

July 2004



IT'S OUR BUSINESS

How Colorado Can Reclaim
Investment From Corporate Accounting Fraud

CoPIRG

**It's Our Business: How Colorado
Can Reclaim Investment from
Corporate Accounting Fraud**

**Nicole A. Boojamra
CoPIRG**

ACKNOWLEDGEMENTS

Thanks to David Milstead of the Rocky Mountain News for many helpful columns and articles. Thanks to Cecily Anderson for the cover design.

© 2004 CoPIRG

CoPIRG is a non-profit, non-partisan organization working on consumer and democracy issues in Colorado.

For additional copies of this report, please send \$20 (including shipping) to:

CoPIRG
1530 Blake Street, Suite 220
Denver, CO 80202

For more information about CoPIRG, please visit the CoPIRG web site at www.copirg.org.

Table of Contents

EXECUTIVE SUMMARY.....	5
BACKGROUND ON RESTATEMENTS.....	7
CONFLICTS OF INTEREST AT ACCOUNTING FIRMS.....	9
Auditors as Watchdogs.....	9
Causes of Compromised Auditor Independence.....	9
Accounting Firms Providing Both Auditing and Consulting Services.....	9
The SEC Response to the Audit-Consult Conflict: The Four Principles.....	10
The “Revolving Door” between Accounting Firms and Their Corporate Clients.....	11
Inadequate Rotation.....	11
SHARED FEDERAL-STATE RESPONSIBILITY IN REGULATION OF AUDITORS, ACCOUNTANTS AND CORPORATIONS.....	11
SEC Passes the Buck.....	11
Sarbanes-Oxley Corporate Reform Act: A Good First Step.....	12
STATE SOLUTIONS TO THE CORPORATE ACCOUNTING CRISIS.....	13
Require a Majority of Independent Members on the Board of Accountancy.....	13
Strengthen the Accountancy Board’s Oversight Power.....	13
Increase Continuing Professional Education Ethics Hours and Implement Periodic Testing.....	13
Institute a Peer Review/Quality Review Policy.....	13
Implement a Self-Reporting Requirement for Accountants If Sued.....	13
Require Auditors to Properly Document Their Work.....	13
Institute Tougher Sanctions for Violations of Accounting Standards.....	14
Grant the Accountancy Board Full Access to All Accounting Documents.....	14
Increase Resources to Bodies Charged with Investigations.....	14
FEDERAL SOLUTIONS TO THE CORPORATE ACCOUNTING CRISIS....	14
Ban Audit Accountants from Selling Consulting Services.....	14
Close the “Revolving Door” between Auditing-Accounting Firms and their Clients.....	15
Protect Public Investments, 401(k)s and Pensions.....	15
Retain Accounting Records for Seven Years.....	15
Impose Tougher Penalties for Certification of Fraudulent Records.....	15
POLICY RECOMMENDATIONS.....	16

Executive Summary

Qwest. The name of the local phone company for 14 states in the West, is plastered all across Denver's skyline. Locally, Qwest is certainly the most well known, example of questionable corporate practices, having restating its earnings for the years 1999, 2000, and 2001.¹ The restatements resulted in a nearly \$1 billion reduction in profit for the years 2000 and 2001 alone and caused the value of Qwest stock to plummet.²

Colorado, like all states, is plagued accounting problems that lead to inaccurate corporate audits, an upsurge in "earnings restatements," and a loss of investor confidence.

Most observers are aware of the massive restatements by Enron, Tyco and WorldCom and others that rocked the markets in 2001 and 2002. Locally, Qwest, Vail Resorts, Level 3 Communication, Newmont Mining, Quovadx and many other Colorado-headquartered companies have also restated their earnings.³ When inaccurate audits are identified, companies are required to produce a restatement of their previously audited financial statements. In the mid-70s through the early 80s, there were only a handful of restatements issued annually.⁴ By 1997, restatements began to spike. From January 1997 through June 2002, restatements due to irregularities in accounting grew dramatically, resulting in a 145% increase.⁵ In 2000, market value losses due to restatements totaled \$31 billion.

These restatements resulted in the immediate loss of billions of dollars in the market capitalization of these corporations, which in turn resulted in the loss of billions of dollars for the individuals who bought shares in these businesses based upon faulty information. Consequently, these restatements call into question the credibility of accounting practices, the quality and oversight of corporate financial disclosure, and erode the confidence of the over 85 million Americans who invest in the stock market.

