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Enhancing Financial Transparency: A Symposium Sponsored by the FDIC

The increasing controversy surrounding financial reporting and accounting transparency in recent months has underscored the importance of these issues to the efficient functioning of the financial markets. Current policy debates are probing the ways in which the financial reporting process, accounting standards and regulatory framework can or should be modified to better ensure financial transparency and protect and inform the investor. Top government officials and leading experts from Wall Street, the business sector, the accounting profession and academia gathered in Washington, DC on June 4, 2002 to discuss these issues in detail at the "Enhancing Financial Transparency" symposium sponsored by the Federal Deposit Insurance Corporation (FDIC). This Bank Trends *report summarizes the remarks of symposium participants, but does not necessarily express the views held by the FDIC.*

FDIC Director John Reich introduces a panel of accounting and financial professionals who offer a private sector perspective on the reporting infrastructure. Pictured (left to right) are Reich, Moderator Jack Murhpy, Dennis Bereford, Frank Marrs and Dennis Powell.

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Introduction

In the wake of Enron's collapse in December 2001, considerable controversy has emerged over corporate accounting practices and the quality of information provided in financial statements, audit opinions, credit ratings and analyst reports. The equity market volatility that has accompanied this controversy has highlighted the importance of transparency to the efficient functioning of the financial markets.

The Federal Deposit Insurance Corporation (FDIC) has a mission of maintaining the stability of and promoting public confidence in the nation's financial system. Dependable, high-quality financial information is of critical importance both to the FDIC and other regulators' ability to assess risk from off-site and to the market's power to complement regulatory oversight. In addition, banks need accurate disclosures on which to base their lending decisions. Thus, the FDIC's June 4, 2002 symposium "Enhancing Financial Transparency" provided a forum for leading experts from the private and public sectors to discuss the issues surrounding the US financial infrastructure and financial reporting system and to identify which features work well and which need reform. The conference offered perspectives on financial analysis, accounting standards, and regulatory policy.

Opening Address

John M. Reich, Director of the FDIC, began the program by setting forth the conference's agenda and highlighting the FDIC's interest in ensuring reliable financial reporting and maintaining public trust in financial markets and institutions. As the day's emcee, Mr. Reich then introduced the first speaker, the Honorable Jon S. Corzine.

U.S. Senator Jon S. Corzine (D-NJ) opened the conference by emphasizing the importance of financial transparency to the vitality of the US economy and outlining the day's themes. While lauded the depth, liquidity and efficiency of our capital markets, he acknowledged that the recent demise of Enron and Arthur Andersen have destabilized and devalued the markets, caused sizable investor losses, and eroded public trust in our financial reports and accounting statements. He underscored that the financial system depends on the provision of timely, accurate information not only to investors, but also to the creditors and employees who are integrally involved in the system itself.

In order to reestablish confidence in the financial markets, Corzine made it clear that he would like to see the nation address the fundamental problems that have undermined our accounting and reporting practices. In particular, he identified the deepening associations between auditors and their clients, and the resultant lack of auditor independence and objectivity, as an important weakness that must be remedied. Even the possibility of conflicts of interest in our current system poses a serious danger to American markets by suggesting that accounting fraud is easy and commonplace. Investors justifiably wish not to overvalue firms whose fundamentals are driven by aggressive, self-serving accounting. However, since the public is unable to distinguish the perception from the reality of improprieties, they may be led to overcompensate by undervaluing all public companies, many of which have not erred.

Thus, Senator Corzine believed that legislation reforming the accounting and auditing systems would be in the best interests of both businesses and investors. Corzine outlined his support for the bill that Senator Sarbanes, Chairman of the Senate Banking Committee, introduced to govern the accounting industry. Indeed, he indicated that many aspects of the Chairman's bill were drawn from a similar piece of legislation sponsored by Senators Corzine and Dodd earlier this year. Senator Sarbanes' bill prohibits accounting firms from providing clients with non-audit, consulting services when such relationships would threaten the auditors' impartiality (accounting firms could still offer actuarial and financial consulting services, but could not provide them concurrently with accounting services). Further, the legislation provides for a "cooling off" period when accounting executives leave to work for a company they have audited, and requires the SEC to hire more accounting staff to handle oversight and enforcement activities. Importantly, the bill also establishes a new independent regulatory agency with broad powers to discipline the audit industry and uphold professional standards. Although Senator Corzine recognized that political stalling tactics and intense special interest lobbying might preclude the passage of meaningful legislation, he was hopeful that the opponents of reform appreciate the dangers inherent in our present situation.

