

**Accounting, Accountants, and Accountability in an Integrated World Economy**

**Remarks by**

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To the World Congress of Accountants

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I greatly appreciate this opportunity to open the World Congress of Accounting this morning.

We are, quite simply, at a truly critical point in the history of your profession. Everyone engaged in accounting, everyone dependent upon financial reports - indeed, everyone concerned with market behavior - has been through a turbulent and disturbing year. What is at stake is the credibility of a profession that, in fact, relies on that credibility as the bedrock of all it does.

The need for change and reform should be plain for all to see. This World Congress presents a grand opportunity to provide impetus to that process.

Meeting here in Asia strikes me as particularly appropriate. Only five years ago, Western economists, financial leaders, and international organizations alike pointed their collective fingers at poor accounting, lax corporate governance, and crony capitalism as strongly contributing to the Asian financial crisis. Perhaps that emphasis was overdone; in my view other systemic factors were at play. But surely the message was appropriate.

Good financial reporting is essential to the effective functioning of capital markets and the productive allocation of economic resources.

What is clear now is that the problems are not limited to the emerging world. In particular, industrialized countries, certainly including the United States, must now practice what they preach. There is no alternative if we are to encourage the rest of the world to accept our model of an open, global financial system as the way forward. The fact of the matter is that there is no satisfactory and credible alternative to making markets work - work with transparency, efficiency and stability. That is true, in the United States itself, in other wealthy countries, and most importantly in those nations where billions of people are still mired in poverty.

Plainly, we here in Hong Kong have the responsibility to push ahead, to bring the practice of accounting and auditing to the standards that we have long professed.

## The Crisis in Confidence

No doubt, the dramatic failures in accounting and corporate governance during the last 18 months have had complex causes. Surely, attitudes generated by the booming American market - what Alan Greenspan has labeled "infectious greed" - have played a part. At the same time, the enormous complexities of new technology and modern finance have presented challenges without precedent for accounting standards and their enforcement. In combination, both developments - unrestrained greed and technical complexity - meant that too often undisciplined, unethical, and even corrupt practices went unchallenged.

Much of the anger and attention has been directed at the auditing profession. After all, it is the auditor whose responsibility is not limited to the client who pays; it extends to investors, to the financial markets and to the public at large. It is they who are dependent upon the reliability of financial reports, and it is that need that justifies the special role and privileges of the auditing profession.

But clearly the responsibility is spread more widely. The investment banks and consultants have developed complex schemes of financial engineering, much of which had as their raison d'être ways around accounting standards and tax regulations. Inadvertently or not, the result has been to load balance sheets and income statements with hard to understand and analyze numbers, or worse yet, to take risks off the balance sheet entirely. The wave of merger activity and the "new economy" with its proliferation of intangibles has added to the imponderables. The large international accounting firms themselves were tempted to divert attention and energy to their lucrative consulting practices.

In all those circumstances, the erosion in accounting and auditing discipline may be understandable. It is nonetheless regrettable; more than regrettable, it erodes the foundation of free and open financial markets.

Now it's time to look ahead. The theme of this Congress recognizes the need for the profession to reform and reshape itself. You in this room and your colleagues around the world have the intellectual resources necessary to build a better accounting model, and to implement that model with consistency and discipline in the real world of the 21<sup>st</sup> century.

## A Path forward

As I see it, action is required to strengthen each of the three pillars of good accounting.

- First, we need high-quality, enforceable standards, clear in principle and sensitive to the complexities and realities of the globalized economy;
- Second, those standards must be enforced by a disciplined and dedicated auditing profession with a strong sense of responsibility to investors and the public at large, and with the means (financial and otherwise) to maintain its independence of judgment; and
- Finally, experience indicates the need for an institutional mechanism to provide effective oversight in the interest of assuring consistent and reliable accounting and auditing practices.

Developments over the past year and more have strongly reinforced the logic of achieving and implementing high-quality international accounting standards. In an age when capital flows freely across borders, it simply makes sense to account for economic transactions, whether they occur in the Americas, Asia, or Europe, in the same manner. Providing improved transparency and comparability will certainly help ensure that capital is allocated efficiently. Not so incidentally, generally accepted international standards will reduce the cost of compliance with multiple national standards.