Despite changes on both the state and federal levels, existing regulation of the securities and accounting industries are still weak.

More effective controls are still needed on both the publicly traded companies and their auditor-accountants to limit the need for restatements. The restatements of the past few years appear to have three main causes: first, accounting firms providing both consulting and auditing services; second, the employment "revolving door" between accounting firms and their corporate clients; and third, inadequate rotation of accounting firms off of clients to whom they provide consulting services.

On the federal level, changes must be made to the Securities and Exchange Commission (SEC) and the Sarbanes-Oxley Corporate Reform Act must be strengthened to implement the following changes:

- Increase funding to the SEC, so that it is consistently funded in a manner that allows it effectively and efficiently hire the staff needed to conduct more frequent and in-depth investigations into allegations of accounting fraud.
- Prohibit consulting accountants from auditing their own work.

- Prevent accountants who provide audit or consulting services from going to work for their corporate clients after leaving an accounting firm.
- Require the *entire* accounting firm handling a specific client's audit to rotate off that client's account.
- Impose criminal penalties on CEOs and CFOs whose actions in certifying corporate financial records are "negligent" or "reckless".

On the state level, changes must be made to the composition, functioning and rule-making powers of the Colorado State Board of Accountancy.

- Alter the composition of the Colorado State Board of Accountancy so that it is composed of a majority of non-accountants.
- Increase resources available to the Board of Accountancy by increasing the accountant licensing and renewal fees.
- Ensure the Colorado Board of Accountancy's subpoena power for relevant documents, including documents not only from the accounting firm under investigation, but also from the corporation whose accounting firm is being investigated.
- Increase the number of ethics hours required for accountants for continuing professional education and institute periodic testing.
- Require accountants to properly document their work and keep their records for a set period of time.
- Require accountants who are sued to self-report lawsuits to the State Board of Accountancy.

Without these changes, investors remain vulnerable and so will the college savings and retirement funds of the millions of Americans who invest in the stock market.

Background on Restatements

Restatements occur when companies need to adjust expenses or revenue, and when they need to address securities-related concerns. When inaccurate audits are identified, companies are required to produce a restatement of their previously audited financial statements. Restatements may be initiated by the company itself, an independent outside auditor, or the Securities and Exchange Commission (SEC), the federal agency charged with oversight of the securities industry on the federal level.

In the mid-70s through the early 80s, there were only a handful of restatements issued annually.⁶ Nationwide, from 1990 through 1997, market value losses due to restatements averaged less than \$1.2 billion per year,⁷ with the combined total of all market value losses from restatements during that 8-year period totaling \$9.3 billion.⁸ Starting in 1997, restatements began to spike. From January 1997 through June 2002, restatements due to irregularities in accounting grew dramatically, resulting in a 145% increase.⁹ Then in 1998 the market value of losses due to restatements were over \$17 billion – for just one year – then over \$24 billion in losses for 1999 followed by over \$31 billion in losses for 2000.¹⁰

During the same time period the number of investors in the stock market grew to nearly 85 million people or approximately half of the adults in the United States. With so many people invested in the stock market either directly or through mutual funds, retirement accounts and pension plans, any issue that affects investor confidence or the flow of accurate information in the marketplace jeopardizes consumers, investors, and businesses alike.

Most observers are aware of the massive restatements by Enron, Tyco and WorldCom and others that rocked the markets in 2001 and 2002. Locally, Qwest, Vail Resorts, Level 3 Communication, Newmont Mining, Quovadx and many other Colorado-headquartered companies have also restated their earnings.¹¹ Restatements for Qwest were nearly \$1 billion—and that figure is just for two of the three years for which Qwest issued earning restatements.¹²

Qwest restated its earnings for the years 1999, 2000, and 2001, after being investigated for its accounting practices.¹³ The restatements resulted in a nearly \$1 billion reduction in profit for the years 2000 and 2001 alone.¹⁴

Qwest has been investigated by the Justice Department—by both the FBI and the US Attorney in Colorado—as well as the Securities and Exchange Commission and the House Energy and Commerce Committee.¹⁵ Yet it appears that little has changed with regard to Qwest's corporate practices. Most recently, Qwest agreed to pay fines to settle claims regarding anti-competitive activity in regard to long-distance phone service in several states, in violation of the 1996 Telecommunications Act.¹⁶ According to the settlement agreement, Qwest offered some competitors special deals so they wouldn't oppose Qwest's attempt to enter certain long distance markets. Qwest did not make these deals available to all carriers in the market. Fines for Qwest's anti-competitive activity

varied from state to state. Qwest paid \$20.7 million to settle the case against it in Arizona, and was fined \$26 million for its practices in Minnesota.¹⁷ In Colorado, the state where Qwest is headquartered, Qwest has reached a settlement to only pay \$7.5 million, under an agreement with the Colorado Office of Consumer Counsel¹⁸.