Session 1: The Analysts Speak

The first panel discussed the importance of financial statements, credit ratings and analyst reports to the smooth operation of the US financial markets. As analysts whose careers entail translating financial information into ratings, judgements and investment advice about the risks and prospects of public companies, the panelists offered an informed perspective on the adequacy of the financial data that is available today. Lawrence Meyer, recently retired from the Board of Governors of the Federal Reserve, moderated the discussion. Dr. Meyer opened the session by describing the recent loss of public confidence and expressing concern that continued dissemination of inaccurate information may increase the risk premium in the market and raise the cost of capital to all American firms.

James Chanos, President of the investment management services firm Kynikos Associates, Ltd., reflected on the fall of Enron and the rise of agency risks. Mr. Chanos surmised that the financial collapse of Enron captured the attention of the American public because it broke the trust that had existed between management and shareholders; while Enron's managers had sold their own company stock, they imposed a freeze on employees' 401(k) stock transactions. Mr. Chanos noted a general weakening of trust throughout the corporate world, a phenomena he attributes to the rise of the stock option compensation culture and asymmetric risk-taking. Option holders will face no costs from their risky financial strategies; it is the stockholders who face the downside risks of management's actions. This can tempt managers to engage in overly aggressive or improper accounting techniques, and can engender employee dissension. Management can skew risks further in their favor by using the repricing mechanism such that increased volatility in either direction will enhance the options' values. This allows managers to benefit even if their aggressive tactics lead to a sharp decline in stock price.

Mr. Chanos saw the low quality of earnings reports issued by public companies as another systemic weakness. Although he viewed depreciation as one of the most important metrics to be monitored by a company, he noted that corporations are increasingly choosing to release earnings before interest, taxes, depreciation and amortization. He further noted the common use of techniques such as factoring, structured leases and special purpose entities, which can distort even the cash flow data on financial reports.

Mr. Chanos suggested several policy remedies, including changing accounting rules to force stock options to be expensed, mandating board and stockholder approval of the issuance or repricing of options, increasing the effectiveness of audit committees, and expanding the involvement of institutional shareholders in governance and compensation issues. Because he views fraudulent accounting schemes as outright theft, Mr. Chanos expressed hope that transgressors will be prosecuted and even jailed.

The second speaker was Abby Joseph Cohen, Chair of the Investment Policy Committee at Goldman Sachs. Ms. Cohen categorized problematic corporate accounting behaviors into four groups. First, there are companies that commit outright fraud, the smallest but most damaging group. Next, there are companies that technically stay within their legal limitations but violate the spirit of the law and intentionally mislead their investors by using measures, such as *pro forma* earnings per share, that can conceal negative information. The third category is characterized by complex technicalities that make it difficult for financial statement users to extract accurate information. The fourth source of confusion is changes in GAAP that, while desirable, lead to discontinuities in reported corporate results. In some cases, the key data may be readily available but obscured by details; the computerized databases used today often miss the fine points of such complex information. Detailed manual analysis may be the only way to thoroughly assess today's financial statements, and analysts should be trained accordingly.

Abbey Joseph Cohen stressed self-compliance, stating that "doing the right thing has to be a part of the culture."

