

Building Public Trust in our Profession

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**Jeffrey C. Steinhoff
Managing Director
Financial Management and Assurance
Government Accountability Office**



Presentation Framework

The Environment

Lessons Learned

Where Do We Go From Here?

Building the Public Trust

The background of the slide is a blue-tinted American flag, with the stars and stripes visible. The text "The Environment" is centered in the middle of the flag.

The Environment

The Era of Financial Reporting Breakdowns

- Enron
- WorldCom
- Tyco
- Global Crossing
- Quest
- Adelphia
- CreditSuisse First Boston
- 10 Largest Wall Street Firms
- CitiGroup
- Lucent Technologies
- HCA
- Micro Strategy
- ImClone
- Royal Ahold, NV
- Waste Management
- Xerox
- Health South
- Superior Federal Savings Bank
- Parmalat
- Countless Restatements

And the Beat Goes On. . .

Now GM Has Woes on Audits: Faulty Numbers Go Back to 2000

“You have to question what controls are in place. When companies like GM are profitable, there is not a need to engage in aggressive accounting. What we are seeing now is a pattern of very aggressive accounting that took them well beyond the limits of generally accepted accounting practices.”

Charles W. Mulford
Professor of Accounting
Georgia Tech

New York Times, March 18, 2006

And on...

“Unfortunately, concerns about truth and transparency aren’t limited to the private sector. Washington got an unpleasant wakeup call when two government-sponsored enterprises, Fannie Mae and Freddie Mac, announced significant earnings restatements for recent years. We at GAO are doing all we can to prevent similar accountability failures in the federal government.”

David M. Walker
Comptroller General of the United States

Conference on Public Service and the Law
University of Virginia Law School
Charlottesville, Virginia
March 17, 2006

Forces Leading to the Recent Accountability Breakdowns

- Ineffective governance systems
- Ineffective regulation of the accounting profession
- Inadequate accounting and auditing standards
- Inadequate attest and assurance procedures
- Management working to achieve certain reporting results
- Inappropriate and unreasonable executive compensation arrangements
- Individual and corporate greed

Forces Leading to the Recent Accountability Breakdowns

- Confusion over who the auditors work for
- Audit failures
- Auditors delivering some services to clients that impaired independence
- Auditors and financial professionals doing what was minimally required and actively fighting tighter standards
- Personal interest trumping the public interest

The background of the slide is a blue-tinted American flag, with the stars and stripes visible. The text "Lessons Learned" is centered in the middle of the flag.

Lessons Learned

Losing the Public Trust

“Even though most accountants did not participate in such schemes, public trust in the integrity of the financial reporting process and the accounting profession took a big hit.”

David M. Walker, Comptroller General of
the United States

*BNA Tax and Accounting:
Accounting Policy & Practice*
Vol. 1, No. 3, November 18, 2005

Hanging Out Our Dirty Wash

“One bright spot to all this is we live in a culture where scandals happen. In many cultures in the world, this stuff would have been covered over. We err by hanging them too high sometimes, but we have a healthy distaste for shenanigans by public institutions. That’s a healthy American sentiment, much more so than in Europe. We’re more inclined to hang out our dirty wash.”

Thomas Donaldson, Ethicist
Legal Studies Department Wharton School
University of Pennsylvania

Another Year of Corporate Scandals
January 14, 2004

Scandals Can Teach Us Important Lessons

“Bad times have scientific value. These are occasions a good learner would not miss.”

Ralph Waldo Emerson

Lessons Learned: A Loud Wake-Up Call

- Must strengthen the systems, oversight mechanisms, and the people involved in the performance and accountability profession
- Reaction to the most recent rash of scandals shows our system can work

A Loud Wake-Up Call

- Financial “sleight-of-hand” is no substitute for integrity and un-reproachable ethical behavior.
- Increased respect for the importance and value of the audit function when it is done right and a recognition of the devastating impact when audits fail
- Greater recognition that the public interest is not only paramount to accountability but also a good business strategy

The image features a blue-tinted American flag as a background. The stars and stripes are visible but rendered in shades of blue and white. The text "Where Do We Go From Here?" is centered in the middle of the flag in a bold, italicized, white font with a dark blue outline.

Where Do We Go From Here?

In Thinking about the Challenges Ahead of Us

“The dogmas of the quiet past are inadequate to the stormy present. The occasion is piled high with difficulty, and we must rise with the occasion. As our case is new, so we must think anew and act anew.”

Abraham Lincoln

The 103rd American Assembly

“Never, in its lengthy history, has the accounting profession been required to deal with the kinds of challenges that it must confront today. A seemingly unending series of sensational accounting scandals has grabbed newspaper headlines over the last three years, eroding public confidence in the accounting profession and leading to the most sweeping amendments to United States securities law since the Securities Act was passed by Congress in 1934. The Sarbanes-Oxley Act of 2002, as well as the Public Company Accounting Oversight Board (PCAOB) established as a result of the Act, now force the profession—and all of those who rely on its services—to rethink its most fundamental principles and practices.”

