GP: Good afternoon, Lynn. I’m Gary Previts, professor at Case Western Reserve University in Cleveland; and today, on behalf of the SEC Historical Society’s Office of Chief Accountant sub-committee, I’m here interviewing Lynn, who was the chief accountant of the Securities and Exchange Commission during the period 1998 through August of 2001. We’re in Broomfield, Colorado; and today is June 16, 2005. Welcome Lynn.

LT: I’m glad to have you out here, Gary.

GP: It’s beautiful. Glad to be out here. Beautiful day. One kind of way we’ll approach this is just to get out and ask you: How does one become the Chief Accountant of the SEC? How does that happen?

LT: I suppose it’s probably different for different Chief Accountants. In my case, it was the result of a call from Chairman Levitt’s office, and a couple of interviews with Levitt, and then Levitt deciding to turn around and make the appointment.

GP: We’ll get a chance to talk about your background. You did serve as a professional accounting fellow at the Commission, so you had some sense of what life was like at the agency. Is this a prolonged period of time? Is this a matter of months, a matter of days, a matter of weeks—how long does this pre-agreement courtship go on, in your experience?

LT: I don’t think it’s really any different than the type of interviewing process that you’d go for at an executive position in private business. In my case, Levitt’s counselors initially called me about the third or fourth week of February in 1998, and I flew out twice to meet with Chairman Levitt, and in addition to that, he asked if I’d speak to some other people.

So I went and talked to Ed Jenkins at the FASB, and talked to some of Levitt’s closest advisors from outside the Commission, such as Paul Colton, who had been a chairman at the American Stock Exchange. After going through those interviews, I think it was probably sometime in April when Arthur turned around and asked me if I’d be willing to take the appointment. I know he’d interviewed a lot of people before me, and for whatever reason, he and the staff could not get comfortable. And it’s my understanding that as a result, he went to his staff and said: “We’re going to go with this other individual that we’ve decided on, unless you can find someone else.” And that’s when I got the phone call.

GP: So it’s a very deliberative process, isn’t it? I mean it’s certainly not anything that you’re necessarily campaigning for, and it’s certainly not something that you could spend your life training for.
LT: No; and in fact, in this case, I was not sure that I would even take it. I loved what I was doing in private enterprise, and really didn’t want to relocate from Colorado back to Washington, DC, having already done that once before. So I really had no interest in doing that; and one of the questions I put to Chairman Levitt was, how long a commitment did he want? And he said, would I be willing to give him an eighteen month commitment, and I said, “okay, I’ll come back for eighteen months,” and agreed to do it for that length of time. I honestly thought that, by the end of eighteen months, he’d probably be stepping down as well, as the second term of the President was rolling out.

And I guess we all know that turned out not to be the case; and instead of eighteen months, it turned out to be a little over twice that—a little over three years. So, it really wasn’t what I had initially planned; and quite frankly, if Levitt had asked me initially to go back for a full three years, I probably would not have done it.

GP: There’s, of course, some economic consequences to this position—government salary schedules are what they are, so there’s a commitment that you have to make to a lifestyle and a work schedule. You’re known for being an incredibly energetic person, so I suspect that those issues are things you have to manage. You have to think about lifestyle and work schedule, and how does that factor in and how do you approach that? It is the fifth of July, I think—the first day that you’re on the job—you go in with a list of to-dos—or how does that happen?

LT: The job is extremely demanding. It certainly takes a lot of time, so from that perspective it is a very demanding job—no questions about it. In my case, because I’d originally planned for eighteen months, I actually just went back and rented an apartment, and kept my residence in Colorado; and as a result, flew back and forth between Colorado and my apartment in DC. So while I was back in DC, I had plenty of time, and so we basically worked from the morning till whenever late at night, and so long days and weekends were probably pretty much the norm.

GP: Your family background is—you have two brothers and two sisters?

LT: That is correct.

GP: You were born in Ogden, Utah, and moved to Colorado while you were in the early years of grade school, and grew up in Longmont, Colorado.

LT: Right.

GP: I guess you’re a man of the West, so it was a change, but it really maintained your identity as someone coming from the West.

LT: I had the good fortune when I was with Coopers and Lybrand. I absolutely had a fantastic time with that firm, and can’t say enough about how good that firm treated me. But I
Interview with Lynn Turner, June 16, 2005

started with Coopers out of grad school. I’d done undergraduate work at Colorado State University in accounting, and then went and got a Masters in accounting in grad school, albeit a lot of the course work were in other fields, like engineering and economics and organizational development. But I started with Coopers in July of ’76 in a very small office in Lincoln, Nebraska; there were only eight of us, with an IBM Selectric to type up the reports. While you had a tax partner there, we actually didn’t even have an audit partner, but with only eight people, you did it all. You did the audit work, you did the tax work, you did the pension consulting—whatever.

So there was really no defining line, like what you saw in the larger offices, between the different parts of the practice. And it was a fabulous learning experience. After two years there, I went to Salt Lake City, which left me in the West, but it’s still a small office—about thirty, thirty-five people—where again, you did a lot. And I actually probably spent about half my time in the Salt Lake City office doing consulting of different types—IT and general management, strategic planning. But I then got asked by the assistant to the Chairman of the firm at the time—a wonderful man by the name of Ken Johnson asked if I’d be willing to come back to New York.

So I spent two years in the New York office, from ’83 to ’85, which was a wonderful experience, because Bob Herz, who’s now chairman of the FASB, was in the national office with me, and also the current comptroller of Comcast, who also chairs the FEI committee on corporate reporting, Larry Salva, was there—a wonderful group of people to work with; and obviously, the other two gentlemen have done exceptionally well since they left the firm as well. But part of the deal in being back in New York was great, great exposure, obviously, to a lot of things like the FASB.

I spent about a year working with the congressional commerce committee in the House—John Dingell’s committee at the time. Dingell was holding hearings, and I worked closely with the minority staff at that point in time, throughout the hearings, doing a lot of work. I also spent about a year down on Wall Street, working with the firms like Lehman, and Shearson, and Goldman, and Dillon, and the crew. And it was a wonderful experience to see how Wall Street really worked, and deals worked, as well as following and spending time with the FASB.

So, it was a great experience, and a great big office. I went from thirty people in Salt Lake City to three thousand plus people in New York—just the opposite spectrum. After two years of that though, the firm had agreed, if I’d go to New York for two, I’d go back to Denver; so that’s what took me back to Denver before the SEC fellowship.

GP: So you were in Denver, then, for four years—any notable experiences there—or any near misses, or anything of that nature, in Denver?

LT: That was a unique time to be in the Denver office. It was from ’85 to ’89. There were some defining things happening in the office at the time. The firm had picked up an audit
from Ernst & Young of a large S&L called Silverado. They also did the audit of a high technology company called MiniScribe. Both would later have unfortunate consequences for the firm when problems developed within those companies, and quite frankly, with those audits. But being able to see firsthand some of the experiences there—some of the problems that also developed in the office at the time, with respect to independence; and going through there certainly sharpened my opinions on some of these issues.

GP: I guess it’s a question of being able to manage it from a firm-wide point of view that involves the educational and the philosophical commitment, and so on. How large an office was Denver at the time?

LT: Denver was about two hundred to two hundred and fifty people—so probably a good-sized, medium-size office, with a wide variety of practice. I certainly did a fair amount of work in technology. It was during this point in time that I also did a lot of work for the firm within the high technology audit practice on a firm-wide basis; and also did a lot of work with some of the smaller, emerging companies as well, but very much enjoyed it. And the office and firm were exceptionally good at using what I’d learned back in the national office, and putting that skill set to work, and sharpening.

So it was a tremendous experience. And it was taking one through difficult times in the marketplace here in Denver, because the oil and gas market had cratered, the real estate market had cratered. We actually saw where Colorado at the time had the highest bankruptcy rate in the country—about two-thirds of the total foreclosures in real estate in one state, on a nation-wide basis. The oil and gas companies picked up and left. A tremendous learning experience in one way; to live through what was a very troubled market; and at the same time, a market that had gotten some notoriety for being a penny stock market. We had the famous case against Blinder, Robinson here at the time, amongst a number of other ones. It certainly allowed one to see the flip side from a good market.

GP: Now, at this point you’ve been with the firm a dozen years—a little bit more; and oftentimes, pre-partner opportunities include not just national office service, but sometimes folks get appointments at the FASB, or sometimes as professional accounting fellows at the Commission. And you had a turn of service that’s going to begin at the Commission in 1989, right?

LT: The firm had come to me, and actually asked if I’d be willing to either apply for the SEC professional accounting fellowship, or take a rotation to Seoul, Korea. At the time we out-rotated one person in from the U.S. firm to Seoul, Korea, for a two to three year stint; and that person would go over there, and in essence, would be the liaison to the Korean firm with the U.S. firm. And I was asked which one I’d prefer to do, and I applied for the professional accounting fellowship; but it was actually almost an accident that that happened. The firm had put one other person up for the fellowship earlier on, and gotten
some indication that these fellowship applications had to be in by the end of December, so December of ’88.

And in this particular case, the firm had had one other person apply back in October, and they’d gotten some indication that that particular person probably would have one of the four slots—and there were only four slots at the time. I think there were eight people up for them. The firm came back to me on the 7th of December of ’88, and asked if I’d be willing to do a paper and apply, because you had to prepare a whole paper, and of course, it’s the end of the fiscal year so you’re trying to get audits wrapped up. And at the same time, they’d asked me a couple weeks earlier if I’d be willing to go to Seoul; and when the national office found out about that, they said: hey, instead would you consider a professional accounting fellowship?

So we put together a paper, and went ahead and applied, and went through the interviews; and got a wonderful callback from Ed Coulson, who was the then Chief Accountant of the Commission, and for me, a wonderful mentor. And he offered me the accounting fellowship, which I, of course, took.

GP: Now, are you the only person that has been a professional accounting fellow, and then has become a Chief Accountant?

LT: No. There was one other person. Bobby Herdman was an accounting fellow, back—I’m going to say in the early ‘80s—about the ’82, ’84 time period; and then Bob became the Chief Accountant right after me.

GP: So there’s at least the uniqueness, historically, that you are the first—that Bob is the second, in that line. And I’m thinking in the context of how the Chief Accountant positions evolved from Carmen Blough through Bill Werntz, and Earl King, Andy Barr—these were people who generally came through the ranks—Clarence, for example. And in discussions about what’s happening here, the need for broad practice experience begins to be indicated, I think, by the fellowship program, which Sandy started when he was Chief Accountant; and which has kind of matured as, at least, a potential resource for—in the two instances we’ve just discussed—a resource for people who have, at least, the ability to get in the selection pool. What kind of assignments did you handle while you were there?

