

REMARKS BY PAUL A. VOLCKER
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REASSERTING TRUTH IN A POST-ENRON WORLD

Here I am, as a neophyte American, about to talk about accounting at the very birthplace of the organized accounting profession. After all, your organization, the Institute of Chartered Accountants of Scotland, has been dedicated to maintaining and improving accounting standards for just about twice my years of life. Standing here feels a bit odd, presumptuous, even arrogant. I've searched my mind for something to take the edge off.

It occurred to me I might claim a head start at least in one corner of the profession. I've spent much of the past decade employing lots of accountants, first to chase down dormant deposits of victims of Nazi persecution in Swiss banks, and now to help reconstruct what went wrong in the U.N. Oil for Food Program. Surely, I thought, I could have something fresh to say about the value of accounting in the forensic world.

Bad luck.

I should have remembered everything was invented by Scotsmen. It took only a little research to discover forensic accounting really started well before your Institute was founded. It was in 1824 that one enterprising Glasgow accountant hung out a shingle announcing his availability in support of "courts and counsel".

Well, even with all that collective experience, yours and mine, it's been more than a little disturbing to learn about so many breakdowns in financial reporting in one big company after another in recent years. Scotland itself seems to have largely escaped, but the problems have been cosmopolitan -- Enron, WorldCom, Tyco, Freddie Mac (I thought it appropriate to introduce a Scottish sounding name), Royal Ahold, Parmalat, Royal Dutch Shell, the UFJ Bank in Japan -- what a litany of transatlantic and transpacific scandals. And the accounting profession has borne the brunt of the criticism.

You know and I know that other once honored professions share the responsibility: the investment bankers who have so much money at stake and dream up the deals; the analysts who bend their analysis to support

those deals; the lawyers increasingly willing to stretch law and ethics to justify "aggressive accounting;" the consultants who seem to be able with a straight face to support and defend the most outrageous compensation schemes -- compensation that must strike the proverbial dour Scot Calvinist as not only egregious but immoral.

But still, we have to concede there is a certain justice in singling out the accountant and the auditor for criticism. In hindsight at least, it's been evident that the profession has strayed from its vocation -- even from the legal obligation to serve the investor -- to tell the truth as it sees the truth.

In my opinion, at least, it is a demonstrable fact that it is difficult enough to hold to principle amid the enormous complexities and pressures inherent in the financial world of the 21st century. It is doubly difficult when one's firm is anxious to sell more lucrative consulting services to an auditing client. It seems to me close to psychologically impossible to, on the one hand, sell opaque and obscure tax-avoidance schemes for a success fee and, on the other hand, maintain auditing discipline for the same company.

Well, whether you fully share these views or not, there cannot be any dispute the profession has had a wake up call. There is a lot of lost credibility to recover. That's not a job for a single firm, however large, nor for one Institute, however honored, nor for a single country, however large.

Unfortunately, it has required legislation in the United States, tough and intrusive legislation with extra-territorial reach. Our Sarbanes Oxley Act is having a large, and I think largely constructive, impact. But it clearly would be wrong -- quite apart from the exceptional burdens placed on individual accountants and firms -- to rest on official regulation.

What's needed is a constructive response by the profession itself, as individuals, as firms, and as collective organizations. I confess to lack of knowledge as to precisely what measures the Institute of Chartered Accountants of Scotland has supported or undertaken. What

I do know is the strong tradition, the experience, and the respect your organization has rightly developed and sustained. Those very facts demand a leadership position.

As you know, I am personally involved, as Chairman of the Trustees of the International Accounting Standards Committee Foundation, in another important effort to deal with one part of the problem. The Committee and the Board we appoint is, in effect, a joint effort by the profession, the business community, and regulators to develop coherent, enforceable, and common accounting standards.