These restatements resulted in the immediate loss of billions of dollars of market capitalization and investor dollars. These restatements call into question the credibility of accounting practices, the quality and oversight of corporate financial disclosure, and result in a ripple effect of eroding investor confidence in the stock market. More effective controls are still needed on both the publicly traded companies and their auditor-accountants.

CONFLICTS OF INTEREST AT ACCOUNTING FIRMS

Auditors as Watchdogs

The Supreme Court, in *United States v. Arthur Young*, a case concerning Arthur Young (now merged into the Big 4 firm Ernst & Young) said that an auditor's "public watchdog function demands that the accountant maintain total independence from the client at all times."¹⁹ This means that auditors work on behalf of investors and the public interest. Yet, as the Enron, WorldCom and Qwest cases show, the lack of auditor independence can, and has, lead to catastrophic consequences for investors and the markets. Public trust in auditor independence, and thus public trust in the markets requires that auditors be completely independent from the companies they are auditing.

Causes of Compromised Auditor Independence

Lack of auditor independence at accounting firms can ultimately adversely affect market value and the confidence of the investing public in the markets. If a firm providing both auditing and consulting services to a large corporate client inaccurately audits the company's reported earnings, the company will eventually have to restate its earnings. As more and more companies restate earnings, not only does market value decline, but investor confidence in those markets declines as well.

Accounting Firms Providing Both Auditing and Consulting Services

A conflict of interest normally occurs when the same accounting firm provides both consulting and auditing services to a corporation. When the auditor examines work performed by consultants from the same accounting firm, it has a vested interest in the outcome of the audit.

A study by three business school professors at MIT, Stanford and Michigan State concluded that the more consulting services a company bought from one of the then Big 5 auditors, the more likely its earnings were to meet or beat Wall Street expectations, using practices such as "big bath" charges (one time write offs), "cookie jar" reserves (setting aside funds to manipulate future earnings) and premature revenue recognition.²⁰ These practices, while legal, stretch the bounds of Generally Accepted Accounting Principles.²¹ The study also found that 95% of companies paid their auditors for some consulting services.²² The study found that there was more creative accounting among companies that paid their accounting firms big consulting bills relative to auditing fees.

Without a doubt, the bottom line for Big 4 (formerly Big 5) auditors is their consulting business. For instance, Puget Energy paid PricewaterhouseCooper \$17 million for non-audit fees and just \$534,000 for its audit, and Marriott International Inc. paid \$30 million to Arthur Andersen for non-audit services, compared with only \$1 million for its audit.²³

Along the same lines, Enron paid Arthur Andersen \$25 million for audit services and \$27 million for consulting services, including development of a computerized financial system for conducting Enron's internal audit. Andersen, then, as outside auditor, audited its own work. In 1997, Andersen questioned the validity of Enron's financial statements, yet failed to insist on a restatement of its books that would have reduced that year's reported earnings from \$105 million to \$54 million.²⁴ Though often technically accurate, these creative accounting practices do not necessarily reflect a company's true operating health.

The SEC Response to the Audit-Consult Conflict: The Four Principles

In 2000, the SEC responded to the fiscal pressures that can compromise auditing judgments with a rule proposal meant to ensure that an auditor's "public watchdog" role could be preserved. Instead of banning the practice of auditor's selling consulting services to their clients the SEC established four principles designed to function as a litmus test for determining whether a conflict of interest exists in an auditor-client-consultant relationship. The commission looks to whether the relationship "creates a mutual or conflicting interest between the accountant and the audit client; places the accountant in the position of auditing his or her own work; results in the accountant acting as management or employee of the audit client; or places the accountant in a position of being an advocate for the audit client."²⁵

These guidelines were a step in the right direction but are ultimately unworkable. The guidelines unrealistically require that the SEC be privy to all aspects of the client-auditor relationship and as a result have done little to hold the Enrons and the Andersens of the world in check. In fact, the SEC recently censured Andersen competitor KPMG once it was revealed that the company acted as an audit accountant while investing heavily in its client, a practice that is forbidden by one of the SEC's principles for determining auditor independence/conflict of interest. Instead of establishing a clearer bright line test between auditing and consulting, the Sarbanes-Oxley Act incorporated these difficult to enforce guidelines into statute.