LT: The accounting fellowship was, again, just absolutely a wonderful experience. I think it has been for most fellows; and certainly, no doubt, for myself, and I suspect for Bob Herdman as well. It has turned around and had an impact and effect on us later on becoming Chief Accountants; albeit that there’s been a number of accounting fellows who have also been censured by the SEC. About a year after I came into the Commission for the two year fellowship—so after the first year - the deputy Chief Accountant at the time resigned, and went back to his firm, and he had planned on doing that. He had been an accounting fellow as well, and then two years as a deputy Chief Accountant, and then
he went back to his firm, KPMG, which left the deputy Chief Account slot open the entire second year I was there.

And just as the second year was starting, in about August of 1990, Ed Coulson also made Chairman Breeden aware of the fact that he was going to leave. That then left the Chief Accountant and the deputy Chief Accountant slots, for the most part, open, although Ed wouldn’t leave until January of ’91. He was recused from much of what was going on then, because he went out and interviewed with a number of other firms, which left a lot of the work then to the two senior PAFs, which were myself and a wonderful gentleman by the name of Greg Norwood. And that opened up experience for us tremendously.

As a result, in the second year I had the good fortune to go spend a fair amount of time again back up on the Hill, with the congressional delegations, including the Commerce committee staff, who had oversight responsibility. I also worked with some of the people over at the GAO, and Charles Bowsher, who was the Comptroller at the time, and with Donald Chapin, who was their top accounting person over there. And I actually ended up drafting, at that point in time, what would ultimately become part of the PSLRA in ’95—the Ron Widen legislation. I was up on the Hill, and drafted that for his staff. I spent a number of times at the tables as the SEC representative before the ITF; and in other events I had the second year, I had oversight responsibility for the auditing standards for—Don Nevis was chairman of the board at the time—and Dan Guide—again, both people who I think are just incredibly outstanding. So, a great learning experience.

GP: I’d just add for listeners that PSLRA stands for Private Securities Litigation Reform Act. There’s a lot of technical and anecdotal information that the two of us will try to be responsive to, but sometimes it just rolls off your tongue. And that’s a major piece of legislation that occurs in the mid-1990s. So that the two years of service is up; you’ve had kind of an enriched second year; you’re back with the firm, and back in Denver?

LT: Again, the firm asked if I’d go back to New York. I’d spent my servitude, if you will, in the national office for two years; and while it was an absolutely fantastic experience, had no desire to go back to New York, and went back to Denver, albeit, I did a lot of national work in the Denver office. Actually, a good piece of my time in the Denver office was more on a national-type level than a local Denver-type level.

GP: And you’re in the high tech end of the audit practice as well, at a national level?

LT: I became the partner responsible for the national high tech audit practice. In fact, I think, at the time was probably one of the youngest partners, if not the youngest partner responsible for a business unit like that. The biggest part of our tech practice was either in Boston or San Jose, and Denver was halfway in between, so maybe that’s why they picked me. But running that was a great job, and an important job. I had a lot of good people working under me within the firm. And I also got assigned roles—what they
called the national technical practice partner for the technology industry; as well as then became an SEC reviewer for the firm on a national level, reviewing SEC filings.

GP: So now you’ve got a pretty long and fairly impressive track record as a public accountant, as an audit partner, as a practice unit leader; but your public accounting career is about to come to a change. What happens next?

LT: I’m doing work on a technology company that had been part of the old AT&T/NCR merger. And it’s kind of interesting because AT&T and NCR was a major issue when I was at the SEC as a professional accounting fellow, and I made the final decision as to whether that merger could or could not go forward, in light of the accounting that was at issue. And after they put it together, they found that there was some components of it that just didn’t work, and wanted to spin out because of incompatibility with where they wanted to go with the telephone stuff.

And actually two of those units was a group that did storage systems and another group did semiconductor logic chips. AT&T put those together and sold them out to a company called Hyundai, which at the time was the largest in Korea. And I was doing some work for them both on the audit, and on the consulting side; and the people at Hyundai, including Chairman Chung from Hyundai, came and asked if I’d be willing to leave Coopers and go to work for them as vice-president and CFO of this unit they had in the United States.

GP: Well this is really kind of a unique twist from your previous Korean opportunity, to go smack dab in the middle of it, so to speak.

LT: It turned out to be, again, a very fortunate deal from my perspective, because the company was probably seven to ten percent owned by the employees; the rest owned by, Hyundai. And the chairman of my board was the chairman of Hyundai; and here you’re talking about a company that’s doing sixty to eighty billion a year in revenues—one of the largest companies world-wide; and yet a company that when the Asian flu hit in late ’97, ’98 would have serious issues in and of itself; and we’d find out just how disastrous poor quality international financial reporting was.

And while we operated as an autonomous, separate company from Hyundai; I did spend time over in Seoul with the executives of Hyundai, and certainly learned how they viewed business, how they viewed transparency, and how they viewed financial reporting and finances, which was very much foreign from what we’re used to here in the U.S.

GP: Culturally quite different from all the limited academic literature that’s out there. And again, a kind of a cultural exchange that expands your breadth of appreciating the complexity. We sometimes have a bit of a Eurocentric view of international accounting; and here you are going east, if you will—to the Far East. And maybe that’s going to
come back, and when we talk about your international accounting interpretations and experience, we’ll have a way to talk about it.

So, now the call comes—and this process that you referred to at the top of our discussion is going to take place; and come July of ’98 you’re in Washington, and you’re the Chief Accountant. Your predecessor has been out of the office now for several months. There was no interim to speak—officially the records say there was no interim; but actually, I think there was a deputy chief accountant who was…

LT: …. in an acting role. Jane Adams—whether they give her the official acting role or not is probably not really relevant. Jane Adams had taken on the day-to-day operations and really did act as the Chief Accountant, starting in January of ’98, and dealt in that capacity through the first part of July, when I arrived.

GP: Now, I had asked…

LT: She had been doing, I might add, a marvelous job.

GP: Did she stay on for part of, or all of, your term?

LT: I was lucky as you can be, in that Jane did stay on for probably about two-thirds of my term, and then went back to New York, and became one of the top equity analysts at Credit Suisse First Boston, and she’s now the top accounting equity analyst at a major fund called Maverick. I think they manage about fifteen billion—just a spectacular position; and she’s been extremely successful since she left the Commission.

GP: It’s time to go back to talk about whether or not when these calls start coming, and you have the time on these plane rides back and forth from interviews to think about your what if scenario. What if I take the position? What is the philosophy? Is it something that you can articulate? Is it something that traces the certain values and certain experiences? Do you have a pat answer for this? Is this a part of your speeches, to talk about what your philosophy is? Or do you send me to the SEC website to read William O. Douglas’s quote? What is it that expresses your thoughts about what it was you were trying to accomplish—without getting into all the particulars about issues?

LT: There are probably a number of things that have impacted how I view financial reporting. First of all: a set of parents that ingrained in me that you should never be a person who tries to get ahead of the game unfairly; or by taking advantage of other people; and that telling the truth, and the whole truth, is what you need to do; and not only talk about it, but practice it day in and day out. And when I went to the University of Nebraska, and did my graduate level work there; the professors that I had, and the courses that I had, turned out to be probably as defining as anything other than my parents, in that I did take some marvelous courses on theory of accounting.
In fact, I believe no one should be able to get an accounting degree today unless they’ve had significant course work in the theory—the how, the why, and the wherefore. Dr. Tom Balki just did a wonderful job on that course work. And then there was a follow-on course in the history of accounting; such that by the time I came out of the University of Nebraska, I had a tremendous understanding of not only the debits and credits, which had been taught extremely well to me from a very good group of people at Carroll State University who were CPAs, as well as PhDs, who had that practical bent.

But the professors at the University in Nebraska, which with probably one or two exceptions, were pure PhDs, gave me the whys and wherefores of what we were doing; so you had a much better understanding of how we got where we were, and where the profession had made mistakes in the past, and a really good understanding of what the pitfalls had been, and the things we needed to consider going forward.

GP: So you had perspective provided by that educational experience that may not be as common to people who are getting a more technically focused education. And in terms of perspective, I suspect when you have the kind of responsibilities you were about to undertake at the Commission, that’s going to turn out to be valuable.

LT: Oh, it turns out to be invaluable. A lot of people—whether you’re talking to people at the Commission—in fact, I’d say the vast majority of people—either within the profession, at the Commission, or the people you deal with up in Congress—don’t have that perspective of how we’ve gotten where we’ve been, what has worked—what hasn’t worked in the past; and it just gives you an insight and ability to craft public policy that others just absolutely don’t have. And it was not only invaluable as an accounting fellow, but certainly as a Chief Accountant, and later on then when we helped work on Sarbanes-Oxley.

GP: Your spouse has got to be fairly heavily involved in these kinds of career commitments, and I know in some of the pre-interview material that you’ve made some comments about how fortunate you are. But this might be, as you’re beginning this particular responsibility—how does that adjustment work out?

LT: Well, one of the reasons that I commuted back and forth between Denver and Washington, DC, which was on my dime—some people thought the SEC paid for that—that was all on my dime; and quite frankly, this assignment probably cost me about a million bucks before it was said and done; and that, and some other things that I had to give up when I left Symbios. But, my wife is a professional herself; she is a practicing dentist. And she had sold her practice when we went back to DC the first time for the two-year fellowship. Again, if we had known upfront it was going to be three years, I probably would not have done it.

GP: Thinking about historical perspective—you go back and read about the folks doing these assignments, and you can kind of understand why you draw from people from the East
Coast. It would be physically impossible to make this on the train. You couldn’t possibly commute. Technology enters into the accessibility, even though it’s still a very expensive assignment.

LT: You couldn’t have done it if you didn’t have the jet planes.

GP: The core philosophy here that kind of comes out is this commitment to what the Commission calls a level playing field. And it seems to me that there’s some correspondence between that and some of the values you just referred to that you held strongly—from values you acquired as you adopted your adult values, and the ones you carried forward into practice. What about this legendary energy that people assigned to you? Is that hereditary? Or is that just kind of competitiveness? Have you ever stopped to think about what causes that drive?

LT: I think it was the fact that the work—whether it was at Coopers, or at Symbios, or at the Commission, or even today—has been absolutely great; and when you get the chance to work on something like that—a lot of those are once in a lifetime opportunities; and you got to seize them; and you only got so much time. And there are those that lead, and those that follow; and those that need to get out of the way. And so I had the good fortune to have the chance to go get into some things, and we took as big a bite of the apple as we could. I also think, having grown up on a farm—you learn the value of hard work.

