For Release at 9:30 a.m. EST
Thursday, October 2, 2003

STATEMENT OF THE HON. CHARLES A. BOWSHER
BEFORE THE SENATE BANKING COMMITTEE
OCTOBER 2, 2003

Thank you Mr. Chairman. My name is Charles Bowsher. I am the former Chairman of the Public Oversight Board. I also served as Comptroller General of the United States and head of the General Accounting Office from 1981 to 1996. I was a partner of Arthur Anderson & Co. from 1971 to 1981, and served as Assistant Secretary of the Navy (Financial Management from 1967 to 1971). Prior to that I was associated with and served as a partner at Andersen between 1956 to 1967 in the firm's Chicago office. Presently, I serve as a director of several public companies and have recently been made a member of the Board of Governors of the National Association of Securities Dealers (NASD).

I am pleased to be here today to discuss the recommendations of the Conference Board's Commission on Public Trust and Private Enterprise, and specifically the seven principles with recommendations and specific best practices for each that are contained in Part 3 of The Conference Board Commission's January 2003 report concerning Audit and Accounting. This report is the second issued by the Commission -- the first one was issued on September 17, 2002 and discussed the issue of executive compensation. In addition, I will describe what progress we think has been made in the last year, and what concerns we still have for the future.

By way of background, The Conference Board (the world's leading business network) convened a 12 member Commission in June 2002 to address the causes of declining public and investor trust in companies, their leaders and America's capital markets. The 12 members of the

Commission, in addition to myself, included Peter Peterson (Chairman of the Blackstone Group, former Secretary of Commerce and Chairman of the Federal Reserve Bank of New York), John Snow (Chairman and CEO of CSX Corporation and former Chairman of The Business Roundtable), John Biggs (former Chairman, President, and CEO of TIAA-CREF), John Bogle (founder and former Chairman of Vanguard Group, Inc.), Peter Gilbert (Chief Investment Officer of the State Employees' Retirement System of the Commonwealth of Pennsylvania), Andrew Grove (Chairman of Intel Corporation), Ralph Larsen (former Chairman and CEO of Johnson & Johnson and former Chairman of The Business Council), Arthur Levitt, Jr. (former SEC Chairman and former Chairman of the American Business Conference) Lynn Sharp Paine (professor at the Harvard Business School), Warren Rudman (former Senator and a partner at Paul, Weiss, Rifkind, Wharton & Garrison) and Paul Volcker (former Chairman of the Board of Governors of the Federal Reserve System), who is with me today to discuss two of the seven principles in Part 3 of the Commission's January 2003 report.

To begin, I strongly believe that the Sarbanes-Oxley Act of 2002, which was largely the work of this Committee is an excellent piece of legislation, especially in regard to audit and accounting issues. This legislation was long overdue. As one Business Week headline stated, the reforms of the 1930's were not adequate for the 1990's.

The introduction to Part 3, Audit and Accounting, of the Conference Board report clearly defines the importance of effective audits and the need for continued reform. I'd quote two key paragraphs:

> The audit process is integral to the confidence required for the financial markets to operate effectively. Every public company must be audited annually by a firm of independent accountants. In the last several years, crises involving companies

such as Enron, WorldCom, Xerox, Cendant, Adelphia, and Tyco have focused attention on the integrity of the audit process and its oversight. The public's trust-including that of investors, insurers, and creditors-that audited financial statements provide an accurate picture of the company's finances is essential for the confidence that the capital markets require. The alleged auditing failures associated with the recent corporate scandals have been a major factor in the erosion of that trust.

The Sarbanes-Oxley Act (the "Act") of 2002, the proposed New York Stock Exchange listing standards, and the NASDAQ corporate governance proposals have each focused on a number of structural reforms to improve the independence of the outside auditors and to strengthen their oversight by the audit committees composed of financially literate independent directors, at least one of whom, under the New York Stock Exchange listing requirements, must have specific financial expertise. The Conference Board Commission on Public Trust and Private Enterprise believes that the following seven principles, particularly with respect to larger public companies, will strengthen the reforms begun by the Act and the NYSE to bolster the public's confidence in audited financial statements.

The first major issue that the Conference Board report addressed is the need for an enhanced role for audit committees. We recommend that corporate boards should make sure and devote sufficient resources and time to implement Sections 301 and 407 of the Sarbanes-Oxley Act, especially in regard to:

- the independence and qualifications of the audit committee members
- the need for one member of the audit committee to be a financial expert
- the need for conducting an annual assessment of the performance of the audit committee and its members
- the right of the audit committee to retain certain outside advisors or educational consultants as they deem appropriate.

Many of the recommendations in our report, and those in Sarbanes-Oxley Act, that relate to an enhanced role of the audit committee were previously discussed and recommended in the 1999 Blue Ribbon Committee Report on Improving the Effectiveness of Corporate Audit Committees, which was created by the New York Stock Exchange (NYSE) and the NASD in response to concerns about the financial reporting process as expressed by the then Chairman of the U.S. Securities and Exchange Commission (SEC).

