish national rather than state-by-state licensing. Accounting and auditing standards don't change from state to state. Licensing requirements shouldn't either.

These measures should still be accompanied by moves to prohibit accounting firms from performing consulting services for audit clients. This should, and would, have been done long ago, except that the bigger accounting firms control the AICPA, which writes the Code of Professional Conduct, the profession's ethics rules. Many of the people involved in that ethics rule-writing process honestly thought we could maintain our independence and objectivity while performing such lucrative services. Human nature is what it is, however. Records reportedly show that when Andersen managers mulled whether to drop Enron as a client because of accounting risks, they discussed the hope that fees from Enron could grow to $100 million a year. Fee growth should be irrelevant in deciding whether a client is too risky. At the very least, Andersen's hopes about Enron fees created the appearance that its audit judgment was affected.

My colleagues will condemn me for this recommendation, but it is essential if we want to restore public confidence in the audit process. Andersen's defense that $100 million is only a drop in the bucket compared with its multibillion-dollar global revenue is a red herring. The Enron engagement team members in Andersen's Houston office cared not a whit for Andersen's worldwide revenue. They cared about not losing their bread-and-butter client -- the source of their individual livelihoods. This is an untenable position in which to put anyone.

Finally, the AICPA must be restored to its proper role as a professional association. A news story in last week's Washington Post referred to the AICPA as a "lobbying and trade group." Once, the AICPA was devoted to protecting our profession's reputation and future. Instead, for at least the past three years, the AICPA's leadership has squandered resources and energy on an ill-fated "global-credential" concept and a quest for profit-making spinoffs such as a dot-com Web portal. We need to return our attention to the AICPA's core purpose, and work with Congress and others to restore auditor independence. "Let's ask a CPA" should be the first thought that comes to mind when someone wants objective, accurate answers to business questions. It once was. It can be again.

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