And I remember going out and milking the cows at five-thirty in the morning, so—while I’m not a morning person, for the most part, and haven’t been since those cows—that was a fantastic experience. You couldn’t have a better experience growing up than what I had on that farm. And I think that also taught you the value of hard work.

GP: You know, it really isn’t fair to ask too many questions that are about values, because, in many ways, they’re deeply personal; and often, we don’t have the chance to think about them that much; they’re just part of who we are; they define us. But I do think it’s interesting that you mention having come from an agricultural background, and also coming from the West.

As I think about Andy Barr coming from Illinois, and Carmen Blough—the first Chief Accountant—having lived and done some things in Wisconsin—there have been leaders in the profession and public servants that have come out of California, and come out of the West; but the Chief Accountant’s position—I think, again, this is perhaps an affirmation of some of the values that you’re likely to find in a rural—sometimes, not always, in an urban culture. You’ve got to be careful of generalities, but it’s interesting that you made the point about coming from a farm background.

The environment—the marketplace that you’re walking into—obviously that has been perking along pretty well—the Dow is moving up rather grandly, the economy is moving in the post-Berlin Wall period, and post-Gulf War period, in incredible ways—what the
chairman of the Fed calls “irrational exuberance.” I’m not sure if that had been identified prior to you getting there; or was that part of the environment—can you recall—the way the market was behaving, you know, in the ’97, early ’98 period?

LT: I think Greenspan originally did his “irrational exuberance” speech back in ’96; and by ’97 Chairmen Levitt had done a number of speeches expressing concern about that as well as the impact that was having on the governance committees. I think, in fact, Levitt’s first major real address on the impact of audit committees on that governance, which was really starting to tee up financial issues, was perhaps in ’97 down in Tulane.

So there had been people concerned and talking about that beforehand. I actually saw it close-up when I was at Symbios, in that I’d be out to chief financial officers’ conferences, or tech industry conferences put on by some of the Wall Street firms, dealing with the analyst. I remember an experience I had at Symbios; we were looking at selecting underwriters, and we interviewed eight, ten firms, including the major firms, and I remember one very well-known Wall Street firm came in to us, and during the meeting, turned around and looked to me and said, “Lynn, you got to get this good will that you got on your books written off beforehand.”

And we were performing exceptionally well; I mean there was no reason to write it off, and the company and the cash flows would certainly not support a write-off. And I turned around and looked at the guy askew, and asked him why. And he said, “Well, getting rid of it will help us with valuation, and oh, by the way Lynn, we’ll help you make the case as to why it would go off.” And of course, we turned around and said not interested, and, you know, it’s not the right thing to do even though it may give us a higher valuation. I remember they later on called the CEO, and in trying to convince the CEO to retain them, said, hey, I think Lynn’s wrong on this, and we’ll help you, as the CEO, get this written off, and get more money in your pocket.

And fortunately, I had a fabulous CEO at the time; and needless to say, they were not part of our underwriting group, and went by the wayside. But you certainly got favors for that in those type of interactions, in working with the analyst, in working with the CFO conferences. The stories you’d hear about what other CFOs were doing. There was no question by the time I had walked into the Commission—into this position, that there were some questionable things going on that were not good for the markets, and certainly not good for investors.

GP: And again, your recent experience seems to give you a very strong background for appreciating it; to be able to speak the language, and to relate to the pure communities and the various constituencies that the Commission expects the Chief Accountant to be able to deal with. The agenda for what you later on—a year later—after you’d been in office—a year you refer to as perhaps “The Year of Accounting,” when you wrote a piece in 1999—you refer to a speech given by the chairman at NYU in September of 1998—
“The Numbers Game.” Is that something that’s important in teeing up this year of accounting? And how does that come about?

LT: Even before I got to the Commission, but after Levitt had offered me the position; the Commission and staff actually asked me to work on a couple things. One was the rewriting of Rule 2E, which is the enforcement rule that the Commission uses when they take action against professionals; and the second thing was they had faxed me a speech that they wanted to do about financial reporting issues and concerns that might exist there. The problem with that speech that I got was it was just a speech about restructuring accounting, and no broader. And it really did not deal with all the issues that were confronting the profession; and the things that were, from my perspective, tearing at the heart, the credibility of the profession; and quite frankly, later on as the bubble burst, would tear the profession apart.

So when I got to the Commission—I started at the Commission on July 5th of ’98, the very same day that Harvey Goldschmid, who was a professor from Columbia, started. In fact, both of us had told Arthur—we’d talked before we ever got down there - and we had both given Arthur this notion of a fairly short term. Harvey is one of the most widely respected members of the American Bar, so I had the good fortune of working with him. Immediately upon getting to the Commission, I started working then on a plan that would address the various financial reporting issues, including the governance. Harvey started to take the lead on some of the stuff on governance, which included the audit committee stuff.

And we looked at where the major issues and problems were; and in fact, we had a series of a large number of meetings with various organizations: the Business Round Table; the Financial Executives’ Institute; the Security Sub-committee of the Financial Executives’ Institute, as well as their Committee on Corporate Reporting, or CCR; with Institute of Management Accountants, and their accounting committee; with representatives from the Financial Accounting Standards Board; the Merging Issues Task Force; from each of the major accounting—actually, not only the major accounting firms, but also other very good—you could say, major firms: Grant Thornton, BDO Seidman, McGladrey, et cetera; and as well as some people that we knew and respected professionally.

And we reached out to those and asked them for their views on what worked, what didn’t work; and actually created a matrix that had each of the issues listed on it, and then how best to get at those issues. And that became the nine point plan, or so, that we built the speech around that Levitt gave in the Numbers Game speech. And we went through many, many drafts of that speech. Quite frankly, the speech that was actually given was, for the most part, written the weekend before he gave that on Monday—in fact, we finished the speech up that Monday morning before he gave it. But that was the genesis of that speech, and the nine points, and how we went around developing, with a lot of input from a lot of very, very smart, very good people.
GP: And in terms of then kind of having a road map, or a list of things to focus on—where do you put earnings management? Is that an umbrella for this, or is that a priority in terms of how you identified the importance of that particular issue?

LT: Earnings management is a term that accountants, quite frankly, are going to probably use more than other people; you’re going to hear it from the green eyeshades. It was a broader issue than that. It really ran to the issue of transparency in financial reporting, and insuring that you’ve got that through good oversight, which brought on the issue of corporate governance, and the audit committees would delve into the role of the gatekeepers and their independence, which would ultimately tee up the independence issues and their ability to carry out their responsibilities and obligations to investors.

And then ultimately lead down to the quality of the numbers in the financial statements, and whether those numbers were being managed to derive the desired result by an unconstrained management team; or in fact, really reflected the underlying economics of the transactions that were being reported and disclosed. And as we delved into this—there’d been a survey done by Business Week that was in the August 2001 version, and in that the survey noted that somewhere around 15 percent of the CFOs that they had surveyed—and these were very respectable CFOs of very respectable companies—in fact, interestingly, before I joined the Commission, or taken this appointment; I’d been asked to attend that Business Week conference where the CFOs were surveyed—and great group of CFOs.

But there was a significant percentage that said that they had actually cooked the books under pressure. There was even a greater percentage that said they were under tremendous pressure to cook the books, but had not done so. And when you saw those statistics—and those statistics were, again, reported in the October CFO magazine that was put out—they had done their own independent survey, independent of Business Week—and their stats were as much, or even more troubling. So clearly, things were going on that were not healthy in the marketplace. And put that together with my own experiences that I had seen, and you knew that we were running into trouble. And quite frankly, going back to even my days at Coopers; you could see things going on within the firm; and I had friends in other firms—and you knew that there was some unhealthy things going on.

GP: Well, we’re at a point where, as a profession, we have two different spirits: one sitting on one shoulder, and one sitting on the other. And one is deregulating; and you know, there’s this whole notion of let the profession take its skills to the market level; and then there’s the more focused view that says the social contract, or the law that we have—going back to the Securities Acts—says that we have this responsibility to provide and see to the provision of quality information.

And so you are coming into the market at a particularly difficult time, because accounting firms, as they began to remove the emphasis of those terms on their business cards, and
became broader support and service operations, certainly were populated by very bright people who, when given a market opportunity, wouldn’t take long to figure out what to do with it. Although, I think that by the ‘90s the culture of the firms had already changed.

By the late ‘90s—an experience with a firm that—I can remember when the first marketing partner was brought in the national office of one of the, then, big eight firms in 1984—brought in from an automobile manufacturing company, because marketing wasn’t something that was part of the culture. It’s clearly, to me, part of the culture by this point in time—by the late ‘90s; and so you’re coming into—I would argue—a very difficult market. And again, at a time when the profession has turned itself into a much broader service-based organization—and you’re leading up to independence and scope of services discussions here. It’s hard to know whether to just talk about those, or what.

LT: I actually see it a little bit differently. The characteristics at the firms, and what made them tick, no doubt changed; and you’re absolutely right. They got 10 percent or less of their revenue—7 to 10 percent from consulting back in the ‘70s, and by the time you got to the ‘90s, and I get to the Commission…

GP: It’s over 50 percent.

LT: And audit is down to thirty percent, or less; so the factors that are critical to the success of that business—not profession, but business—have changed dramatically. And if you’re a CEO in one of these firms, you’re put there to be successful. And so the things that are critical to your success have changed dramatically from what they were in the ‘70s. Now, notwithstanding that, from the date I went into the profession in July of ’76, through ’96, even through today: marketing has always been important. You had an obligation as an employer—as a partner—to sell your services. And so—and I was always very successful at that, and ended up—we had a bonus pool that got paid to probably one out of every five partners, and that tended to be the ones that were successful on the marketing, not the auditing side; but you could be a successful marketer, and still do a very good audit job.

GP: That’s a good point; that one is not always at the exclusion of the other.

LT: I think you could be highly successful at both, if you’re a very good communicator, and a very good manager. And I’m not sure that the firms always develop the right people; sometimes politics played a bigger role in who got promoted than what it should have. But there was no question that, by towards the end of the ‘90s, these firms were no longer professional firms, they were businesses. And you talk about the two little people standing on your shoulder—I think it was more succinct; I think it was, quite frankly, greed on one side. You had people that we dealt with that, quite frankly, absolutely saw no obligation to investors.

And that wasn’t their client; and that isn’t why they were there, notwithstanding the fact that that was the franchise. And they ignored investors, because they thought that their
objective was making as much money as possible as a business; and to do that selling services as broad as they could. And in fact, when the AICPA, in 1999, came out with the publication leveraging an audit to become more profitable and sell more business; that publication, more than anything, probably told it all: that, at that point in time, the profession had lost its heart and its soul.