Ms. Cohen made five suggestions for improving financial reporting and the quality of information. First, she asked that the Financial Accounting Standards Board (FASB) and Securities and Exchange Commission (SEC) be permitted to complete their technical tasks without political interference. Next, she asserted that companies need guidelines governing the calculation of earnings and earnings per share and asked that clear definitions be set forth. Third, Ms. Cohen called on the SEC to move promptly in cases of fraud, and supported increasing the number and quality of SEC staff. Fourth, she recommended that the U.S. study international standards, since capital markets and financial institutions today operate in global markets. While U.S. accounting standards are superior in some areas, such as pension accounting, we have benefited from adopting international standards in other areas, such as merger and acquisition activity. Finally, Ms. Cohen recognized that there will never be enough "accounting cops" to monitor all financial activity, so she asked that companies be encouraged to increase their self-compliance and self-regulation efforts. Investors and creditors, too, should be encouraged to bolster their monitoring activities.

Steve Galbraith, Chief Investment Officer and Managing Director of Morgan Stanley, spoke next and shared his views of the recent changes shaping the investment world. He emphasized the importance of clarity and efficiency in the capital markets, stressing their correlation with GDP. In his view, the first priority in improving financial transparency should be investor education. The advent of the Internet and the growth of equity-based 401(k) plans have allowed many Americans who had not previously actively controlled their financial assets to essentially become their own portfolio managers. Unfortunately, many of today's investors do not have a proper understanding of risk and reward and require appropriate training. Mr. Galbraith also contended that investors are being inundated with too much information but are not being provided clear, strong analysis. Items such as restructuring charges and stock options, for which there are no clear accounting rules, make the financial reports presented to investors even more difficult to interpret.

Mr. Galbraith asserted that the best way to make progress in improving financial reporting would be to charge a third-party, not-for-profit entity, such as the SEC or FASB, with creating a coalition of interested parties and having them work towards agreement on reform efforts. Finally, he warned that the level of risk in today's economy is very high, implying that the investment world is at a tipping point. He cited both the escalating volatility on Wall Street and the incredibly high turnover rates for equity investments as indications of the tumult in the market today. Mr. Galbraith pointed out that nearly 25% of the S&P 500 earnings were being generated by the financial sector at the start of the 2001 recession. These finance firms, built on trust and collateralized reputation rather than physical products, are driving the economy today, making the issue of public confidence in the financial system such a pivotal concern.

Vickie Tillman, Executive Vice President of Standard & Poor's (S&P), addressed financial transparency issues from the perspective of the rating agency, sharing some of the specific initiatives that S&P is taking to enhance transparency. First, S&P is fully in favor of measures to establish stricter accounting standards, more disclosure and more compliance. She pointed out the many structural changes, including aggressive debt leveraging, off-balance sheet financing, and international transactions, that have made it more difficult for investors to understand how businesses are really operating, and easier for companies to obscure their true financial position. Thus, she saw a critical role for the rating agencies in providing fundamental analysis, but noted that agencies' credit and equity opinions rely on the completeness and accuracy of public disclosure.

Ms. Tillman explained that as S&P identifies new areas that become important to financial analysis, it works to increase public disclosure requirements. She outlined how it has recently supported public disclosure of contingent commitments, liquidity and funding risk, and risk transfer and risk transformations in securitizations. In order to better inform investors, S&P has always made its entire ratings criteria accessible to the public. Further, S&P contributed to the standardization of financial disclosures by devising *Core Earnings*, a new definition to be used for calculating earnings. *Core Earnings* is designed to capture the difference between the earnings from a company's principal business and the costs incurred in generating those earnings; this measure makes the concept of operating earnings more consistent across companies and makes the earnings data more understandable and transparent. In addition, Ms. Tillman hoped to see international convergence of standards. Finally, she explained some of the tools that S&P provides, such as comparative surveys and assessments of transparency, disclosure and corporate governance practices, which allow investors to judge the relative quality of companies' practices.

During the question and answer period that followed the presentations, the panelists received questions regarding the importance of rules-based versus principle-based accounting standards. Ms. Cohen responded that many recent problems involve failure to comply with accounting rules, rather than with the rules themselves. She noted that, in some instances, the concept-based approach might allow our accounting system to match the fluidity of our economy. Mr. Galbraith added that some rules need to be maintained, although they should be changed as appropriate; to this end, Ms. Cohen lauded the FASB effort to clearly define earnings.