The prime justification for International Accounting Standards is a positive one. An essentially borderless world of finance requires a standardized set of accounting standards if it is to operate effectively, promoting a truly economic allocation of capital. But there is an important defensive purpose as well. Agreement on a uniform set of well-understood accounting principles -- and I emphasize the importance of clarity in those principles -- should help those applying the standards to maintain professional discipline. Not so incidentally, high quality common standards should help to restore the credibility and pride of the profession.

I've also come to realize, however simple the objective and however great the potential benefit, achieving international convergence and well understood, conceptually defensible, standards is an immensely difficult job.

There is, first of all, the huge intellectual challenge of developing accounting standards relevant to the modern world, with all its complexities and the inherited differences in national approach. The old rule book of historic value doesn't seem quite right for a world with layers and layers of volatile finance -- with derivatives of every kind dominating trading, with new complexities of insurance and pensions, with leasing that mimics ownership. But can we be so sure that marking everything to market, even when we have to simulate a market price, really captures underlying reality? Must we live with a mixed and inherently complex and abstractly illogical accounting system?

Those are issues that lie behind the current debate in Europe on one particular part of the now celebrated or infamous -- take your choice -- IAS 39. The differences in opinion will not be easily resolved. That is why I take great encouragement from the extraordinary efforts launched by your own David Tweedie, as Chairman of the IASB, to resolve the questions. Ad hoc advisory groups have been created to help develop approaches appropriate for insurance and financial institutions. Another high-level group is dealing with the particular issues in IAS 39 raised so vigorously by some European banks, as well as the underlying questions. With the cooperation and good will that is characterizing this work, there are grounds for intellectual and practical progress.

Equally evident is another simple fact, reflected in these constructive efforts. Accounting standards are certainly a matter for experts, but they cannot emerge full blown from an ivory tower. After all, standards affect, for better or worse, business behavior.

Clearly, organizational genius is required to square the standard setting circle. The technical judgment of accounting professionals needs to be tempered by practical experience. At the same time, the process must not be politicized in a manner clearly destructive of the essential purpose.

Achieving that balance is the essence of the Constitution of the International Accounting Standards Committee that I chair. We are in the final phases of reviewing that Constitution, but I can tell you there is no intention to disturb the ultimate responsibility of the independent and expert IASB to set the accounting standards.

There is, I suppose, a certain ironic justice that on both sides of the Atlantic at the same time different technical standards are under political attack. In the U.S. it is the expensing of stock options, already accepted in Europe, that is under attack; in Europe, it is a certain aspect of hedge accounting, long accepted in the United States that is vigorously questioned. Obviously, quite a lot rests on the outcome of those

disputes. That is not just because of their intrinsic importance but because of the example that will be set for accepting other standards that may be controversial in one country or another.

But not lose sight of the main story. There is a great deal of good news in achieving convergence and common standards. Moreover, that convergence has not been a matter of agreeing to the least common denominator. There is a vigorous effort to achieve the best result: rigorous standards applied with discipline.

In little more than three years, the IASB has completed five entirely new standards and revised 17 standards inherited from its predecessor organization. Taken in its entirety, this work provides a workable platform for advancing common international standards. More particularly, it provides a practical framework for European companies that are required to adopt international standards in 2005. The reservations about parts of IAS 39 should not and has not, it seems to me, diminished in any way the commitment within the European Union, and particularly the European Commission, to support the concept of international standards.

Beyond the European Union, a large number of other countries in all continents are preparing to adopt, or already have adopted, International Financial Reporting Standards. A recent DeLoitte & Touche survey indicates 92 countries will encourage, permit, or require these standards in 2005.

Of course, the big prize is convergence between American GAAP and the international standards. In that respect, there is certainly good news.

My sense is that the strong reservations about international standards in the United States have faded. In the light of all that has happened, no longer can American standard setters, regulators, or even politicians sit back and claim that U.S. GAAP is the logical and only model for the world. I believe current members of both FASB and the SEC are committed to convergence.