Sarbanes-Oxley imposed new standards for auditor independence, but stopped short of imposing a complete ban on consulting services. An auditor can still provide an audit client with tax services, and any other services not specifically prohibited by the act, if the company's audit committee approves the work in advance.

Recently, the state PIRGs and other leading consumer groups urged an SEC investigation because at least one of the remaining Big Four audit firms, Ernst and Young, was exploiting loopholes in the recently adopted auditor independence rules to systematically undermine the requirement that audit committees review and pre-approve any non-audit services to be provided by the company's independent auditor.²⁶

Ernst & Young was recently barred from accepting any new audit clients for six months, following a finding by a judge at the SEC that the accounting firm improperly audited PeopleSoft Inc., a corporation with which it had a highly profitable relationship.²⁷ The judge in the case was also critical of the Ernst partner in charge of overseeing independence issues for failing to keep written records and learn enough about the facts before finding that the relationship between the firm and PeopleSoft was in fact proper. This partner was also a former chief accountant at the SEC.²⁸

As a result of waning confidence in the auditor/consultant, investors are demanding, and in many cases getting, more complete financial disclosures. Though the market may be temporarily buoyed by this flood of information, we cannot expect companies to regulate themselves and thus the new disclosures will do nothing but further muddy the water. This lack of transparency and investor confidence will continue to plague a hiccupping economy unless more drastic measures are taken.

The “Revolving Door” between Accounting Firms and Their Corporate Clients

Another conflict of interest occurs when an accountant moves between the accounting firm and a corporation for which that firm has provided consulting and auditing services. Unfortunately, this is not an uncommon situation.

Enron's financial department was chock-full of former Arthur Andersen accountants; Arthur Andersen was chock-full of former Enron employees—the two groups were so interconnected that at times it was difficult to tell which individuals were employed by which company.²⁹

Enron is not the only corporation with which Arthur Andersen had a “revolving door” policy. Andersen auditors also had a close relationship with employees at Waste Management, one of its most lucrative clients. Up until 1997, every chief financial officer and chief accounting officer during Waste Management’s history as a public company had worked previously as an auditor at Andersen. Throughout the 1990s, 14 former Andersen employees worked for Waste Management in major accounting and financial positions. In June 2001, the SEC settled an investigation of Andersen dealing with its auditing of Waste Management. Arthur Andersen agreed to settle charges without admitting wrongdoing that it had issued "materially false and misleading audit reports on Waste Management, Inc.'s financial statements for the period 1993 through 1996." Andersen paid record civil penalties of \$7 million in the settlement.³⁰

Inadequate Rotation

The Sarbanes-Oxley Act provides for some degree of auditor rotation. The status of the auditor and the size of the accounting firm determine how often an audit team and its lead partners are rotated off a particular client’s audit. Yet again, Congress stopped short of requiring mandatory rotations of an entire auditing/accounting firm off of a client’s account, which would ensure that auditors and clients do not become too close for investors’ comfort.

Shared Federal-State Responsibility in Regulation of Auditors, Accountants and Corporations

The regulation of auditors and accountants is a shared federal-state responsibility. The Securities and Exchange Commission provides federal regulation based on laws passed by Congress, and state regulatory boards license accountants and enforce accounting laws passed by state legislatures. Prior to the passage of Sarbanes-Oxley, Congress and state legislatures have taken few actions to deal with the regulation of the accounting profession, especially with regard to what are now the Big 4 accounting firms: Deloitte & Touche, KPMG, Ernst & Young, and PricewaterhouseCoopers.

SEC Passes the Buck

The SEC has been criticized for largely deferring its responsibilities to the accountants' major professional association—the American Institute of Certified Public Accountants (AICPA)³¹, an organization ill-equipped to conduct extensive and thorough investigations. The AICPA lacks investigational authority, and therefore can’t subpoena the information it may need in order to investigate alleged wrongdoers. Additionally, the

maximum sanction the AICPA can impose on an accountant found guilty of violations is expulsion from the organization—an action that does not affect the ability of the accountant in question to practice. Individual states, not the AICPA or the SEC, are responsible for licensing certified public accountants, so expulsion from the AICPA has a limited effect professionally on an individual accountant, as it does not affect their license.