Another conference participant asked whether there had been a failure in the marketplace that allowed companies to use *pro forma* earnings, special purpose entities and other misleading techniques without being punished. Ms. Cohen emphatically agreed, and recounted a situation in which her estimates, which conformed with generally accepted accounting principles (GAAP), were actually excluded from the consensus database because they did not use *pro forma* earnings. Mr. Galbraith, however, argued that the market has become very efficient in punishing misleading disclosures, and Ms. Tillman added that when questionable activities are not revealed, it is impossible for the market to take them into account.

Finally, the panelists discussed a question relating to the conflict between the need for additional disclosures and the complaints about the voluminous and complex nature of data already available. Ms. Cohen responded that efforts should be made to ensure that the important information is provided upfront and clearly stated. Mr. Galbraith agreed that the "noise" should be separated out from the financial information. Ms. Tillman added that information should be targeted to its intended audience, but Ms. Cohen pointed out that even accurate information requires that investors be diligent, noting that data already available in matters such as pensions, stock options and off-balance sheet items were often not used.

Session 2: Reflections on Financial Rules of the Road

The second panel addressed the current reporting infrastructure and the speakers offered their views on the key issues surrounding financial reporting today. Moderator Jack Murphy, sensing a strong force for change in the current environment, presented the panel's goal of identifying the issues and proposals most deserving of consideration from among the many meritorious legislative and regulatory initiatives that have been set forth in recent months. He listed four areas that should be assessed in evaluating financial accounting and reporting reforms: the quality of accounting standards and the standards setting process; the level of oversight of and control over the accounting profession; the general strengths and weaknesses of the financial disclosure system; and corporate governance practices.

The first speaker was Dennis Beresford, a Professor of Accounting at the University of Georgia, Director and Chair of the Audit Committee at National Services Industries, and former Chairman of the FASB. Mr. Beresford focused his remarks on the process of setting accounting standards. While he saw the standards-setting process as reasonably well-functioning, he offered some suggestions on ways in which the system can be improved. First, Mr. Beresford explained that credible private sector standard setting must be subject to government oversight. While Congress should not be involved in technical issues, the SEC has statutory authority to specify public accounting practices. However, increased trust among regulators, reporting companies and auditors is necessary if the public/private partnership between the SEC and the FASB is to continue to be productive.

Mr. Beresford also argued that the standards-setting process could be streamlined and quickened. FASB could reach resolutions more quickly by limiting standards' content to the most significant matters, eschewing perfect conceptual purity in favor of timeliness, and increasing staffing. External discipline imposed by the SEC would also help the FASB meet its completion targets. Another concern of Mr. Beresford's was the complexity and detail of today's standards; he supported the more generalized approach now being taken by the new international accounting standards board. Finally, Mr. Beresford expressed skepticism of any approach that would involve the government as an intermediary in funding the FASB. He viewed the voluntary contributions that now provide much of the FASB's funds as an important mechanism through which its constituents can register their relative level of satisfaction with the FASB's work.

Frank Marrs, a retired National Partner of Audit at KPMG, addressed the conference next, offering perspectives from his experience in the auditing profession. He viewed the blame currently being directed at the accounting industry as problematic because it focuses attention on details and overshadows the more general issues. For instance, he perceived a desperate need to modernize the profession and acclimate it to today's risk-focused, change-driven business environment. Accountants turned to consulting activities to escape the inflexible, compliance-driven exercise that auditing had become. Now, however, Mr. Marrs sees an opportunity for the profession to reinvent its core audit functions in a more flexible manner.

Mr. Marrs set forth four fundamental building blocks that can be used to guide reforms in financial reporting and corporate financial transparency. First, corporate culture needs to reward honesty, integrity and openness; incentives for employees, including top managers, should be set so as to promote ethical behavior. Next, standards should be simplified and changed to better reflect companies' business models, risk portfolios and other performance measures that drive financial performance today. Third, audits themselves need to focus on the business and financial health of the organization in question, rather than looking solely at its accounting health in terms of legal compliance. Finally, Mr. Marrs indicated that forward-looking identifications of risks and evaluations of ongoing risk management techniques are essential to both internal and external audits.