There is still work to be done, a lot of it. But what is so encouraging is how much of that work is being done together, by close liaison, by joint or complementary projects, by agreed research, not just between the United States and the IASB, but with a number of other countries as well.

I'd like to permit myself a little unaccustomed optimism.

At the end of the day, I expect the weight of professional opinion and increasing business practice will deflect the intense, but highly concentrated, political effort to overturn expensing of stock options in the United States. In Europe, there seems to me a reasonable prospect that many internationally active financial institutions will be ready, willing, and able to implement IAS in its entirety, pending final resolution of the controversy.

I've taken a long time discussing accounting standards. Plainly, that is only part of the reforms needed. At least as important are strong auditing standards and performance. In the United States, the clear decision has been to impose that result by law. We have a new regulatory apparatus, the Public Company Accounting Oversight Board.

In concept, there may well have been better ways to achieve the desired result. My parochial view is that a thoroughly reformed Arthur Andersen might have been a better vehicle for constructive change - and not so incidentally have left us with a less concentrated, more competitive, accounting profession.

Personal predilections aside, PCAOB is on the job. For all the sharp corners of Sarbanes Oxley and the costs involved, a forceful response to what was happening was surely justified. The Law has been recognized as constructive by most American businesses. Skillful diplomacy and a complementary strengthening of supervision in a number of other countries has gone a long way toward smoothing extra-territorial concerns.

The fact is such concerns are practically inevitable if we are to reap the benefits of open financial markets. The only way forward, as with accounting standards themselves, is a willingness to work toward common approaches.

There is another area, clearly related, where reform is in the air - or perhaps more accurately in corporate board rooms. There is, I think, much greater understanding in the United States that the day of what came to be known as the "Imperial Chief Executive" is passing.

Endless models for good corporate government have been set out, by business groups, by "wise men", and by governments. In detail, it's enough to make the head spin to keep track of it all. I don't want to join the new cottage industry of advisors on corporate governance, but there are two or three points that I think are important.

The common element in most of the discussion is that a corporate board should recognize that its indispensable role is not to manage the firm but to oversee the management --- to assure itself of the appropriate corporate values, to demand strong financial controls, and to independently determine remuneration policies.

All that requires a spirit of independence among board members, whatever the technical requirements. To my mind, for the typical large corporation, a non-executive chairman -- at least a designated lead director - is a key, as is a strong audit committee, insisting upon and supporting a strong audit function. To make my own bias explicit, fixed price stock options with no performance test are demonstrably a highly capricious form of compensation. All too often heavy use of those options produces the precisely the patterns of behavior that undercut sustained performance.

Well, plainly a lot has needed to be done, and a lot is going on. I can't say it's all been smooth sailing. The tendency to return to business as usual is still there.

In its partial initial inspections of the remaining "big four" accounting firms, the PCAOB found continuing flaws in compliance and quality control. We begin to see reports of accounting firms rebuilding lucrative consulting practices -- the equivalent, in my view, of "just one more drink". There is reluctance to give up what is euphemistically called "aggressive tax planning" despite one challenge after another. Overall top executive compensation in the United States somehow continues to rise from already highly questionable levels.

Here we are in the true home of the accounting profession - the mother lode from which David Tweedie himself has emerged to lead the profession. This may be the place to share with you a personal vision.

The role for the accounting profession above all else is to be a guardian of truth in markets. Its prime responsibility is not to the company that employs it but to the investing public.

To discharge that responsibility, I see a group of proud professionals dealing with intellectual and practical challenges the equal of any profession. The services provided should be highly valued, with compensation reflecting that value, even if the financial rewards don't match high-flying traders and investment bankers.

I see signs that talented young men and women have renewed interest in a profession that our best - or what have been popularly considered the best - business schools have neglected for years.

All that is consistent with the fine traditions, the professional commitment, and the sense of pride characteristic of the Institute of Chartered Accountants of Scotland for so many years.

Congratulations on your 150th birthday and many thanks for having me.