It is heartening to report that it appears that numerous public company boards in the last year have moved forward to strengthen their audit committees. Audit committee members who were not independent and/or properly qualified have been replaced, and many very qualified financial experts have been named to audit committees. The General Electric (GE) Board is a good example.

However, it appears that not all boards have moved forward on this much needed reform and this is an area that the SEC should monitor on an annual basis when the proxy and annual reports on Form 10-K are submitted. I would think the Committee might wish to consider requiring an annual report from the SEC on this issue.

The second major issue that the Conference Board report addressed is that of audit committee member education and the need for an orientation program for each member of the committee as well as the need for continuing education programs.

The third major issue that the Conference Board report addressed is that of improving internal controls and internal auditing, which was an important section (404) of the Sarbanes-Oxley Act. Our report states that every public company board, and especially the audit committee, should make enterprise risk assessment and internal controls high priorities in order to facilitate the certification and report processes required by Sections 302 and 404 of the Sarbanes-Oxley Act.

The Public Company Accounting Oversight Board (PCAOB) has not yet issued the standards for Section 404. However, it is my view that many public companies are moving ahead to document and improve their internal controls in order to be ready to include a management report in their 2004 annual report and to be ready for their outside audit firm to review and attest to the company's report on internal controls.

For companies that have adequate and well documented internal controls and an adequate internal audit function, it will not find the reporting on internal controls to be a major or costly effort. However, those companies that have not put an emphasis on internal controls will have a one-time investment to make, but investors will be much better protected once management and outside auditors can attest to proper internal controls. This area is the basic framework for the CEO and CFO certifications regarding the annual financial statements and quarterly reports.

The PCAOB and the SEC must monitor this area very carefully and again, should keep this Committee informed about the progress achieved beginning with the 2004 company reports.

An important consideration to keep in mind is that outside auditors should not be involved in the documentation of clients' accounting and operating controls. This is in keeping with the principle that an external auditor should not audit its own work. The Sarbanes-Oxley Act specifically prohibits an external auditor from performing internal audit services for audit clients.

The fourth area that the Commission report addressed was auditor rotation. We recommend that in order to assure the independence of any audit, the audit committee should seriously consider rotating outside audit firms when some or all of the following circumstances exist:

- the audit firm has been employed by the company for a substantial period of time, e.g., over 10 years;
- one or more former partners or managers of the audit firm are employed by the company; and,
- significant non-audit services are provided to the company – even if approved by the audit committee.

I recognize that the General Accounting Office (GAO) was requested by Section 207 of the Act to study and report on the issue of mandatory rotation of registered public accounting firms. As of now, this report has not been issued by the GAO.

It is interesting to note that the recently released WorldCom report requires rotation of the auditors every 10 years.

My fellow Commission member, Paul Volcker, will discuss the next two major issues that the Conference Board report addressed – professional advisors for the audit committees and services performed by accounting firms.

The last major issue that the Conference Board report addressed directly relates to the Big Four firms which, as a recent GAO report indicated, audit most of the public companies in the United States and the rest of the industrial world. Our concluding paragraph in this section of our report stated that the business model, strategies and focus of the Big Four should ensure that quality audits are their number one priority. The Big Four must be sure that they each represent a "gold standard" in auditing.

The question here is this: has the leadership of the Big Four accounting firms each examined their business model to ensure that it is consistent with the idea that quality audits represent their number one priority?

Many observers of the accounting profession would say "no," that the Big Four firms have still not changed, are primarily focused on their litigation risks, and are resistant to major reform. Some, including the Big Four firms, would be more positive. One firm has invested heavily in full page advertisements in the New York Times and Wall Street Journal to convince the public that the answer is "yes."

I believe the jury is still out. Daily press coverage and other reports of continued problems with Big Four audits and other professional work indicates that much work and re-thinking is still to be done.

A very distinguished accounting professor, Art Wyatt of the University of Illinois, just gave a very thoughtful speech entitled "Accounting Professionalism – They Just Don't Get It" to the recent annual meeting of the American Accounting Association, which is the group that represents the accounting professors of all our major universities. I commend this speech to the

Committee (Mr. Wyatt's speech is available on the American Accounting Association web site, www.aaahq.org).

I certainly agree with SEC Chairman Donaldson's recent statement before the House Financial Services Committee when he said that "[w]e should all realize…that the PCAOB alone cannot restore investor confidence in the integrity of the accounting profession. If these efforts are to be successful, each accountant, from the CEO of the accounting firm to its most recently hired employee, must demonstrate a willingness to place the interests of investors above all else. Remaining independent and 'telling it like it is' is fundamental."

Mr. Chairman, this concludes my prepared testimony. I would be happy to answer any questions you may have.