The next speaker, Dennis Powell, Vice President of Corporate Finance and Corporate Controller at Cisco Systems, Inc. spoke from the viewpoint of one who is responsible for preparing the financial reports for a company. In discussing his recommendations for rebuilding public confidence in the financial infrastructure, he referenced his participation on a task force supported by Financial Executives International.

Mr. Powell identified four areas in which financial reporting and corporate governance can be improved: ethics, effectiveness of audit committees, timely reporting, and auditor independence. First, integrity must be embraced as a core value in American corporate culture; ethical conduct is not something that can be legislated. Continuous messaging at company events, an annual signing of a code of conduct by each employee, and the active involvement of the board of directors can help impart this value. Second, audit committees' effectiveness needs to be improved. To this end, Mr. Powell called for Congress or the SEC to create regulations ensuring audit committee members have appropriate skill sets and financial literacy. Third, quarterly and annual reporting should be accelerated and its content streamlined. He noted this change would place a short-term burden on companies, however, so a sufficient transition period should be permitted. Finally, auditor independence should be assured. Although Mr. Powell did not himself believe accounting firms' provision of both management consulting and audit services represents a serious conflict, he acknowledged the importance of public perception and thus recommended auditors be prohibited from performing management consulting projects for their clients. This change, too, would cost companies since audit fees would likely increase, but Mr. Powell saw long-term benefits that would outweigh the costs.

William Trubeck spoke from the unusual point of view of having recently overhauled the financial accounting practices and restored credibility to Waste Management, Inc., after the firm suffered accounting and legal problems in 1999 and 2000. Mr. Trubeck related actions he took to bring the goals of financial transparency and ethical conduct to the forefront of the business. First, the firm changed its internal system of reporting controls and analysis. It established new accounting policies, changed the reporting relationships for the accountants in the field so that the financial reporting structure now leads directly to the CFO, created a financial planning analysis department, and introduced a new internal audit function that uses a risk-based approach to its internal activities. Next, in order to instill integrity throughout the organization, the company created an ethics hotline and hired a vice president of ethics and compliance. Trubeck believes the company established the appropriate tone at the top of the management structure, and is working to filter that down to the rest of the company. Third, Waste Management improved its external reporting to focus on clarity, plain language, and accuracy; each earnings release is reviewed in detail by the audit committee and then posted on the company website. It has also eliminated *pro forma* reporting. While the company agrees that an even faster schedule would enhance the credibility of the entire financial reporting process, the company is concerned that an appropriate transition period be established for firms that are as yet unable to comply with an accelerated reporting time frame. Finally, Waste Management has set high standards for the board of directors and audit committee, who meet often to discuss financial performance.

A series of questions addressed by the panelists focused on the high expectations now being placed on corporate audit committees. Mr. Powell and Mr. Beresford agreed that audit committee members face serious, time-consuming responsibilities, but they emphasized the importance of the committees' function and suggested members should be ready to make a significant commitment. They also recognized that while adding new responsibilities might make it more difficult to recruit audit committee members, there are CFOs, retired CFOs, and retired auditors who would make excellent additions to the committees in place of some of the busy CEOs that currently serve. Finally, Mr. Marrs pointed out that companies should provide their audit committees with usable information and analysis to reduce the time required to interpret the data. Mr. Trubeck added that all audit committee members should be financially literate.

In a separate question, when asked about the role that an independent regulatory board should play in the accounting profession, most panelists expressed skepticism of the value of additional regulation, preferring to allow market forces, self-compliance and private oversight to discipline the industry. Mr. Beresford, however, supported the idea of new government oversight combined with private initiatives.

Luncheon Address

During the luncheon address, Lawrence Lindsey, Assistant to the President for Economic Policy and Director of the National Economic Council, discussed the types of abuses that have recently plagued the financial markets and explained how and why such practices may have developed at this point in time. He also outlined President Bush's plan to improve corporate governance and protect shareholders.