When the SEC does act, its penalties for financial reporting and accounting violations are limited. It can issue cease and desist orders, assess financial sanctions, and/or bar individuals from serving as an officer or director of a public company and from appearing before the SEC.³² Additionally, the SEC only has the manpower to act in a small percentage of cases. To be more effective, staffing and funding for the SEC must be consistently increased, over the long-term, so that the SEC can ensure that it has the needed resources to effectively and efficiently hire and train the staff needed to conduct more frequent and in-depth investigations into allegations of accounting fraud.

Sarbanes-Oxley Corporate Reform Act: A Good First Step

In 2002, Congress passed the Sarbanes-Oxley Corporate Reform Act. This act strengthens corporate governance while improving accountability and transparency to strengthen the financial markets, and investor confidence in them, by ensuring the accuracy and integrity of the corporate financial reporting system³³, through the creation of the Public Company Accounting Oversight Board (PCAOB).³⁴ This Act is both a landmark and a good first step. Despite this important step, Congress must provide still more leadership to reform the accounting and financial services industries in order to prevent another Andersen/Enron-Qwest-WorldCom debacle.

The Sarbanes-Oxley Act also requires CEOs and CFOs of publicly traded companies to personally certify the accuracy of financial reports and provides for stiff criminal penalties for “knowing” violations (up to 10 years in prison) and “willful” violations (up to 20 years). These provisions will be difficult to enforce because the government will have to prove an officer’s intent—that the officer acted at least “knowingly”, as opposed to the officer just being reckless (acting with indifference to the consequences of one’s actions)³⁵ or negligent³⁶ (Negligent conduct may involve either an act that the actor, as a reasonably prudent person, should recognize as involving an unreasonable risk, or the failure to do an act necessary for the protection or assistance of another and which the actor is under a duty to perform.).³⁷ If the corporate officers at the center of recent scandals serve little or no prison time, the deterrence effect of these stiff penalties will presumably be minimal.³⁸

As was the case with the Securities Act of 1933, which was revised and expanded into the Securities and Exchange Act of 1934, the Sarbanes-Oxley Act, while a positive step in the right direction, should be reviewed and revised to ensure it is achieving the goal of ensuring accurate accounting and auditing of publicly traded firms. It should include a complete ban on auditors providing consulting services to companies they audit. Entire firms must rotate off clients’ audits for a specified period of time. Criminal penalties must be stiff, and enforced upon those who act negligently or recklessly, as millions of Americans are relying on his or her judgment and decisions for their financial future.

State Solutions to the Corporate Accounting Crisis

States are responsible for licensing accountants and are responsible for handling disciplinary action against accountants licensed in their state. CoPIRG would like to see the follow changes made at the state-level with respect to the Colorado Board of Accountancy.

Require a Majority of Independent Members on the Board of Accountancy

On the state level, the Colorado Board of Accountancy is unduly influenced by the profession that it is supposed to regulate. Seventy-one percent (71%) of members of the Colorado State Accountancy Board have accounting ties; only 29% are public members without accounting ties.³⁹ California's Board of Accountancy is required to be comprised of a majority of public, non-licensure, members.⁴⁰

Strengthen the Colorado Accountancy Board's Oversight Power of the Profession

Colorado's Accountancy Board must be given increased power to oversee and regulate the state's accounting profession. It has only recently been granted the power to issue subpoenas and share information with governmental and law enforcement agencies.⁴¹ There is still much room for improvement.

Increase the Amount of Ethics Hours Required for Continuing Professional Education and Implement Periodic Ethics Testing

Under current Colorado regulations, accountants have to complete 80 hours of Continuing Professional Education (CPE) every two years in order to renew their licenses. Only two of those hours have to be on the topic of professional ethics, and accountants are not tested on their knowledge of current ethics rules as part of their CPE requirements!⁴² The State Board of Accountancy should increase the required number of ethics hours to eight hours every two years, as well as implement periodic ethics testing.

Institute a Peer Review/Quality Review Policy

Peer review/quality review is a periodic review of an accounting firm's audit practices by accountants who volunteer with the state board of accountancy. Colorado has not implemented a peer or quality review process as a condition to accounting firm license renewal. The Colorado State Board of Accountancy must adopt a mandatory peer review/quality review policy, which would review a firm's audit procedures, as a condition for license renewal, in order to protect the investing public and restore investor confidence in corporations and the financial markets.