The Future of the Accounting Profession
103rd American Assembly, November 2003

Excerpts from the 103rd American Assembly Report: The Future of the Accounting Profession*

- **Structural Challenges Facing the Accounting Profession:**
 - Rules-based versus principles-based standards
 - A revised and expanded financial reporting model
 - New and enhanced audit and attestation standards
 - The number of major accounting/audit firms
 - A balanced approach to auditor liability and accountability
 - Valuing quality audits and audit personnel
 - Reinvigorating audit committees
 - Preparing for the future—the talent search

**The Future of the Accounting Profession*
103rd American Assembly, November 2003

Future of the Profession from the Eyes of the PCAOB

“I have not been shy about telling members of the accounting profession that we expect a lot from them, and that they will have to work harder than they could have imagined before enactment of the Sarbanes-Oxley Act. We will scrutinize accounting records, accountants’ practices, and we will adjust the rules as necessary. In the wake of Enron and Arthur Andersen, the accounting profession was weighed and found wanting, but it was given a meaningful shot at redemption. In my mind, facilitating that redemption, and not just punishing miscreants, is a key objective - one that the Board must not lose sight of even when we are, as we will need to be, tough on the profession.”

William J. McDonough, former Chairman, PCAOB
Testimony before the Senate Committee on Finance
October 2003

A Precious Franchise

“Every accountant in America has been handed the same precious franchise, granted its special privileges, and charged with its care. But, by the same token, all must bear the burden of its responsibilities if public confidence—this sacred trust—is ever lost.”

Arthur Levitt
Former Chairman, SEC

Protect Trust—Once Lost, It May Never Be Recovered

“Character is much easier kept than recovered.”

Thomas Paine
18th Century American
Political Activist

The background of the slide is a blue-tinted American flag, with the stars and stripes visible. The text is centered over the flag.

Building the Public Trust

Three Fundamental Conditions

- Incentives for people to do the right thing.
- Transparency to help assure that people do the right thing.
- Effective accountability mechanisms if people don't do the right thing.

At the core of that system, you must have
People of Integrity

Key Concepts in the Accountability Profession

- Public vs. personal interests
- Recognizing the difference between the floor (e.g., rules, regulations, laws, accounting standards) and the ceiling (e.g., principles, values)
- Doing what is right vs. what is acceptable
- Economic substance vs. legal form
- Being concerned with both fact and appearance (e.g., independence)
- Using judgment vs. completing checklists
- Recognizing that continuing improvement in today's rapidly changing world is essential
- Remember that trust is hard to earn, but easy to lose

Attention to Ethics

“Professionalism is fundamentally an ethical orientation, implying integrity and adherence to high ideals. Thus, any reform that attempts to articulate, once again, the highest ideals of professionalism for an accountant, must necessarily pay careful attention to ethics. There can be no true professionalism without attention to ethics.”

Understanding Accounting Ethics

Mark L. Cheffers and Michael Pakaluk, 2005

What Is Ethics?

“Ethics is the careful study of standards of behavior that apply to real-world problems and decisions. It gives us insights into what we should do.”

Kirk O. Hanson, Executive Director
Markkula Center for Applied Ethics
Santa Clara University

Integrity of Government Is Indispensable

“Public confidence in the integrity
of the Government is indispensable to faith in
democracy; and when we lose faith in the system,
we have lost faith in everything we fight and
spend for.”

Adlai E. Stevenson Jr. (1900-1965)

Institutions Must Have Clear Ethical Values

“Truly successful institutions have clear ethical values. Great companies have always walked on a high ethical, moral plane.”

John D. Macomber
Former Chairman and
President of the Export-Import
Bank of the United States

Ethics and Morality

“In a restless sea of moral and financial expectations, managers cannot navigate with financial perspectives alone. To meet the new financial, legal, and ethical accountabilities, companies will need to integrate the moral point of view into their decision making.”

Lynn Sharp Paine
John G. McLean Professor
Harvard Business School

*Value Shift: Why Companies Must Merge
Social and Financial Imperatives to Achieve
Superior Performance*

We Are All Personally Responsible

“A nation, as a society, forms a moral person, and every member of it is personally responsible for his society.”

Thomas Jefferson

Ethics Is at the Heart of Trust

- Without trust, institutions and leaders cannot succeed.
- With trust, institutions and leaders can achieve great things.

Leading by Example

- The government accountability profession is well positioned to be leading by example.
- Honest, reliable, and transparent fraud reporting combined with competent, independent auditing are critical to the functioning of capital markets.

GAO: Core Values Set a Framework

- 1. Accountability:** We help the Congress oversee federal programs and operations to ensure accountability to the American people.
- 2. Integrity:** We set high standards for ourselves in the conduct of our work. We take a professional, objective, fact-based, nonpartisan, nonideological, fair, and balanced approach to all activities. Integrity is the foundation of reputation, and our approach to work ensures both.
- 3. Reliability:** We want our work to be viewed by the Congress and the American public as reliable. We produce products that are timely, accurate, useful, clear, and candid.

What Does It Mean to Be Ethical?

A Few Personal Thoughts

- Be aware of appearances—the law, regulations, and standard are merely the floor
- Rules should be in the service of principles—not the other way around
- Don't look for gray areas or loopholes to hide behind—remember, substance over form is what's important
- If you say you'll do something, do it—even if it doesn't appear to benefit you
- Do the right thing—not the easiest or most expedient
- Always put yourself in the other person's shoes—are you being fair to them?
- Don't ask others to do something you wouldn't do yourself

What Does It Mean to Be Ethical? A Few Personal Thoughts

- Don't rationalize by saying:
 - It doesn't hurt anyone
 - Everyone else does it
 - I deserve to get this (perk, favor, etc.) because I worked so hard, am underpaid, etc.
- Tell the truth all the time—if you've done something wrong, admit it, everyone makes mistakes
- **Always ensure the public interest, not your personal self-interest, is #1**

A Final Thought: Accountability Means Doing the Right Thing

“Always do right. This will gratify some people and astonish the rest.”

Mark Twain