GP: Those are elements and environment that clearly kind of foretell what happened following some of the severe market adjustments; and we’re not just talking about Enron/WorldCom; but we’re talking about the entire shift in investor attitude toward the capital markets, and the options that investors seem to have taken in the post-2000 period; the capital market—it’s not clear it is the principal choice of a lot of investors any longer; and that’s one of the issues.

LT: Even before 9/11 hit—the market had dropped substantially; and we actually had seen, in 2001, net cash outflows out of the market, which we hadn’t seen for decades. And you saw—you were actually seeing a net cash outflow. There was a sizable net cash outflow out of the market; I believe it was in August 2001. So by that point in time, investors were already very concerned about it; very concerned about the risk premiums they were having to pay to acquire stocks; and rightfully so.

By the time you got to that point in time, we’d seen several significant blow-ups—Cendent, and Oxford Health Care, Waste Management, Microstrategy—so even before we ever got to the Enron, the warning signs were already out there; and in fact, some of the hedge funds, such as HighFields and the Jim Chanos fund had warned as early as towards the end of 2000 that there were serious problems afoot at Enron.

GP: Well, so the challenges are—you know—we now have that twenty/twenty hindsight working for us; but in the flush of all of this market enthusiasm and all these competing and changing dynamics; you’ve also got to relate to a number of very complex constituencies—and I’m thinking from the accounting side, about the standard-setting process in the private sector with the financial accounting standards board—as well as deciding how you’re going to employ your own ability to set rules, or to provide policy guidance; through either releases, or through staff accounting bulletins.

And there are three staff accounting bulletins that come out during your term of office that deal with important issues relating to materiality and so on, and earnings; and the recognition of revenue. Those seem to me to be pretty important legacies. They’re still looked upon as focusing on qualitative, and not just quantitative, measures, and so forth. Was there a particular precipitation for ‘99 staff accounting bulletin—’99, and so forth—what’s the genesis of that thinking? Is this part of your approach to dealing with the issues that you’d identified?

LT: When we did the matrix of what the various issues, or problems, were with respect to governance and quality of financial reporting, and getting down into numbers; revenue
recognition was one, just because we’d seen such a—you know, that’s where most of the restatements and problems were; so that was fairly easy to recognize.

The restructuring charges had been in the press, and been a problem for many years, going back to the early ‘90s. One of the problem companies early on had been some charges that had taken at companies like Xerox that would come back around and nip them in the bud; and some of the big telecoms; and I’d actually seen some of the problems with that amongst the big telecoms when I was at Coopers, because we audited some of those, and saw some of the fierce fights in the firm about whether or not we would, or would not, accept what they were doing—that were, quite frankly, unfortunate decisions by the firm about where we ended up on.

But so, really—we went through all these issues, and sat down and decided how we’d deal with them. Jane Adams and I made several trips up to the financial accounting standards board where we met with FASB chairman and vice-chairman, as we laid out this matrix; and decided who would take on each of the major issues, and how we would approach them.

GP: Okay. So this is involving the board, you and your staff, and also involving the EITF?

LT: We had a meeting with a number of…

GP: That’s the Emerging Issues Task Force.

LT: We had some meetings with a number of the representatives from the Emerging Issues Task Force. One of the partners on it, who I knew very well, and actually had worked for when I was in the national office at Coopers, in the ‘80s—Ray Dever was on it; and Ray helped pull together a number of people. Ray was very helpful; Bob Herz, who was running the national office of PwC at the time, was very instrumental; he was also chair of the SEC Regs committee at the time; and quite frankly, when Levitt first asked me about the Chief Accountant job, the very first call I made was to Bob Herz, asking him whether or not I thought I should take this job.

We met with all these people, and started picking them off as to how we’d deal with them. Research and development, which actually—one of the first major charges had come through when I was a PAF, and I left before I was able to finish off that issue; and had decided when I went back we’d finish that issue off once and for all. Bob Herz was willing to take that on, and put some guidance out from the SEC and the Regs committee, and a practice publication; so that took care of that one. On restructurings, which had been problematic—the basic accounting had to be fixed; so we asked Ed Jenkins if he would do that, and he agreed to do that, in what would ultimately become Statement 143, I believe.
We decided that, in the intervening time period, we would deal with it by tightening up some of the disclosure, and formalizing some of the disclosure things that the staff had already been pushing for—that became SAB 100. And I also knew, from a practical perspective, how people were playing the games with that from the business side; and this is one big advantage of having been a CFO—I knew what I could do in SAB 101 to go put that problem to bed; so we did that, and put forward some of the guidance—for example, if you go back and look at SAB 100, it says that whatever plan you’re taking to the board is the plan that you’d better be using in accounting for your restructuring; and I knew that that would eliminate some of the problems.

So that’s how we dealt with the restructuring issue. On revenue recognition: I was fortunate to have a person—a former partner of mine at PriceWaterhouseCoopers—by the name of Jim Gurson, who was then chairman of the auditing standards board; and went to him and Sue Coffey, who was vice-president of the AICPA, and very helpful; and they agreed to put out a practice alert, and some guidance on the auditing side—which they ultimately would issue an audit guide especially for the high tech industry. But we decided we had to deal with some of the basic fundamental accounting issues, where we knew there were abuses; and we dealt with that through the QNA and SAB 101. We had actually discussed that with Jenkins as well, and—decision made that was probably best dealt with in a SAB at the time.

SAB 99 on materiality really is two questions; and a good piece of that work had already been done for us before I ever went to the Commission, in that back in ’96 the Chief Accountant down in the Division of Corporation Finance had done a good speech raising questions about accountants and accounting firms playing games with materiality; and as a result of that speech at the annual SEC conference at the American Institute of CPAs, the big four firms put together a task force led by the former chairman of the auditing standards board, Dave Lansfell…

GP: Sure.

LT: And they developed a white paper that further defined how to establish materiality. That white paper had been completed about the time, or just after I came to the Commission; and laid out really good guidance on how to assess materiality. That white paper really became the basis for the first question about how should you judge materiality in SAB 99, and some of the key points were the same. So we really got a lot of help. The second piece in SAB 99, which is the question about if you’re intentionally cooking the books as of materiality—that came from Ed Jenkins.

In one of the meetings with Ed, he asked me if I was going to write something on materiality; and he agreed it’d probably be best done in a SAB. He turned around and said, “if you do that SAB, Lynn, would you put a question and answer in about whether or not people can intentionally cook the books and avoid the rules, and hide under materiality.” And of course, I agreed to turn around and do it. One of the reasons I did
was because within weeks after I’d gotten to the Commission, we had a very large, extremely well-known public company, which makes hamburgers, that had booked an inappropriate adjustment that was 4.99 percent of net income.

And when I challenged the CFO on it—even the national office of his accounting firm had said we can’t do anything about it because it’s only 4.99. And of course, they hadn’t disclosed that to their investors at all, and clearly were hiding behind that to make numbers. That, coupled with Ed’s request made it clear; we had to address this issue, because what was going on was really shortchanging investors, hiding things in the most inappropriate fashion from them, and the national offices were aware of it, and weren’t stepping in and saying no. And so, SAB 99 became the answer that said no more to that type of behavior.

GP: Clear shot across the bow, I guess. The issue of bank reserves—do you get into that early in your term?

LT: That actually gets started before…

GP: You get there.

LT: …ever get there. In fact, that had actually got started under my predecessor, Mike Sutton. In 1997, the SEC staff—probably about October in ’97—had been contacted by the Canadian banking regulators, and the Canadian banking regulators had complained that the U.S. banks were booking excess reserves, and using them as cookie jars, and came in and said that if you’re going to let the U.S. banks do that, then one, you put us in very bad position as Canadian banking regulator, but more importantly, you ought to let our banks do it as well.

GP: It’s kind of a code word in a lot of Levitt’s speeches to talk about cookie jar reserves. And for the benefit of those who may at one point be listening to this conversation: the opportunity to build up reserves in a good year, and avoid taking too high a profit, and maybe managing earnings; and then in a bad year, drawing those reserves down to shield maybe some unfortunate results, and make things nice and smooth—is what a cookie jar reserve, at least, is designed to do; as fundamentally as we understand it.

LT: If you think about a kind of a roller-coaster type road, you know; earnings, realistically, are never smooth and trendy; and so it’s taking off those excess earnings in the good years, and using them to fill in the valleys in the bad years. And unfortunately, that’s not the real economics, and don’t portray the real value of the company to investors; and investors are certainly misled. And obviously, we did a number of enforcement actions related to that.

GP: Well we’ve still got a technical item or two to talk about. There are some other big issues, including independent scope of service and international standards, which are before us
as we continue our conversation. But what about financial instruments? And particularly, the issues that involve securitizing of various types of financial instruments? Was that a big item on your watch?

LT: The FASB had just issued Standard number 125 shortly before—I think, as I was coming into the Commission, or thereabouts; and almost immediately it had turned out to be a disaster. They put out one Q&A, and then I think a second Q&A. It was clear that it was problematic—securitizations, in general, were clearly problematic. And so the FASB undertook to do a second standard on that, which would ultimately turn into Statement 140. And the board struggled with that; and in fact, I remember—must have been about Thanksgiving of ’99, that in fact, we got a call from one of the national offices of one of the big firms—I think it was probably Andersen—who said that they had just heard the FASB was going to issue the Standard that week, and it still had some major holes in it.

So we called up Ed that week and said he should not put the Standard out, and asked that he meet with the Big Five again before the Standard ever got issued, which Ed was very good about it; and graciously agreed to do that. Unfortunately, what we found was the Big Five firms knew there was some major problems in the Standard, but had not discussed those in their comment letters to the FASB. And they’d been unwilling to publicly make some statements because of concerns that some of their clients may not like the positions that they were taking; so they left them out of their comment letters, so the FASB wasn’t aware of it.

Ultimately, what would happen would be there would be a private meeting amongst certain board members of the FASB, and the Big Five accounting firms, where they would express their concerns. The FASB would eventually go back and substantially revise that final standard and issue what would become Statement 140, albeit probably still not getting the job done.

GP: Other technical items? I mean you mentioned in process R&D; and certainly, in your writings in office, you spend a fair amount of time articulating the issues—the inconsistencies you discovered; the large percent of acquisition cost that was given this—and the inconsistency, as you pointed out before, between what the board would do to make a merger work; and yet, all of a sudden, their valuation model seemed to change once that point has been reached.