I do not think it reasonable today, if it ever was, to take the position that U.S. GAAP should, de facto, be the standards for the entire world. Rather, the International Accounting Standards Board, whose oversight Trustees I chair, is now working closely with national standard setters throughout the world to develop common solutions to the accounting challenges of the day. The aim is to find a consensus on clearly defined principles, and I am delighted that the American authorities appear sympathetic to that objective.

Clearly, the intellectual challenges are large. I am sure Sir David Tweedie, Chairman of the IASB, later today will touch upon some of the specifics of the effort.

What we know for certain is that the necessary decision-making, given the strong interests at stake, will generate controversy. The standard setters must understand that they are not themselves residing in an ivory castle - or a series of national ivory towers - free to resolve the difficult issues in isolation.

At the IASB and elsewhere, consultation with the accounting profession, preparers and users will be an essential element in achieving a result that is reflective of economic reality, useful, and enforceable. At the same time, the need for moving with "all deliberate speed" is urgent.

Nothing that has happened this year has reduced the intellectual, organizational, and political obstacles. But what seemed unrealistic, even impossibly visionary, a few years ago now seems both necessary and possible.

My confidence is bolstered by the fact that major countries, including those of the European Union, have agreed to adopt international standards rather than maintaining or developing their own approach. Moreover for the first time, the United States is actively engaged in the process and is playing a leadership role with the IASB and other standard setters in the convergence process.

For all that, good standards, responsive to the needs of a new century, will not be enough. The standards must be applied with consistency and discipline.

I confess to a certain mental image. I see the role of an auditor as guardian of "truth in markets", acting in the public interest to maintain reliable and consistent financial reporting. That will not always be a popular role, nor can the practitioners anticipate remuneration at the extremes that have prevailed for some entrepreneurs or investment bankers. The natural constituents for your efforts - business corporations, financial institutions, even investment companies -- are not always supportive when their perceived particular interests are at stake. Matters of judgment are involved, and perfection in every decision can't be expected.

But at the end of the day, the need is clear, the responsibility profound, and pride in an old and proud profession essential. That is my vision.

I well understand you must deal with reality as well as a vision. You know as well or better than I that corporations, with teams of lawyers and investment bankers, are themselves dedicated to keeping reported profits, and not so incidentally the value of stock options, on track. The auditing firm itself may be dependent on revenues from other services. So the pressures multiply to shade judgments, consciously or not.

Indeed, the potential conflicts and distractions inherent in the growing emphasis of accounting firms on non-audit work, to my mind, has raised serious issues regarding the ability of auditors to carry out their primary responsibility to investors. It is time for these conflicts to be removed or minimized.

That is a strong reason, at least in the United States, for greater official oversight over the auditing process and the extent of non-audit services of accounting firms. Those matters are at the heart of the Sarbanes-Oxley legislation adopted last summer.

Different regions might well have different approaches to ensuring effective auditing standards. But I believe there is a

lesson to be learned from the U.S. experience. Self-regulatory, industry-controlled oversight efforts alone may not be sufficient to maintain auditing standards and discipline in the face of the marketplace pressures.

Be that as it may, I am entirely in agreement that ethics cannot be legislated. In the last analysis it will be the culture of the auditing firms themselves that counts. An important reorganization of international accounting firms is underway, and I believe necessary. We all have a stake in measures to strengthen the quality and independence of the external auditor. That will require emphasis on recruiting qualified individuals, effective training programs, and, not least, fair and competitive remuneration.

I know these issues and others will be discussed at these meetings over the next few days. I trust there will be a broadening consensus on the way forward. We cannot succeed without the accounting profession itself taking an active and constructive role in that process.

#### Major Stakes, Great Opportunity

Opponents of a system of global markets will cite - are citing - the recent corporate and accounting failures as evidence for retreating into controls and financial isolation. I believe yielding to that opinion would be a grave mistake.

It would be a mistake most importantly for the emerging nations dependent upon capital from abroad and foreign markets for their products. But we will not win that argument if we sit on our hands, deny the need for change, and reject reform. What we must do is demonstrate in practice that open markets, with reliable and transparent reporting, will bring about real benefits to both developed and emerging economies.

This World Congress, here in Hong Kong, in the year 2002, can provide the symbol and the focus for a fresh start for an essential and honorable profession. You have a really unique and promising opportunity to signal your commitment and support for strong and sensible international standards, for a renewed sense of purpose and discipline.

The simple fact of the matter is all those dependent on markets can't do without you!