CPAs look for changes to rules

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CPA Dick Jacobson knows the public is looking critically at what he and his colleagues did during the last decade.

CPAs, he admits, used audits to gain lucrative consulting work. Now, with his profession under attack in the wake of the Enron debacle, Jacobson knows something has to change so investors can regain confidence in the annual reports they read.

"Accounting firms must set a tone that once again puts the firms' professional responsibilities ahead of all other business considerations," said Jacobson, managing partner of Grant Thornton in South Florida.

Change is certainly on its way. From Congress to the Securities and Exchange Commission to President George Bush, critics are making proposals that include sweeping legislation to overhaul audit practices. Even the profession itself is weighing in.

Last week, President Bush proposed a new regulatory review board to develop stricter standards for accountants' conduct.

Also last week, the Securities and Exchange Commission began by convening roundtables in New York City and Washington, D.C., to examine proposals for better protecting investors by reforming financial disclosure and auditor oversight. Meanwhile, lawmakers in both houses have introduced more than 30 accounting-related bills.

And Florida's Board of Accountancy, which licenses and disciplines accountants, has a task force looking into new rules regarding auditor independence. Changes would apply to individuals or firms who audit private companies as well as public companies.

"There's absolutely going to be change in how we do business with public companies and private companies," said Byron Shinn, a practicing CPA and chairman of Florida's Board of Accountancy. "We need to show the public the industry's high level of integrity still exists."
Scores of new regulations proposed for CPA conduct

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the numbers. Critics believe Andersen may have been unwilling to point out problems because they had other lucrative contracts with the Houston company.

But Enron is far from the only company beset by questionable audits. In recent years, major accounting firms have failed to uncover financial problems at companies as varied as Rite Aid Corp., Xerox, Waste Management and Sunbeam Corp. Just last month, concerns about corporate accounting practices triggered a wave of selling on Wall Street that sent the Dow Jones Industrial Average sliding.

How did the problems surrounding the accounting profession get to this point?

The conflict always has been there. Simply put: Auditors have to judge the financial integrity of companies that pay them.

The already-inherent conflict became worse in the 1980s as increasingly complex businesses turned to auditors to give them advice on mergers, valuing assets, implementing new accounting systems or tax planning. By the 1990s, the audit became a tool for a firm to get in the door, then sell expensive consulting services. In South Florida, a recent report by The Herald showed that auditing firms earned more providing non-audit services to South Florida's largest public companies than from inspecting those companies' books. In fact, non-audit fees exceeded costs for financial inspections at eight of the 10 largest South Florida public companies, based on revenues, in 2000. The pressure on audit fees had its effect, some contend.

"Because audits were sold at a lost, firms tried to hold down costs and sent low-level staff to do the work," said Dr. Dana Forgione, director of Florida International University's school of accounting.

Christian Bartholomew, a lawyer with Morgan Lewis in Miami who specializes in securities enforcement defense, believes a lot of the problems in financial reporting were driven by the incredible pressures from the economic boom in the 1990s.

"Companies were crushed for not making numbers and rewarded for making them," he notes. "The real question is, 'Is the system fundamentally broken? Is it too susceptible to manipulation?' I don't think we know the answer to that. A lot of longtime accountants believe Enron has nothing to do with accounting and everything to do with human nature."

Meanwhile, auditors have become the deep pockets for shareholders who suffer a loss when their stock tanks. For big firms, shareholder lawsuits arising from audit failures have become part of the cost of doing business, explains Alex Fernandez, a former Big Five partner who now serves as an expert witness in lawsuits involving accounting firms.

"There's a public misperception of what auditors do. There always has been," Fernandez said. "You could have a flawless audit and not uncover fraud."

For example, if management misrepresents or withholds information about a transaction, an auditor could come to the wrong conclusion.

Part of the problem, Fernandez said, is that businesses want to control costs so they negotiate bottom-line fees with their auditors, who in turn staff the job as leanly as possible and fail to do the in-depth analysis the public now demands.

"The public needs to have a better understanding of the limitation on audits. There are some major gaps and no easy answers," Fernandez said.

While most of the changes on a national level would affect firms that audit public companies, those made by state boards would apply to small firms that audit private companies as well.

Fernandez of Grant Thornton said he's afraid that if lawmakers try to ban auditors from offering consulting services to corporate audit clients, they'll try to prohibit them from doing tax work as well.

"It's the appearance of conflict and the huge fees involved in consulting services that are the problem," Jacobson said. "Tax work is the bread and butter of CPA firms for many years. It's an extension of the audit practice."

Some proposals will go through because of the political climate," said Art Bowman, who publishes a newsletter on the accounting profession. "They think they are going to far in forcing audit firms to do no consulting for audit clients because there are benefits there."

Thomas Beier, chief financial officer of Ixax in Miami, knows about those benefits firsthand. He said he's closely watching the proposals and waiting to see whether he needs to make additional changes at his public company. He's already given the internal audit work and some outside consulting work to a firm other than Andersen, its outside auditor.

However, he said, there is some consulting work it just makes sense for Andersen to do, such as due diligence work on acquisitions. "They understand our accounting framework and the way we operate," he said. Still, Beier says, the credibility factor is a big concern for public companies and the investment community: "We know something needs to be done, but I think it needs to be well thought out."