LT: I remember one company in particular—I think there were fifty, sixty companies that had to restate for that. And I remember coming in and requesting one of the companies early on to give us a copy of a board package that they had presented the board. And I think they were telling the board they had expense, like, half a million—that there was really half a million in value; and then when you got down to what ended up in the financial statements, there was about ten million in expensing.
On another one, I remember—and this would be a company that would later on be the subject of two enforcement actions—but this particular company; their CFO had come in and proposed to take a great big write-off for in process R&D; and again, we asked for the package that got sent to the board. And when we looked at it, we found a slide in the middle of it that noted that the product had been out on the marketplace for some period of time; and in fact, got eight awards as product of the year; and so hardly something that was in process. And yet, even in that case, the national office of the firm, once again, defended what they were doing—not withstanding what had been given to the board, and like I said, AOL will later on be subject to two enforcement actions.

GP: International accounting had to be a big-ticket item for you. It really begins to heat up when the thought about putting in place—I won’t call it officially criteria, but the philosophy, or the concepts, of what will make international standards acceptable for filings with the Commission, in lieu of the reconciliations, and so on. There’s got to be economic—call it political, if you will—pressure from agencies and the exchanges for that business.

In other words, to have the Commission say accept those international standards. At the same time, you’ve got domestic preparers who are going to say, wait a minute; if it isn’t equally as rigorous and as fair, it isn’t a level playing field. What was the state of the argument when you walked into having to manage this type of an issue? Obviously; IOSCO—the International Organization of Security Commissions—has got a role to play; but I know that there have been episodes where everyone in IOSCO has voted in favor of something; but David Ruder raised his hand and said, in 1987, no, we’re not going there. So, without the U.S., IOSCO really doesn’t have the heft it needs to do things.

LT: Well you have to step back and keep in mind that the U.S. really is the worldwide security markets. When you look at even some of the bigger ones, like for example, London—once you get by what’s known as the FTSE 100—their equivalent of our Dow 500, S&P 500—once you get past a hundred companies over there, it’s really a debt market. And in fact, most of Europe is a debt market; and their laws are written to protect debtors, and not to protect investors. And so the flow and the ability to attract capital over there is not that great, and in fact, that’s why they have such small markets. They lack transparency, lack protection for investors; and certainly, I’d seen that with the Asian markets and what transpired at Hyundai; and had a very good flavor for how some of those markets worked, as well.

So when you say there’s pressure—I had the good fortune of working underneath David Ruder for a short period of time; and certainly, Chairman Ruder was fantastic with the international accounting issues. And in fact, as I rolled into the Commission; former Chairman Ruder was a key player on an international committee that was coming out with a proposal on how to redo the international accounting—what was then the international accounting standards committee, or IASC. It was generally acknowledged
that that was a weak organization comprised of political appointees; and certainly not one that could generate—nor had it generate—the best financial standards; it needed to be redone. Another key player here was Linda Quinn from down in the Division of Corporation Finance. She was probably one of the most prominent directors of Division of Corporation Finance ever.

Linda did a lot of international work. And on several occasions, I asked her to come spend some time with me at the Commission, and give me her views, since she did so much work in this area. She was probably the number one person I could seek their views on—along with David Ruder—in this area. And you know, David and Linda just kept saying, “Lynn, the key guiding point here is you have to have enough good information in the markets to make them work. And either you do, or you don’t.”

So while the New York Stock Exchange and NASDAQ would go up on the Hill, with their checkbooks, quite frankly, and ask Congressional people to beat up on us just so that they could get greater listings and greater fees—one might view that as a lot of pressure, but on the other hand, not really. I mean you’d have to figure out how to deal with it strategically; but from the perspective of any Chief Accountant, it’s a fairly simple decision - are you going to be able to get the necessary information for the capital markets to work or not?

And if you decide not, then you’re also willing to allow innocent people on the street to be taken advantage of and lose money. And when you put it in that perspective; it’s a very simple question. The politics get taken out of it, and you got to get back to deciding whether you’re going to be a principle-based person or not. So, I don’t think it was actually that tough. What we had to do, and what took effort, and what took time was to decide how to get from where we were when I came into the Commission, to where we had a good end product—keeping in mind that at that point in time—and still to this day—the international companies—the foreign-domiciled companies that list in the U.S. make up about 10 percent of the market.

So it’s important that those companies have good disclosures. So we laid out a framework for what we thought it would take to make it work. And while up to that point in time, everyone had been focusing on these international accounting standards. I knew from my experience with the Asian companies that you could have the best standards in the world, you could have standards much better than we write in the U.S., but if no one enforced them, no one would follow them, and the reality was you had no standard.

So we started to develop—quite frankly, as soon as I got to the Commission—a framework that would, in essence, say not only did you have to have good standards, but you would have to have good gatekeepers, good auditors, and you would have to have good governance, and a good structure for insuring that process would take place. And we reached out and started working immediately with Jim Wolfenson, who was president of the World Bank; Stanley Fisher, who was deputy at the IMF; and all of his staff,
including a wonderful comptroller they had at the time—Jules Mews, who’d been a former partner at E&Y in Europe.

We reached out to the White House, and met with Commerce and Treasury, and Greenspan; and Gene Sperling, who was chair of the Economic Council for the President, at the time, and really started building a coalition around this notion of you really got to have quality to make the capital markets work. And once we did that; it really did help us deal with the issue of where you go with this whole project.

GP: I mean it is a very interesting contrast when you talk about—for the most part, the capital markets are debt markets in other cultures; it’s a very fragile development toward equity ownership. And then you also had the Asian crisis in ’97, which would reveal some of the weaknesses in the way in which audits were being done—even by the largest firms, in other parts of the world. And the World Bank’s response to that is essentially to approach the firms, and ask them to begin to create—to reach out and begin to establish the kind of the infrastructure of global auditing standards; although it’s going to fall short with regard to enforcement, it would have proper application.

LT: Actually you won’t get proper application worldwide until you get enforcement. And in Asia—when the Asian crisis hit in ’97, ’98, the laws were such that, in Asia, there was no one that could enforce. In fact, there were specific laws on the books, for example, that prohibited security regulators from taking certain enforcement actions. You couldn’t, for example, take an action against one of the major accounting firms. And in Europe, organizations such as the Financial Services Authority—they’re equivalent of our SEC and banking regulators put together—had no ability to take enforcement action.

And in fact, at that point in time, they didn’t even have the ability to pick up and review a filing, and issue comments on it. The French Bourse cop—the securities regulator in France—had no power to take enforcement action; nor did the Canadian—the Ontario Securities Commission.

So when you went around the globe, the only party that had power to enforce the standards was the SEC; and it showed up when—probably the most prominent case——was when one of the largest pharmaceutical companies out of Switzerland came in, and the auditors had called us in advance and said that they had failed to follow the international accounting standard rules on special purpose entities, or SPEs. And they had many more off balance sheet than Enron, and the auditors told us they did; but the company refused to follow the standard, and the firm had given clean opinions on that basis in the past. And so, the firm refused to tell the company no, and so we had to go in and tell them no.

So you knew you had no enforcement there. One of the largest banks in Europe—if not the largest bank in Europe, at the time—had also had problems with their financial reporting. They came in and met with Chairman Levitt and me on a couple of occasions,
and asked us to waive the rules. They’d listed on the Frankfurt Exchange just the year before, and had acknowledged that they had not followed the international standards appropriately—their CFO actually acknowledged that to us. And yet, they asked us if we’d allow them to come in and list in the U.S. with the improper accounting in the past—that they would fix it in the future, going forward; but investors would be buying on bad info.

And of course, we declined to do that; and as a result, they had to change their accounting; albeit to the best of my knowledge, those financial statements used on the Frankfurt Exchange were never fixed.

GP: So you get involved—even though, you know—sometimes when people see—gee, there’s really a bunch of Chief Accountants at the Commission; there’s the Chief Accountant in the Enforcement division; there’s a Chief Accountant in Corporation Finance and then there’s the Office of the Chief Accountant. Yet when it comes to setting policy, there is only one Chief Accountant.

LT: That’s correct.

GP: And to some extent, that doesn’t mean that you’re not in very close consultation with the others; but when it comes to calling the shot, it’s coming in your direction.

LT: Ultimately you have an obligation to make the right call. And there’s probably some calls that I—in fact, I know there are some calls that I made that if I had to do over again, I’d make differently. But it’s your obligation to get them right ultimately, at the end of the day; and if you disagree with Enforcement, or disagree with Corp Fin—which we did from time to time—you needed to put your foot down and make that decision—hopefully make the right one.

GP: Do you feel that international standards are—I mean is there any drumbeat, pulse—I mean the sovereignty issue is so significant in Europe—let alone other parts of the world. China is such an emerging powerhouse, and yet it’s such an enigma, in terms of its ability to do these acts in a mature way—in terms of whether they have the people trained in accounting, for example.

Whether, in fact, U.S. accounting education is adequately preparing individuals to be able to relate to international standards. It just seems like every time we get excited about perhaps seeing closure under national standards, it evades us a little bit. I’m not trying to be judgmental; I’m simply saying: How do you approach that from the point of view of a policy maker—to not feel that maybe you’re just pursuing Don Quixote-style windmill tilting, by being involved in international standard setting; when what really matters is that the SEC makes the right call, you know. But if you don’t support international standards, maybe it never gets done.
LT: Well it’s not a matter of whether you support international standards. And if you go back and look at our statements, it wasn’t that we did or didn’t support international standards; it was a question of whether or not whatever the standards were, and whoever they were issued by—gave the markets the information they needed such that you could make timely and informed decisions, so that capital got allocated to the companies that could use it the best. For example, one of the real travesties in the U.S. markets is you had nine hundred to a thousand dot coms that entered the public market, and took a tremendous amount of capital out of that, that might have been put to better use by other companies.

In fact, I remember a dinner that Arthur and I had with two of the top people in the Business Round Table, or BRT, in which they very much so expressed a concern to us that capital was being misallocated from companies where it would be lost and not put to good use; and that capital would be taken away from companies who could give a better return to investors. And certainly, that turned out to be true. Now even as we’re meeting with the leadership at the Business Round Table on that, we’re also meeting with members of Congress, who said we don’t care in essence, because you guys just don’t get it. These internet companies are all the new economy, and that’s where it’s going to be.

GP: The new economy—the information economy is a powerful club.

LT: And the real club was the big checks that they would leave up on Capitol Hill. As history would ultimately prove out; the dot coms would contribute to the bubble; there would be bad allocation of capital based on some less than desirable financial reporting. And quite frankly, tens of millions of American investors paid a very severe price for that when the markets, overall, declined by some nine trillion dollars at the bottom of the market.