Mr. Lindsey first offered historical evidence of financial abuses during periods of general societal excesses, implying that today's improprieties are not surprising following the financial surfeit of the 1990s. When companies and stock prices are thriving, there is little motivation for observers, or even interested parties, to question the behaviors that are generating such success. Many of the abuses of the 1990s occurred due to this type of carelessness, combined with a general erosion of ethics in society; there was insufficient oversight of and self-policing in the corporate realm, there were individuals who put their own interests ahead of the needs of their clients, and there were instances of outright fraud.

In order to re-introduce morality into the financial sector and ultimately safeguard the public investor, President Bush presented a ten-point plan to bolster corporate responsibility. Mr. Lindsey delineated the plan's three core principles: provide better information to investors; make corporate officers more accountable; and develop a stronger, more independent audit system. The first principle highlights the importance of access to information. This sentiment is consistent with SEC guidelines which state that even strict compliance with GAAP may not be sufficient to satisfy disclosure obligations. Other principles hold that CEOs and other corporate officers should not profit from misrepresented financial statements and should personally vouch for the veracity of company disclosures. In addition, the public should be informed promptly when corporate insiders buy or sell company stock. Finally, the President's plan calls for the creation of an independent regulatory body, such as the oversight organization the SEC is establishing under its existing legal authority. Mr.

Lawrence Lindsey explained that the type of "financial excesses" seen in the 1990's are historically common but emphasized that they are inexcusable.

Lindsey recognized that uncovering financial losses can be painful and that current reform efforts are of little solace to those who have suffered such losses. However, he cautioned that only after the problems are addressed can the American financial markets regain their prominence and vitality.

Session 3: Policy Round Table

The third panel discussed the public policy challenges of reforming the accounting profession and the financial reporting and disclosure systems. Moderator H. Rodgin Cohen explained the necessity, from a policy perspective, of assessing which proposals have merit and which might prove counterproductive.

Representative Michael Oxley (R-OH), Chairman of the House Committee on Financial Services, was the first speaker. Congressman Oxley discussed the provisions of the Corporate and Auditing Accountability, Responsibility and Transparency Act (CAARTA), recently passed by the House of Representatives. One of the bill's main objectives is to increase transparency in the financial markets. The legislation calls for real-time disclosure of anything that materially affects the financials of a publicly traded company. Insider sales would need to be revealed more quickly, and corporate executives would be banned from buying or selling stock during time periods when employees' transactions are suspended. The bill also specifies that new relationships among corporate officers and affiliates, or any jointly owned properties, be disclosed to reveal possible conflicts of interest. The CAARTA also provides for the creation of an auditing oversight board that would be comprised of both experienced accountants and non-industry representatives. This body would certify any accountant wishing to perform audits for public companies, and could punish accountants who violate the securities laws. Furthermore, the CAARTA would place additional limitations on the types of services that could be performed for a company by the firm that audits its financial statements. He urged the Senate to act on reform legislation during this Congress.

Former Chairman of the Federal Reserve Paul Volcker spoke next, sharing his thoughts regarding the changes that should be introduced in response to the current crisis in financial reporting, and calling for real structural reform. Mr. Volcker stated that accounting standards today attempt to apply rules that are better suited to the industrial era than the financial age. The degree of complexity in modern business has gotten ahead of the standards themselves. Mr. Volcker called for a convergence of standards around the world, with special attention paid to the international perspective. He addressed the fact that the accounting industry has seen an increase in internal conflicts of interest. Although the biggest accounting firms still see a large market for auditing services and derive a considerable portion of their revenues from auditing, their marketing efforts have been targeted at the wider array of consulting services. This indicates that these companies perceive their future to be outside of traditional auditing.

Mr. Volcker concluded that a strong governmental regulatory body is necessary to oversee the accounting profession. The regulators should not be dominated by industry insiders, and should be given disciplinary and investigative powers. In particular, the organization should be charged with disentangling the conflicts of interest now present in the auditing business. Only under a framework of regulation and supervision can the accounting profession reclaim its integrity, win back its respect, and fulfill its responsibility to the investor.