Implement a Self-Reporting Requirement for Accountants If Sued

The Colorado Board of Accountancy should follow the lead of the AICPA and the state of California by requiring auditors who are sued to self-report the lawsuit to the board. It must be noted that the AICPA has had this self-reporting requirement for over 20 years. Auditors who fail to do so must be subject to disciplinary action.

Require Auditors to Properly Document Their Work

The Colorado Board of Accountancy must ensure that auditors properly document their work. Proper documentation is essential to any complete and proper investigation,

whether it be an investigation involving the auditor, accounting firm, or the corporation, and ensures that potentially valuable evidence is not lost and is capable of being understood by industry professionals.

An example of such a requirement is once again provided by California, which requires audit documents to contain sufficient documentation to enable a reviewer with relevant knowledge and experience, but with no previous connection with or knowledge of the audit, to understand critical information, including the results of the audit, evidence obtained, conclusions reached, and the identities of the people who performed and reviewed the work.⁴³ Auditors must also maintain written policies and procedures regarding the retention of written audit documents, as well as their destruction.⁴⁴

Institute Tougher Sanctions for Accountants and Accounting Firms Who Violate Accounting Standards

Institute tougher sanctions against accountants and accounting firms who knowingly violate accounting standards and who collude in the preparation or approval of misleading reports. Fines must be increased and assessed not only to the individual auditor, but to the auditor's accounting firm, as well as the chief financial and accounting officers of corporation whose reports are at issue, as well as the corporation itself. Auditors' licenses must be suspended for longer periods of time, if not completely revoked.

Grant the Board of Accountancy Full Access to All Accounting Documents

Give the Accountancy Board full access to the accounting documents it needs to review when it investigates irregularities and potentially misleading reports. The board must be able to subpoena all of the documents it needs to investigate accounting irregularities—not only all of an auditor's work papers, but also the pertinent documents from the company that is being investigated.

Increase Available Resources to Bodies Charged with Investigations

Increase the resources available to the State Board of Accountancy, as well as the State Attorney General's Office so that they can conduct more frequent and more extensive investigations. The Colorado State Board of Accountancy has a full-time staff of four individuals and a budget of only \$594,000 to regulate 10, 236 CPAs.⁴⁵ The Arkansas State Board of Accountancy has a comparable annual budget (\$538,000) but six full-time staff to regulate just 6,656 CPAs; the State Board of Accountancy in Louisiana has 9 full-time staffers and an annual budget of \$616,000 to regulate 10, 344 CPAs.⁴⁶ This increase can be accomplished by having the Accountancy Board increase its fee for license renewals, which is now only \$79. Wyoming's renewal fee ranges from \$95-\$190; New Mexico's renewal fee is \$100.

Federal Solutions to the Corporate Accounting Crisis

Ban Audit Accountants From Selling Consulting Services

Auditors are "public watchdogs," yet many of the largest accounting firms earned more money from selling consulting services to their clients than from audits. Congress and

state legislatures should ban accountants from selling non-audit related consulting services to their audit clients.

Auditors have grown overly reliant on consulting business from their clients. According to a recent study by University of Illinois professor Andrew D. Bailey, among 563 companies examined under new SEC disclosure rules, only two paid no non-audit fees to their auditor, and, on average, clients reported paying their accountant \$2.69 in fees for non-audit services for every dollar spent on audit fees.⁴⁷ In some cases, however, the imbalance was far greater.⁴⁸

CoPIRG and other consumer groups believe that an outright ban on non-audit services to audit clients is a better solution than allowing some non-audit services subject to unworkable rules.

Close The “Revolving Door” between Auditing-Accounting Firms and Client-Companies
Auditors should be completely banned from working for clients to whom they provided auditing or consulting services for at least two years following an audit. California prohibits an accountant from accepting employment with a publicly traded corporation (or an affiliate of that corporation) within twelve months of the date of issuance of a financial statement where the licensee had a specified level of participation in the audit engagement and the employment would afford the accountant significant authority over accounting or financial reporting.⁴⁹

Protect Public Investments, 401(k)s and Pensions

Enron CEO Ken Lay told employees to keep on investing in Enron stock while he was furiously dumping his own holdings. The state legislature and Congress should enact legislation guaranteeing greater protections for employee retirement accounts. Employees need to have retirement investments that are diversified across many industry sectors, with investments in their own firm capped to avoid catastrophic consequences of under-diversification. Employees shouldn't be prohibited by management from selling off their company shares. Employees need a guarantee that their retirement accounts are being managed in their own interest, not the company's interest.