GP: Well those macro environmental results take time to heal. I’m speaking historically now, in the sense of 1837, 1857, 1873, 1893, the Knickerbocker Trust in 1907—as you look at these, it takes time. But there appears to be in place now many more agencies and individuals capable of stepping in and providing remedies, and rebuilding trust. And of course, the agency that you’re involved with at this point in time, may be prescient—they may be able to see this happening.

But what is it that has been often attributed to some of the leaders saying—after the Securities Acts were passed in the 1930s—do you think there will be another Great Depression? And someone said you can’t outlaw human folly. The world of the Commission is, in part, to help make human folly a little less folly. Do you have any sense of frustration when you encounter these on a continuing basis—that maybe, you know—particularly if you’re short on staff; if you see turnover—how do you live with those limitations? Because I think they are limitations; there’s only so much that you can do.

LT: The day that I walked in the Commission, the Chief Accountant’s office had a grand total of about twenty people in it, and down in the Division of Corporation Finance, they had
about eighty-five accountants to review about a hundred thousand filings a year. So, there was no question that you had limitations. In any corporate setting though, you only have so much budgeted money, and so you have your limitations; so you have to learn to decide to set the priorities, and take on what you can. On the other hand, you have to understand you have to take on as much as you can; and work whatever it takes to get that done.

So, in our particular case, we did as much as we could take on; there were probably some people at the Commission that would have preferred that we did less, but there was so much we just flat-out had to do. On the other hand, Chairman Levitt was wonderful, in that he gave us a number of additional slots; and I think I—by the time I left, we were up to about twenty-eight; which still is miniscule when you think that in the national office of these accounting firms at the time, there were more than three times that in any one of the firms.

So there’s no question we were shortchanged; but the talent of the people, and the dedication of the people in the Office of the Chief Accountant were phenomenal; and they worked for nickels and dimes. I remember one of my associate Chief Accountants coming into my office one day, and almost crying. This particular person had decided to leave and go to one of the Big Four firms; and he was apologetic—you know, the most I could pay him though was about eighty-five grand a year, plus maybe up to a ten, fifteen thousand dollar bonus. And he had had an offer for half a million dollars a year as a partner with one of the other firms.

And the guy had served the government well, and served the public great, for ten, twelve years, and that opportunity came along, and he just had to take it. I encouraged him to take it. You know, you’d be crazy not to. Yet at the same time, tremendous dedication—you felt bad about leaving. I think that was pretty much across the board, with a few exceptions—the way the staff were inside the Commission, and inside OCA. You couldn’t have asked for better people to work for.

GP: So that type of dedication—it’s almost a esprit de corps that you have that makes taking on what some people might, tongue-in-cheek, refer to Don Quixote-like—people aren’t going to step back; that dedication makes the difference; it holds the organization together.

LT: It really does. Like with any organization, you got your exceptions; but that organization is made up, and comprised of a phenomenal group of professionals who really do work on behalf of the American public and investors. And quite frankly, in the past, they were certainly underpaid for what they did; and that’s one of the reasons a lot of us worked very hard to get that corrected, as the Sarbanes-Oxley Act, or SOX, got passed, and appropriate funding got restored to the Commission.
GP: There are—I think earlier perhaps—maybe in our pre-taping; you mentioned Paul Colton, former American Stock Exchange executive, and someone who was an advisor to people in many different positions. He was involved in—and of course, Ed Jenkins was at the FASB when you began your term of service. There was a project called the Business Reporting Research Project that was going on during your term of office.

LT: Bob Herz and Ed Trott were also involved.

GP: Ed Trott’s involved in that. Does any particular element of that rise to a point of reflection as to what it was about? It was obviously about moving from the financial reporting to the business reporting model. That’s been a very difficult thing to get people to embrace, at least on the practice side.

LT: The problem with it is how the profession viewed it. And it was doomed from Day One. The AICPA sponsored it really; and what they did was, with the original—what became known as the Jenkins committee at the American Institute of CPAs—they put out a report, probably about ’93, ’94, that recommended that there be an expansion of reporting into factors other than the financial statements. But it was a report written out by, and for, the accounting and auditing firms.

And as a result, you were never going to see the business community endorse it; and you really never had the right people in the investor community involved, and buying into it. One of these days, the accounting profession will learn that they’ve got to embrace investors much more, and bring them into the greater scheme of things; and then they’ll have greater success rates. But after the Jenkins Report got issued, then there was this effort to put out some guidance on business reporting; but again, it was all voluntary.

And you know, history has told us—this is a great point about learning from history—and unfortunately, the profession does a terrible job of learning from history, but does a fantastic job of repeating it—and this is a prime example. So they came out with what I thought were some good disclosure proposals, but voluntary; and they told the business community from Day One, as they started this project, it’d be voluntary. And so quite frankly, the business community totally ignored it; and has done absolutely nothing with it.

At the same time, we formed a separate committee—or actually, we didn’t form it; we got Jeff Garten, who’s the Dean of the Business School at Yale, to form a committee to take a look at this as well, because I, personally, think expansion into reporting the things such as key performance indicators, is absolutely very important, and should be mandatory within our financial reporting model. Whether you have it audited or not is another issue.

GP: So the concept is appealing to you.
LT: Oh, the concept is not just appealing; the concept, to me, is a must. I mean we’ve got to get there; and part of that is driven by my experience in the past within the business community, and as a CFO. I know just how key and critical some of those items are; and even where I participate on a corporate board—we have started expanding our reporting in that area, as well. And we formed the Garten Committee to delve into that even more so. Unfortunately, the Garten Committee wasn’t able to get its work done timely; they had some very well-known people on it, but they got sidetracked into a debate about such issues of reporting on stock options—God only knows why—but they did have a couple key people from the tech community that Jeff picked that—I think he probably picked the wrong people for the committee—and so it never really got to where it should have been.

But certainly, the business reporting model was one of the things that we discussed while we were there. Interestingly enough, Paul Colton was also one of the members of what would become a major impact—not only while I was there, but afterwards—and that was the O’Malley Panel. Paul’s served with people such as Lou Lowenstein; Shaun O’Malley; Bevis Longstreth, the former Commissioner—Shaun, of course, had run PwC; and you had Zolvana—well-known academic—Zolvana; Pomrose; and some other people on that committee.

GP: You had Dave Pierson as chief of staff, I believe.

LT: They came out with some recommendations on how to redo, or improve, the regulatory structure of the accounting profession; and we came very, very close to getting the firms to buy into it. In fact, we’d gotten down to all but one firm; and when we couldn’t get that—we actually had the CEO call us up and tell us he was on board when we were there, and then shortly thereafter withdraw; or we would have been able to put those recommendations in place—and interesting enough; because the firms refused to do it; although PwC and Ernst & Young were very much in favor of supporting it.

But when we couldn’t get them all there, that would ultimately lead directly to the establishment of what’s now known as the Public Companies Accounting Oversight Board, because the profession wasn’t willing to adopt what were, quite frankly, some very good recommendations of the O’Malley Panel.

GP: Another example of the limits of self-regulation, in terms of getting agreement in a competitive environment, I guess. You detailed that little episode in some e-mail recently, and I think it’s very timely. It does lead in some ways up to the discussion of the biggest of the big ‘I’s—I remember Ed Colson once saying that the two ‘I’s he has to keep his eyes on were international and independence—and the ‘I’ of independence, which some people interchangeably discuss as scope of services; along with the consulting services issues; and all of these proprieties that lead back to the Kirk Panel, and then to the O’Malley Panel, are kind of a big-ticket item for any chief accountant.
And probably one of the biggest attempts that you made to bring about—shall I call it “reform”—during your term of office. What—do you walk into the office and have this one handed to you? Or is it just kind of an automatic—there were some things going on about independence in one of the large firms in Florida, that I think was kind of there when you arrived, if I remember correctly.

LT: It actually blows up about the time I arrive. Of course you’re talking about the matter that would lead to an enforcement action against the firm of PricewaterhouseCoopers. From my prospective, independence has always been a very key, important part of the profession. And there were some people in the profession who did better job than others. As you mentioned, there had been the Kirk Panel, back around ’93, ’94, which had Don Kirk, George Anderson…

GP: Ralph Saul.

LT: And Ralph Saul, who had chaired the committee; and looked into allegations by the then chief accountant, Walter Schuetze, that had been made during one of the annual SEC/AICPA conferences, which I actually attended.

GP: The cheerleading episode.

LT: Yeah. And there was no question in my mind that Walter Schuetze was absolutely right. I’d delved in the national office and seen enough of it that there was no question; and unfortunately, that panel, rather than endorsing what Walter had said, actually took shots at Walter in their report. It was very unfortunate; and I think it was driven, probably, by the fact that Walter had made a company restate where one of those gentlemen was chair of the audit committee. And it became a tit-for-tat; in fact, the SEC, at the time, wanted different people on that panel, because there was a direct conflict with one of those people on that panel, before it had ever gotten started.

And unfortunately, it led to what I considered to be—and what I think a lot of the people at the Commission considered to be—a whitewash report. That would also have an impact on us as we set up the O’Malley Panel. We were much more careful, and had a lot more discussions with the then chairman of the Public Oversight Board, the POB, Al Sommer, who was the consummate gentleman, and much more careful about how that panel got overseen and how it got established, so as to avoid that type of whitewash; which is what led to some of the members that were on it…

GP: So, in large respect then, there’s a lost opportunity with the Kirk Panel, and a new opportunity with the O’Malley Panel. What gives the community the energy to establish the O’Malley Panel?

LT: Again, it was part of the plan to deal with the larger issue of financial reporting and the gatekeeper part of that. And a couple years earlier, the then Chief Accountant, Michael
Sutton, had written a letter to the profession, expressing concerns about how they were going about doing their audits. I had been both a partner, and then a recipient of one of those audits; and I, personally, didn’t think that in many of the situations we’re seeing the quality audits done; so based upon that, and the gatekeeper having such an important role in the public markets—because of course, the SEC doesn’t audit those numbers.

The SEC only uses the data that they’re provided. If they’re provided wrong data; and the gatekeepers have turned their eye when they’ve seen wrong data, then the system doesn’t work. And certainly, had had enough experiences with that not working by that point in time—again, Cendant, Oxford Health Care, Waste Management, had occurred; and then all of a sudden in the July, August timeframe of ’98—within a very short period of time of when I get to the Commission—I learned that in the Tampa office of PwC there’s been an allegation of major problems with independence and other matters.

