BRINGING CORRUPTION INTO THE CLASSROOM

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ABSTRACT

The Sarbanes-Oxley Act of 2002 is the most important corporate governance legislation enacted since the 1933 and 1934 Securities Acts. The Act's eleven titles address specific abuses which surfaced during the stock market bubble of the late 1990's. Section 404 of the Act, requiring the identification, documentation and evaluation of internal controls by management and auditors, has the broadest current impact. The Act also establishes an accounting and auditing standards board, the Public Company Accounting Oversight Board (PCAOB), which has issued detailed requirements for audits of internal controls. These two particular provisions have a significant direct impact on accounting, auditing and information systems curricula. Perhaps more important is the need to address the root causes of the abuses identified by the congressional committees, leading to passage of this legislation. The call for corporate reform goes beyond incorporating specific technical requirements into business courses. The monumental bankruptcies and investment losses suffered as a result of irresponsible, unethical behavior by management, analysts, accountants and others, underscore an even greater need for enhanced ethics training. When combined with recommendations from organizations such as the Association to Advance Collegiate Schools of Business (AACSB), the opportunity to incorporate focused ethics training and principles in business curriculum becomes clear. Stand-alone ethics courses need to be reinforced by integrated efforts in all disciplines, stressing ethical behavior, objectivity, responsibility and stewardship.

INTRODUCTION

The unprecedented waves of corporate scandals that have rocked the markets since 2000 have triggered strong reactions throughout the public and private sectors. The ongoing prosecution of the perpetrators has kept their massive frauds in the public eye. The continuing visibility of the accounting and financial frauds, poor stewardship and inadequate governance provides a unique opportunity for educators. It is critical for business educators to incorporate the lessons learned about unethical behavior and the abuses of the law, accounting and professional standards.

House and Senate committees held investigative hearings into the collapse of Enron, Worldcom and others. The testimony given before the committees ranged from Enron alleged conspirators and employees to accounting and legal experts. Popular sentiment at the time suggested a high degree of distrust of public corporations and accounting firms. The capital markets, in the meantime, experienced a "flight to quality" in light of uncertainties about the reliability of published financial statements. Against this backdrop, Congress enacted the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley, 2002).

Sarbanes-Oxley is the most far-reaching US governance legislation since the Securities Acts of 1933 and 1934. The law consists of eleven titles or divisions which address: auditor oversight and independence, responsibilities of corporate executives and boards, financial analyst conflicts of interest, tougher fraud accountability and sentencing guidelines, enhanced SEC resources and a new focus on internal controls. Section 404, which sets forth the new internal controls rules, requires management to document financial reporting controls and assess their effectiveness. The independent auditor must then evaluate management's assessment as well as independently assess control effectiveness.

Reactions from academia and professional societies, such as the American Institute of Certified Public Accountants (AICPA) stress enhancing ethics and fraud education in undergraduate and graduate business curriculum. A report issued by the ethics education taskforce of the Association to Advance Collegiate Schools of Business (AACSB) suggested that "All of us involved in business education need to think more deeply and creatively about how to guide business leaders …" (Phillips, 2004). At a National Association of State Boards of Accountancy meeting, W. Steve Albrecht, the associate dean of Brigham Young University's Marriott School of Management stated that educators shared the blame for Enron. "We haven't taught ethics, we haven't taught fraud, we haven't taught students how to think," he said (Haberman, 2003).

The implications are that specific courses dealing with fraud and internal controls need to be enhanced or developed, alongside efforts to incorporate ethical analysis of the scandals into existing curricula.

NEED FOR NEW COURSES

Sarbanes-Oxley Section 404 reporting requirements are currently only required of "large" public filers (those with public float in excess of $75 million), however, eventually all public companies will fall under this regime. After numerous delays and public comments, the first round of statements containing the new controls reports have been filed with the Securities and Exchange Commission (SEC). The early reporting experience is telling: there is a 10.9% rate of control weaknesses and deficiencies being reported (Compliance Week, 2005). At the same time, the estimated costs of compliance have risen dramatically; a recent Financial Executives Institute survey of 217 large companies which reports a 39% year over year increase in the estimated Section 404 compliance cost to an average of over $4 million (FEI, 2005). While many factors play a role in contributing to the failure rate and high costs; lack of formal control curriculum, training and education certainly need to be considered among the contributing factors.

The National Commission on Fraudulent Financial Reporting ("The Treadway Commission") recommended in 1987: "that business and accounting curricula convey a deeper understanding of the function and importance of internal controls and the overall control environment within which financial reporting takes place" (Treadway, et al, 1987). The Treadway Commission's concerns about the definition and role of internal controls in fraud prevention led to the founding of the Committee of Sponsoring Organizations (COSO) and their development of the COSO integrated framework for internal controls, (COSO, 1992). The prescribed framework methodology is widely accepted as the conceptual foundation of internal controls in the United States. Paradoxically, the framework is not formally acknowledged and reflected in the operational control structures of many corporations.

While the conceptual framework for controls sets forth a coherent and integrated approach for internal controls, the policies and procedures employed by most US corporations reflect a mixed pedigree in terms of design principles. Evaluating this collection of controls, developed over various timeframes and reflecting varying control philosophies is a daunting proposition. The evaluation becomes even more challenging when trying to apply the logical structure of the COSO framework in performing Section 404 control assessments.

The gap between practice and conceptual framework can be closed in part through education. A controls course addressing the design, implementation, operation and assessment of internal controls using the COSO framework, would be a significant step in training future accountants and corporate managers. Elevating the controls curriculum to full course status, would be a step towards fulfilling the educational expectation set forth by the Treadway Commission.

INTEGRATION WITH EXISTING COURSES

Transcending the educational implications of Sarbanes-Oxley, there are significant opportunities to use the lessons learned from corporate scandals in the classroom. While the involvement of accountants and auditors in the scandals is prominent and an obvious starting point, educators have opportunities to expand use of these cases into many other business disciplines.

For example, the group dynamics and conspiracies within corporate management as well as among auditors, bankers and clients provide opportunities for management and behavioral studies. The compensation schemes which provided strong and ongoing motivation to so many conspirators could be studied for ethical implications and improvements. The introduction of significant "reliability risk" of audited financial information in the valuation of public securities can be analyzed in finance courses, along with the roles played by analysts as co-conspirators in the frauds.

The requisite research, case studies, papers and discussion material can be developed from a wealth of sources. Particularly appealing are the vast amounts of testimony by accounting experts, company employees and others before Congressional committees. These readily accessible sources are staggering in volume. The insights offered by both the experts and alleged conspirators in these documents make the task of searching through the volumes of testimony worth-while. These can be supplemented by SEC reports and releases, news articles, legal complaints and other sources.

SUMMARY

The scandals that rocked financial markets at the turn of the new millennium continue to have significant implications for business curriculum. The enactment of Sarbanes-Oxley creates demand for enhanced fraud education as well as for new comprehensive courses dealing with all aspects of internal controls. Beyond addressing these accounting and auditing topics, other disciplines can integrate aspects of the scandals into existing courses. The ethical and other implications of the forces which led to actions taken by Enron, WorldCom and other executives should provide for rich learning experiences. Much of the raw material for the analysis and discussion can be obtained from readily accessible sources.

Business educators have a responsibility both to their students and to society at large to help raise ethical awareness of students. In this way, we can follow George Santayana's advice by helping business students understand the implications of the mistakes of past, and perhaps prevent repeating them.

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