Retain Accounting Records for Seven Years

Require Colorado Companies to retain copies of their accounting records for 7 years so that the state is not prevented from investigating wrongdoing as a result of destroyed records.

Impose Tougher Penalties for CEOs and CFOs with Regard to Fraudulent Certification of Financial Records

In addition to the current provisions regarding financial record certification, CEOs and CFO should also be subject to criminal penalties for financial records that they certify negligently or recklessly.

Policy Recommendations

State Policy Recommendations

- Alter the composition of the Colorado State Board of Accountancy so that it is composed of a majority of non-accountants.
- Increase resources available to the Board of Accountancy. This may require an increase in the accountant licensing and renewal fees.
- Increase board subpoena power for relevant documents.
- Increase the number of ethics hours required for accountants for continuing professional education and institute periodic testing.
- Require accountants to properly document their work and keep their records for a set period of time.
- Require self-reporting of lawsuits against accountants to the State Board of Accountancy.

Federal Policy Recommendations

- Increase funding to the SEC.
- Prohibit consulting accountants from auditing their own work.
- Prevent accountants either from accepting employment with a corporation for which they recently performed audit work or from moving from a corporation to an accounting firm, which has recently audited the corporation.
- Require the *entire* accounting firm handling a specific client to rotate off a client's account.
- Impose criminal penalties on CEOs and CFOs whose actions in certifying corporate financial records are “negligent” or “reckless,” per the relevant and applicable legal definitions of those terms.

-
- ¹ Kris Hudson, *Qwest to Restate '99-'01 Earnings*, The Denver Post, July 29, 2002.
- ² Rob Reuteman, *Fallout for Janus and Qwest Likely Will Linger*, Rocky Mountain News, September 6, 2003.
- ³ For a partial list of Colorado headquartered companies that are on the Bloomberg Colorado Index and have restated their earnings, and/or are the subject of an SEC investigation, see the table printed above.
- ⁴ Consumer Federation of America, Barbara Roper: Investor Protection Lessons from the Enron Collapse and an Agenda for Reform, February 11, 2002.
- ⁵ Financial Statement Restatements: Trends, Market Impacts, Regulatory Responses, and Remaining Challenges, GAO-03-138, October 4, 2002.
- ⁶ Consumer Federation of America, Barbara Roper: Investor Protection Lessons from the Enron Collapse and an Agenda for Reform, February 11, 2002.
- ⁷ Consumer Federation of America, Barbara Roper: Investor Protection Lessons from the Enron Collapse and an Agenda for Reform, February 11, 2002.
- ⁸ Consumer Federation of America, Barbara Roper: Investor Protection Lessons from the Enron Collapse and an Agenda for Reform, February 11, 2002.
- ⁹ Financial Statement Restatements: Trends, Market Impacts, Regulatory Responses, and Remaining Challenges, GAO-03-138, October 4, 2002.
- ¹⁰ Matt Krantz and Greg Farrell, *Fuzzy Accounting Raises Flags*, USA Today, June 22, 2001.
- ¹¹ For a partial list of Colorado headquartered companies that are on the Bloomberg Colorado Index and have restated their earnings, and/or are the subject of an SEC investigation, see the table printed above.
- ¹² Rob Reuteman, *Fallout for Janus and Qwest Likely Will Linger*, Rocky Mountain News, September 6, 2003.
- ¹³ Kris Hudson, *Qwest to Restate '99-'01 Earnings*, The Denver Post, July 29, 2002.
- ¹⁴ Rob Reuteman, *Fallout for Janus and Qwest Likely Will Linger*, Rocky Mountain News, September 6, 2003.
- ¹⁵ Kris Hudson, *Criminal Probe of Qwest is Reported*, The Denver Post, July 6, 2002; Kris Hudson, *Investigators of Qwest Getting in Line*, The Denver Post, July 8, 2002.
- ¹⁶ Tom McGhee, *Qwest to Pay \$20.7 Million in Settling Arizona Case*, April 22, 2004.
- ¹⁷ Tom McGhee, *Qwest to Pay \$20.7 Million in Settling Arizona Case*, April 22, 2004.
- ¹⁸ Tom McGhee, *Qwest to Pay 20.7 Million in Settling Arizona Case*, April 22, 2004.
- ¹⁹ U.S. Supreme Court, *United States v. Arthur Young*, 1984.
- ²⁰ "Study Faults Work of Auditors Who Consult," Aaron Elstein, Wall Street Journal, August 1, 2001.
- ²¹ "Study Faults Work of Auditors Who Consult," Aaron Elstein, Wall Street Journal, August 1, 2001.
- ²² "Study Faults Work of Auditors Who Consult," Aaron Elstein, Wall Street Journal, August 1, 2001.
- ²³ Consumer Federation of America, Barbara Roper: Investor Protection Lessons from the Enron Collapse and an Agenda for Reform, February 11, 2002.
- ²⁴ Consumer Federation of America, Barbara Roper: Investor Protection Lessons from the Enron Collapse and an Agenda for Reform, February 11, 2002.
- ²⁵ SEC Independence Rule (11/2000)
- ²⁶ http://enronwatchdog.org/PDFs/auditintr6_5_03.pdf
- ²⁷ Floyd Norris, *Big Auditing Firm Gets 6-Month Ban on New Business*, The New York Times, April 17, 2004.
- ²⁸ Floyd Norris, *Big Auditing Firm Gets 6-Month Ban on New Business*, The New York Times, April 17, 2004.
- ²⁹ "Were Auditor and Client Too Close-Knit?" Thaddeus Herrick & Alexei Barrionuevo, Wall Street Journal, January 21, 2002, pg. C1+.
- ³⁰ After Enron, New Doubts about Auditors, David Hilzenrath, Washington Post, December 5, 2001, p. A01.
- ³¹ Consumer Federation of America, Barbara Roper: Investor Protection Lessons from the Enron Collapse and an Agenda for Reform, February 11, 2002.
- ³² Financial Statement Restatements: Trends, Market Impacts, Regulatory Responses, and Remaining Challenges, GAO-03-138, October 4, 2002.
- ³³ <http://enronwatchdog.org/PDFs/derivative.pdf>
- ³⁴ Financial Statement Restatements: Trends, Market Impacts, Regulatory Responses, and Remaining Challenges, GAO-03-138, October 4, 2002.
- ³⁵ Barron's Law Dictionary, Model Penal Code § 2.02