And before I ever went to the Commission, I went and visited with the CEOs of each of the major accounting firms—each of the five major firms; and I met with them even before I went to the Commission; and I told them all if we ever had a problem, I’d give them a call directly. So of course, I called PwC’s CEO up, and said, hey, let’s have a chat. And obviously, as we got into it and looked at it, it became problematic; and then we asked the firm to look wider, and more problems popped up; and then we asked for an outside independent investigation. At that point in time, we found many, many problems—much broader problems—a lot that never became public. And the report came out from former U.S. attorney Jesse Fardella.

GP: The Fardella Report is how it’s referred to—I think—by people at the Commission. It’s less well-known, I think, outside the Commission by that name.

LT: Right.

GP: But it is the tipping point in that event.

LT: And at that point in time, we had gone and met with the Public Oversight Board, and met with their members in December of ’99 in Washington, D.C., and advised them that that report would be coming out. And the then members of the POB, including Mel Laird, former Defense Secretary; Chuck Bowsher, who was chairing it by that point in time, the former head of the GAO; others—were appalled by it. And as a result, they decided themselves—they actually voted to go ahead and start their own investigation of the firms; an investigation that would lead, in April of 2000, to—in essence—a Saturday night massacre, if you will; when the AICPA cut off their funding to prevent the investigation.

At the same time this is going on; and of course, Pricewaterhouse is having their problems; and in fact, as the Fardella Report comes out, a number of very prominent companies are looking at actually dropping PwC. And Chairman Levitt and I talked to a
number of those companies, in fact, about that issue. Some did, some didn’t. We didn’t think it was necessarily in the best interest of the profession if a bunch of them walked away from PwC; we certainly saw what happened with that in the Andersen case.

But at the same time the POB was looking at it, we saw the problems with PwC, and their independence problems; we had actually had some issues with a couple of the other accounting firms as well, but didn’t get to the prominence of the PwC matter. We also felt—you know, the rules really hadn’t been redone for decades...

GP: ‘70s.

LT: And there was another thing that was driving the independence issue; in August of ’98, KPMG and its CEO Steve Butler had come to us and had indicated to us that he wanted to sell an interest in his consulting firm; and asked if we’d work with him on a structure, which we were more than happy to do so. Unfortunately, they wanted to keep control of that structure, and still view it as independent; and we objected to that. And PwC found out that we were working on that issue with KPMG and called up Chairman Levitt and requested that it be put to the entire ISB, where both the CEO of PwC and the CEO of KPMG sat on it.

GP: Now, ISB is the Independent Standards Board, which is an agency which we may have to kind of trot back and bring into this; because in this period of what some people would call deregulation, there was an attempt to create—in the—maybe the image of the FASB—an independent entity. In October of ’97, I think, was their first meeting. And Bill Allen, the former chief judge of the Chancery Court in Delaware was the chairman; and it was composed of a broad array of—was it twelve members—fifteen?

LT: No. No, it actually wasn’t that broad. It was chaired by Chancellor Allen; it had three of the CEOs of the big four firms; and Steve Butler from KPMG; Phil Laskoway from E&Y; and Jim Sherrill from PwC on it.

GP: And Barry Melancon.

LT: Barry Melancon was on it.

GP: The other side though.

LT: Of the AICPA. And the other side had on it: Bob Denham, who had—and actually still remains an attorney and councilor to Warren Buffett, and had been the CEO at Solomon, Smith, Barney; Jack Bogle…

GP: Vanguard.

LT: Well-known founder of Vanguard; and Manny…
GP: Johnson.

LT: Johnson, who had been the vice-chairman of the Federal Reserve, and was chairman of the Trustees of the Financial Accounting Foundation, or FASB, at the time; and the organization at the ISB was hammered out in the ’96 and ’97 timeframe. It was an absolutely brutal negotiation between the SEC and the accounting profession—very contentious—was a very difficult time for Mike Sutton, in that it was such a terrible, tough negotiation.

And unfortunately, the way it got negotiated out probably doomed it from the very beginning, because it was a four/four vote, if you will—although none of the votes turned out four/four. The other problem was that, unlike the FASB, where when they pass a new standard it goes into effect automatically, the SEC doesn’t approve or disapprove; when the Independent Standards Board was set up, any standard that they passed then had to go through, and be subject to approval of the SEC.

So ultimately, the SEC would agree or not agree. And I once asked one of the key people involved with the establishment of it why it was set up the way it was; and both people from the Commission, profession, confirm this; and that was: each side thought that with the four/four vote they could block the other side from doing anything.

GP: So it was designed to, perhaps—to stalemate. Art Siegel was essentially the executive director; I’m not sure if that’s the proper term.

LT: Right.

GP: But he carried a lot of the responsibility. They had a research function. It was—at least on the face of it, an attempt to bring the issue of enforcement, and perhaps the definition of independence into an operational framework that would be independent of not only—

LT: Independent of the influence of other forces in government.

GP: Were in the Institute.

LT: Were in the offices of the AICPA; and it probably didn’t help that, at the very first meeting, there was a white paper presented that had been drafted by the accounting firms, with the help of Harvey Pitt; and the profession demanded that that be put out for exposure as the conceptual framework. It so infuriated the SEC that Chairman Levitt boycotted the meeting.

GP: Well he was there. I was at the meeting. He was there.
LT: He boycotted the next one though.

GP: He was there for—he was there for the very—he was in the Institute boardroom; and he was there for the first meeting, as was Mike. And the major presentation was the white paper done by the Yale faculty, under the auspices of the Institute and the firms; and it was—it was far from the center of…

LT: The Yale faculty had been basically hired guns for the profession though.

GP: That’s right.

LT: And it so infuriated the SEC that from the get-go, at the first meeting—this was well before I got there—there was just no support for it. And in fact, I remember getting a copy of the white paper before I ever talked to Levitt or the SEC, when I was still CFO at Symbios, Inc.; and I was appalled by the white paper. It was just appalling the way it was written, so it—you knew it just was never going to go anyplace.

GP: In the various forms of interpretation of independence and the long gestation of independence, and fact, and events, and appearance; it really was an attempt to abrogate that traditional line of thinking; replace it with entirely new markets-based approach to independence.

LT: It was not even a market-based approach. It was an approach—because, if you go to a market-based approach, you’d have disclosure of everything. It was a very evil, deceptive approach, in that what it called for was for the accounting firms themselves to decide, by themselves, as to whether or not they felt something would violate independence. It was the furthest thing one could imagine from protecting investors.

GP: I’m speaking as an academic—in the market-based. Let me explain it. But I don’t want to take away from your time to discuss your views on it. Bill Allen was attempting to find people who could conduct research to measure the value of independence in the marketplace—a very challenging assignment.

LT: And in fact, it never happened.

GP: It never happened.

LT: They had about a two million dollar budget; and every time academics came in and proposed research projects, they got rejected. Quite frankly, when the deal got negotiated, one of the things that you—if you will look at the financial reporting release where the SEC announces the initial establishment of the ISB, they note one of the reasons they’re willing to go along with it is the fact that it supposedly will do research.

GP: It’s FRR 50, right?
LT: I think that’s right.

GP: I think that’s right.

LT: And in fact, very little research gets done. There is one survey done by a Canadian group called Capital something—anyway—that is nothing more than a survey in which some people take one view, and some people take the other view, and is...

GP: Very difficult to isolate the value of independence in a share—a share of stock—you know, I mean other than maybe around a market event that might trigger a change in a pricing structure—I think it was—in that sense, looking for market evidence as to the value of independence—might have been an impossible proposal; and maybe it was just part of what was being used to change the dynamics of independence. So you’ve got that going on. But that isn’t—is that concluded—is the ISB wrapped up by the time you depart office?

LT: We put it out of its misery, and out of its business, intentionally, before I left.

GP: January 2001—was it that early? Or a little bit later?

LT: What transpired was—again, going back a little bit here in time; what happens is we asked the ISB to take on the big issue of consulting, and what firms ought to be able to do, or not be able to do, on consulting. And we have a phone call—Harvey Goldschmid and I have a phone call with former Chancellor Allen in November, December of ’98, saying that if he’s willing to take on this project and do it within a twelve-month timeframe, rather than the SEC doing it, we’ll give it to the ISB—which we do. And we say but we need an answer. And the reason we said we need an answer within a year is that Steve Butler, the CEO of KPMG, was waiting for an answer. And we were holding up his transaction.

GP: That was Pricewaterhouse.

LT: That was PricewaterhouseCoopers. Morgan Stanley had been shopping a proposal around to all the firms; and he was one of them. Ultimately, he would spin it off into what would become BearingPoint.

GP: That’s right.

LT: So—but he proposed something; at PwC’s request, we let the ISB debate it for a year. And then in December of ’99, Bob Denham, one of the ISB members, runs into Chairman Levitt at a hotel or airport someplace, and asked if he can come talk to us. He comes in with Manny Johnson, one of the other members; we had no idea what they were going to talk to us about. But when they meet with us—just before Christmas in ’99—they ask us
to take the project back, and go into rule making. Their argument was: it was such a contentious—major public policy issue, that they felt it was inappropriate for the ISB to do it, because they wouldn’t get the public input that they thought was necessary to deal with the issue.

GP: And then there’s a question of whether or not the vote would ever…

LT: Two of the firms had, by that point in time, recused themselves from the issue. So the vote at the ISB probably would have gone against the firms. And in fact, there had been a meeting—a key meeting—in November of ’99, of the ISB in New York, at which the four public ISB members—without any of those from the profession—met one-on-one with each of the firms and gave each of the firms one hour to present what they think should be done with consulting. And five of the firms—or four of the five firms—because I said in the meeting, four of the five firms expressed extremely strong viewpoints that the firms should once again be able to do whatever they wanted to do in consulting—is the plain English version.

One firm, led by Phil Laskaway, E&Y—urged the ISB to take action on the consulting issue. And he was the last one to go. But Phil urged that they do something. Now keep in mind, this is November of ’99. What transpires then is, shortly after that, at the Commission, we get the draft of the Fardella Report, which is just damning with respect to independence and PwC. We meet with the Public Oversight Board in December; let them know about the draft report; and they start to see it. They’re appalled. They decide to do their own investigation. The report comes out in January. It has very negative impact. And literally, PwC starts to lose clients. And they’re starting to lose major clients; they lose Compaq…

GP: This is where we were before…

LT: Yes. And then what transpires is that we have a meeting with all the members of the ISB and the chair of the POB—Public Oversight Board—in January, in Arthur’s office, at which they all turn around and in totality—the four public members of the ISB, and Chuck Bowsher, recommend unanimously that we take on the project and go do it. We have another meeting the first week of February, at which we meet with the same group in New York at the law offices of Ira Millstein, and we ask them again; and they again vote unanimously to do something, and tell us the preferred approach is to ban all consulting with a few minor exceptions; and that’s where they thought we should go with rule-making.