Commissioner Cynthia A. Glassman of the SEC emphasized the importance of financial transparency in a society where more than half of all US households participate in the markets and choose from an increasing number of financial instruments in deciding how, when and where to invest. She discussed the SEC's efforts to enhance financial transparency through regulation, enforcement, examination and education.

Several regulatory initiatives have been announced: the SEC proposes to accelerate the financial reporting requirements, to enhance the disclosure of accounting issues in the Management Discussion and Analysis (MD&A), and to regulate analysts' conflicts. The SEC will soon release recommendations for a new public accountability body for the accounting profession. Its core principles will be independence from the profession, mandatory membership, independent funding, meaningful discipline for unethical or incompetent conduct, and a fair and effective system of audit company reviews. In addition, the SEC's enforcement actions have increased in number and cases have been brought forth earlier in order to prevent fraud before investors are harmed; the examination staff is also conducting several preemptive reviews in addition to their regular inspection activities. Finally, the SEC has introduced new investor education programs by implementing a new question and answer database, providing interactive calculators and quizzes, and launching a fraud website to warn investors of known and potential scams.

Eugene Ludwig, former Comptroller of the Currency, was the final panelist. He likened transparency to a powerful medicine that has the potential to improve the functioning of our free market economy, but can also produce notable side effects in terms of the safety and soundness of our financial institutions. Mr. Ludwig contended that in order for transparency to be effective in informing the public, it must focus on information that is reliable and meaningful. Further, it must yield information in a form that can be clearly understood by the public. He saw the problem of eclipsed transparency not as one related to a lack of information, but rather as a failure to assess the right information. He suggested, for example, that companies disclose a much more detailed set of risk management information than is currently publicized. He also saw potential problems from information derived from flawed models, but stressed that this is separate from fraudulent data.

Mr. Ludwig was also concerned about complex and constantly evolving accounting rules. Again, he differentiated between Enron-type crises, in which management deliberately breaks the rules and misrepresents financial information, and cases of well-intentioned human error, during which management strives for integrity in their financial reporting, but relies on principles that are out-of-date, or simply misinterprets the rules' intentions.

Finally, Mr. Ludwig asserted that there are cases, at least in the banking industry, in which certain revelations should be limited to bank supervisors so as to prevent the liquidity crises or contagion that could arise from disclosing sensitive bank financials, and to keep the information from being misused by competitors and other market participants.

During the question and answer session, the panelists were asked whether the discussed enforcement and disciplinary proposals would be sufficient to reform the accounting profession, or whether more fundamental changes in the accounting principles might be appropriate. Mr. Volcker and Congressman Oxley agreed that fair value accounting is a troublesome principle because it introduces considerable subjectivity into accounting issues.

The panelists also discussed whether lessons learned from bank regulation and supervision and direct corporate oversight could be applied to the accounting profession. While Mr. Volcker lauded the effectiveness of bank examinations and their restraining effect on management, Dr. Glassman pointed out that there are substantial differences that make it difficult to compare a bank exam, which focuses on the safety and soundness of the institution, with an audit, whose purpose is to ensure compliance with GAAP. Congressman Oxley highlighted the role of the market as disciplinarian in the corporate, non-bank sectors. Mr. Ludwig added that questions linger regarding the treatment of large financial institutions that are essentially, but not technically, banks, and are therefore not regulated.

The panelists also responded to inquiries regarding the legitimacy of withholding information from the public. Mr. Volcker stated that withholding information can be justified when an institution is particularly crucial to the nation's economic stability, and is already regulated, supervised and protected by the government. Mr. Ludwig agreed that limiting disclosures can be acceptable for regulated institutions, while pointing out that such entities will still need to be completely transparent to their supervisors. Dr. Glassman disagreed, citing the rights of banks' investors and shareholders to access relevant financial information.

At the conclusion of the program, emcee John Reich closed the conference by sincerely thanking all participants and speakers and promising the FDIC's continued commitment to advancing financial transparency.

About the Author

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