-
- ³⁶ Graziadio Business Report, 2003, Volume6, Number 1. Larry Bumgardner, J.D. Reforming Corporate America: How does the Sarbanes-Oxley Act impact American business?
- ³⁷ Restatement (Second), Torts §284
- ³⁸ Graziadio Business Report, 2003, Volume6, Number 1. Larry Bumgardner, J.D. Reforming Corporate America: How does the Sarbanes-Oxley Act impact American business?
- ³⁹ Colorado State Board of Accountancy website, May 26, 2004.
- ⁴⁰ California Assembly Bill Number 270. Approved by Governor August 23, 2002. Filed with the Secretary of State August 26, 2002. Requiring the California State Board of Accountancy be composed of eight public members and seven licensee members.
- ⁴¹ Colorado House Bill 03-1197.
- ⁴² Rules and Policies of the Colorado State Board of Accountancy, Rule 5.3 (a).
- ⁴³ California Assembly Bill No. 2873. Approved by Governor August 23, 2002. Filed with Secretary of State August 26, 2002.
- ⁴⁴ California Assembly Bill No. 2873. Approved by Governor August 23, 2002. Filed with Secretary of State August 26, 2002.
- ⁴⁵ National Association of State Boards of Accountancy Conference Manual. 96th Annual NASBA Conference, October 26-29th, 2003.
- ⁴⁶ National Association of State Boards of Accountancy Conference Manual, 96th Annual NASBA Conference, October 26-29th, 2003.
- ⁴⁷ Consumer Federation of America, Barbara Roper: Investor Protection Lessons from the Enron Collapse and an Agenda for Reform, February 11, 2002.
- ⁴⁸ Consumer Federation of America, Barbara Roper: Investor Protection Lessons from the Enron Collapse and an Agenda for Reform, February 11, 2002.
- ⁴⁹ California Assembly Bill No. 2970. Approved by Governor August 23, 2002. Filed with Secretary of State August 26, 2002.