Within a week or two, PwC is in risk of losing a number of major clients. And whereas in November, in the meeting to the ISB, they were adamant that the ISB let them do whatever consulting they wanted to do; in the second week of February, they announced, and published a full page Wall Street Journal ad calling for regulation; and saying that they’re now ready to do whatever the right thing is; and they think that is to do something
with the consulting practice. About the same day they run that full page ad, they come in and meet with Chairman Levitt and myself, and then with the POB chairman in a separate meeting, and say they’re ready to sell their consulting practice; although they’ve got no real plan for how to do that. That would eventually lead to them trying to do a deal with HP towards the end of the year; that ultimately fails.

GP: Because the market’s changing. The market values of stock are changing, at that point in time. The HP shares, I think, are dropping a little bit. I’m not sure if that’s…

LT: It was really an issue—it was an issue with HP being able to complete their due diligence, because of some issues.

GP: Knowing how to price the service…

LT: But this is all in 2000. And interestingly enough, when you bring up the PwC matter—jumping ahead a little bit—that would have a major impact on how this story would all turn around and play out; in that Arthur charges me with going home in December of ’99, and coming back and doing a major public policy speech, which I did in January, out in California at the SEC Securities Law Institute—well-known conference, that we do on independence and regulation at the accounting profession. And we set in motion, with that speech, the notion we’re going to take a look at independence and we’re going to take a look at regulation of the accounting profession.

And then we start actually drafting new rules on independence, and we start working with the firms and the O’Malley Panel to try to come up with a regulatory scheme. When the firms become aware that something’s going to happen, they go off on the Hill, and get many members of the people up on the Hill to write a letter to Chairman Levitt—a several page letter with many, many questions challenging on this; and actually, if you look at it, and you look at the contribution records, all those people signing the letter got contributions that week from each of the accounting firms. It put that in play, but we had decided we were going to go forward one way or the other.

GP: And is this the principles-based independence—the thing that you write about—you know, there are four governing principles.

LT: Correct.

GP: Is this the program that’s involved at this point in time?

LT: Yes.

GP: And those are having mutual, or conflicting interests with another client; auditing one’s own work; functioning as a management or an employee of an audit client; and—and to me, this was a new one, maybe it wasn’t to anybody else—maybe us academics just
weren’t tuned in—acting as an advocate for an audit client. That was specified. And to me, that was new at that point in time.

LT: It actually wasn’t new. If you go back to some of the AICPA principles, advocacy is actually discussed in some of those.

But what really drove it was the result of the Kirk Panel Report. And there was no question in my mind that Walter Schuetze had been dead-on point that people were acting as advocates—as cheerleaders—for their audit clients.

GP: So advocacy, here, isn’t necessarily advocacy in the same sense as legal services advocacy—or is it?

LT: It is.

GP: It is.

LT: At the end of the day, you can slice the sausage which way you want to; but whether you’re acting as an advocate for them on a legal matter—because some of the firms had wanted to do that, and support them on their positions in court—or trying…

GP: Tax advisory services.

LT: Tax advisory services; or becoming a cheerleader on an accounting issue, where you knew it was wrong. And quite frankly, you know, I’d seen that many, many a times—including my own former firm—and knew that that just had to come to a conclusion.

GP: That, to me—I mean the exclusive use of the word advocacy in that proposal—and I’ve started history of scope of services a little bit, and even attempted to write a book on it once in 1984—it’s a turning point to me. I think it may not be to you as clear a turning point, because you were in the midst of it; but that word kind of signals that: Gee, the accounting profession is not socially determines—the social contract isn’t about you guys being advocates; it’s about you being something other than advocates. You’re the advocates of the public interest, not necessarily the advocates of the client’s interest.

LT: Absolutely. Unquestionably.

GP: That’s the turning point that I see here.

LT: And for me, what I’d seen coming out of the Kirk Panel Report, and what we’d seen—you know, keep in mind: we’ve talked about the situations where the audit firms were aware of data that showed the IP R&D was being booked wrong, or materiality was being booked wrong; and the national office would still come in and support that and argue it, even though there, in black and white, there were facts. There was no question that there
was a cancer here, eating at what was going on in the profession; that quite frankly, had to be taken out surgically, or otherwise.

GP: In medical terms: Do we know what it was in the diet, or what was it—you couldn’t necessarily argue it’s hereditary that this cancer came about, because previous generations had seemed to be more aware of some line in the scope of services.

LT: I’m not sure they had been. You know, we like to talk about the good old days when people didn’t have this problem. Certainly it wasn’t as big a problem prior to the decision of the Federal Trade Commission that opened up competition a lot more. So probably, as a regulatory matter, wasn’t as big an issue before then. But I think the number one driving factor was dollars—greed. The firms had become so competitive with one another, starting with the early ‘80s, and the willingness of firms to give whatever opinion on an accounting matter was required to pick up the client. That’s driven by dollars. Dollars have a phenomenal impact on people’s behavior. You know, we’ve seen academics who are willing to do research for whatever dollars, and the dollars influence them. Dollars influence people in Congress. The soft dollars that are in the capital markets are probably one of the most…

GP: Yeah. It’s a very difficult issue—mutual funds.

LT: …problems that we still have today. And the accounting firms were not immune from that. The impact that dollars would have on people and their earnings and their pocketbooks—it just influences people. And what more can you say about it? People—and it’s not now, but that’s been the case over the—you know, the couple hundred years of the capital markets—we’ve always problems with dollars influencing—Quite frankly, the parents were no different.

GP: At least—I wouldn’t call it mythology, but I would say the hoped-for interpretation of the past was that we were a little more noble than that, as a profession. And perhaps…

LT: I don’t know that we were though. When you think about—going back to—even the days of the Accounting Principles Board, and when you had these executives of the firm on the Accounting Principles Board; and the Accounting Principles Board having a meeting to decide how the accounting for business mergers should be decided, and there’s a positive vote, and then—you know—one of the major firms goes back home and gets a call from one of their companies that they audit, and they say: You got to change your vote, or—you know—that’ll be a problem. And the CEO of the firm changes.

GP: There’s a lack of, maybe, a critical perspective in some of that history. I think that’s probably—that’s probably true.

LT: Again, I’d like to think that the good old days people were better; but when you actually go back in history and look at actual decisions that were made, and decisions that were
made on accounting—specific accounting issues—you know, think about how the
decision was made on why we ended up with APB 16 and 17, versus one standard, or
some of these other things.

**GP:** You go back to income—to, you know, the income recognition rules back in the ‘40s,
as—you know—under Earl King’s Chief Accountantship—taking on all-inclusive versus
current operating...

**LT:** Right.

**GP:** Same kinds of issues. The difficult part about that is that it doesn’t offer us a lot to hope
for. If we don’t get it right now with the kind of legislative format that we’ve placed in
with the PCAOB—knowing human weakness; knowing the things that we can
acknowledge with a critical evaluation of the past—it suggests—it doesn’t augur well.
We’re not doing something right—maybe in our educational preparation, and other
things.

**LT:** I think we’ve got some serious shortcomings in academia, and the educational
curriculums. I think there needs to be major changes made there. We look at the medical
profession; we look at the legal profession—certainly they have some shortcomings too;
but I think there’s some things we need to look at there—but also, within the firms. The
firms are very much an inbred organization. There’s no outside forces, so it’s the politics
of internal who decide who their leadership will be; and as we’ve seen in recent cases
involving, you know, either Andersen or the TravelGate cases that have been in the *Wall
Street*—where they—you know—knowingly…

**GP:** They’re charging for services and for airfares, and so forth.

**LT:** You know—and even this morning, we see the lead article in *The Wall Street Journal*
about how KPMG is under indictment. It doesn’t say a whole lot about the leadership.
And I, personally, feel; and feel very strongly about this; that until we get some outside
independent governance, just like we’ve established for all public companies; the firms
themselves will not rectify their problem. I’m convinced that we have got to get
independent, outside board of directors established for each of these firms, or we will *not*
get the problem fixed.

**GP:** You could argue that—or at least develop the argument that Andersen attempted that for
a time.

**LT:** No, Andersen’s outside board was more of a cosmetic board that had very little power,
and got together but once a year to look over the annual reports, and…

**GP:** So it wasn’t really involved the way a board of directors today is supposed to become
involved.
LT: Had no ability to influence selection of leadership, transparency of reporting to the public, behavior or compensation—all those things that an external board has the ability to do at public companies. Andersen’s was more of a—let’s go find some well-known people, and a PR stint—quite frankly—than—Of course went away about the time Andersen started to actually go down a path that would lead to their destruction.

GP: The whole effort in the independence and scope of services area, you know, begins to gravitate to these principles. And the program expands from just one of the major firms to all of them, in a so-called loop-back program.

LT: It actually—what happens is—again, in December of ’99, and formally announced in January of 2000; the POB decides that they’re going to undertake to do this investigation. And in April of 2000, the senior partners of the major accounting firms—all of them, not just the Big Four, but others; who constitute the majority of what is then called the AICPA SEC Practice Section Executive Committee—vote for the first time ever to cut off the funding for the Public Oversight Board so that they couldn’t do that investigation. I think from what we had seen at the SEC, all the firms had the same problem; it wasn’t a PwC problem. And we certainly had started the investigation. We’d seen things like that on at KPMG. We’d seen some issues at Deloitte & Touche. So there’s no question all the firms had a similar type problem, and we needed to get to the heart of it, and get on with cleaning it up. And we got on the POB, rather than the SEC, should do that, in the notion of self-regulation. I very much preferred that the profession would take care of that themselves; and yet, the profession intentionally decided not to cut off the funding. And so then the SEC had to step in and negotiate with the firms to require them to do an investigation that would get us what we needed. Unfortunately, Chairman Levitt, and then I, left; and—before that could ever occur; and by the fall of 2001, as Enron is blowing up…

GP: That’s right. October 2001 is the critical period there.

LT: Yeah. One of the firms—E&Y—demands certain limitations on the POB’s inspection. That’s out there publicly, I think—in writing. And the POB, ultimately, is never able to get inside a single one of the firms. Which again, is one of the factors that leads to the POB taking exception with Harvey Pitt, and deciding to go out of business, and support the creation of a new regulatory organization with funding—no strings attached type funding—and the ability to do these type of independent investigations.

GP: Well I see our time is running out. Thank you for taking the time to talk to me today.