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# Keynote address

## Paul Sharman

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**Paul Sharman** is President and CEO of the Institute of Management Accountants.

**Paul Sharman:** It is a great pleasure to be here in the wonderful city of Newark at the wonderful Rutgers University. As Michael said, you might notice that my accent is somewhat British. Until the beginning of last week, I also lived in Canada, so you had a British person who lived in Canada running an American institution, which is a little unusual. It certainly created havoc with many of my peers in the accounting profession and with the leaders of the association and the accounting firms and other folks because they kept wondering, 'Where is this guy coming from?' I'll give you a little bit of a sense of it.

The Institute of Management Accountants (IMA<sup>®</sup>) is the association that represents finance professionals who work inside corporations, and this community represents about 90 per cent of all finance function workers in the United States. If you take a look at the Department of Labour's statistics, there are about five to six million people who work in finance function activities, five to six million people who do things like accounting, budgeting, forecasting, planning, preparing financial statements, preparing tax report forms, doing auditing. So of five million people, what proportion do you think would be involved with audit and compliance?

**Cynthia Connelly:** Sixty per cent.

**Paul Sharman:** Sixty? Anybody else? Ten? The stats would show 7 per cent. And think about

the constructs; it is really simple. It is going to take more people to do the work than it does to check the work, right? It is pretty logical. The stats would suggest to us that about 93 per cent of all finance function workers in the United States work inside corporations. You would not know that. Again, I apologise because of my foreignness here, but it seems to me that, in America, marketing is more important than facts. Can you relate to that? Think about this: I get on an airplane in the United States and sit next to somebody I have never met before — many of you have been in this situation — and I ask that person, 'What do you do for a living?' They tell me whatever it is. And they say, 'So what do you do for a living?' And I say, 'Well, I'm an accountant.' Then that look comes across their face, suddenly interested. And the very next question is — what?

**Male voice:** Taxes?

**Paul Sharman:** Yes. 'Can you do my taxes?' I say, 'No.' 'Are you a CPA?' 'No.' 'What kind of accountant are you?' I say, 'I'm a management accountant.' And they look totally dumbfounded like, 'What is that?' I say, 'Well, that is only 90 per cent of all the accountancy professionals in the world.' If I were to do the same thing in Britain or in Canada, they would say to me, 'What do you do?' I would say, 'I'm an accountant.' The words that would come out of their mouth would be, 'So what kind of accountant are you?' Can you explain why it is the case one way in the United States and that it is a different case in Britain or Canada?

**Male voice:** Lobbying.



**Paul Sharman:** Lobbying? Anything else? Yes?

**Male voice:** It is much more difficult to escape taxes in Britain and Canada so no one bothers.

**Paul Sharman:** That may not be true, but I'm not sure I would ever take on the IRS. I do not know whether I would take on Revenue Canada either. But they tend to be slightly more inclined to negotiate in Canada and Britain than they are here. And the litigiousness of the United States — you are guilty until found innocent. Meanwhile, you have just gone bankrupt in trying to demonstrate you are innocent. In Britain and Canada, it is the other way around — you are innocent until found guilty. Actually, there are many different things going on here. You now have to ask the question: What is the purpose of accountancy in society? What is the answer?

**Male voice:** Compliance.

**Paul Sharman:** Compliance. What is an accountant? USAID, the government funding agency that works to spread democracy around the world, is influential in the distribution of accountancy practices in the former Soviet Union countries and the Arab states and many other countries. Why would they do that? It is to promote commerce because that is how you create wealth and because that is what creates democracy, and it is what feeds people and allows people to go to bed at night with a full belly.

Accountancy is the facilitator of business. Accountancy is the language of business — it helps us build commerce and economies. Where compliance is actually one aspect of accountancy, the more important role of accountancy is to facilitate the understanding of the application of resources to business activities in a business situation in order to create valued outputs for customers and, in the process, to produce value and revenue to pay employees and revenue to produce profits for investors. Think of it this way: If there were no business, there would be no taxes. Do you agree? If there were no business, there would be no financial

reports. If there were no business, there would be nothing to audit. So accountancy is central to society's needs — to democracy. Am I making sense?

Yet, in America, an accountant is somebody who does audit or taxes because of the emphasis on compliance. How convenient for the government. What does a politician want? He wants to throw out some idea and be able to enforce it. Let's have SOX 404. Let's create the scourge of commerce in the United States. Let's try to create a lack of competitiveness.' They did not think any of that, nor do they think about the practicality of implementation. Nor do they test the effectiveness of their ideas. People who do not have to think about things will actually throw rules against the wall. Sometimes when those stick, others suffer.

Do you know that Argentina had one of the world's leading economies until some politician brought in a rule and it destroyed the economy? Could that happen here? You absolutely have to believe that it could happen here. Oil revenue is flowing into the Arab states, into Russia. The economy in China is growing — they are the most voracious, the cleverest people in the world in many ways. The power is shifting with the economy. Go to Russia, and you will see more nice cars in the streets of Moscow than you will see in New York. Think about that. Go to the Middle East. Do you think they are sitting there going, 'We will keep giving all this money to American or multinational firms forever?' No, they have Saudi-isation programmes, Bahrain-isation programmes. They are taking their money, and they are putting it into education and creating commerce for locals in order to prosper.

What kind of accountancy professionals do they need? Do they need to focus on compliance, or do they need to focus on how to build value and build revenue and build business opportunities? Do you not think the emphasis is on building business? Compliance is for the sophisticated; it is for those who already have the businesses in place. Oh, yes, let's have another rule. Imagine that society is like a pristine city;

it is a thing of beauty. We have created this thing of beauty, and we have done it through freedom of choice. We have done it through freedom of speech. Then we start putting in rules until we create this Kudzu vine creeping through society's ways of building business. We gradually grind business down. In other parts of the world, where the regulations and laws are less complex, their businesses are growing.

Every great civilisation began as a theocracy and ended in bureaucracy. In other words, great civilisations ended up destroying themselves because they ground themselves into the mire with increasingly complex regulations and rules established by people who really do not understand or take the time to appreciate the implications of those rules. Let's say, for example, that our country contributed to ISO standards which describe the meaning of risk, for example, as being top-down. Even though the US is part of ISO, apparently our regulator feels it is unnecessary or the 'accounting profession' is unable to follow the standards on risk management.

I asked the Chairman of the PCAOB: 'How come the audit community does not follow global risk standards?' He looked at a piece of paper and said, 'Well, we are getting better.' In other words, the auditing profession in the United States knows little about risk as it is broadly defined elsewhere in the world. It is not what they do. The firms have this old 30-year-old audit-centric logic that they follow. This is what they use to make a living. They are not going to follow global standards on risk. They know how to do this other audit-centric stuff, and, by the way, they can charge US\$35bn for it. Is it logical that audit partners want to perpetuate that? Consider that they depend on about 100,000 people between the ages of 21 and 26 to do the billable work. How could their work force possibly be able to assess risk, but they can follow check lists.

How is it that we have regulations where we do not bother to assess the cost/benefit before we implement them? Our regulator

does not actually know whether PCAOB AS2/5 can be implemented in small businesses. We do know, though, that accelerated filers struggled for four years to implement AS2.

I have a few slides I was going to use, but just before I get to them, I'll make another observation. The way you get good financial statements and the way you get a good audit outcome is by educating and certifying the people inside the corporations and because they do their job right. All this emphasis on compliance is important to accounting firms. I understand that there is a US\$100bn revenue business behind all of that compliance; it is the accounting firms' revenue. I understand that they are hugely successful and that they have huge amounts of influence in the United States. But I tell you absolutely: You cannot inspect quality in, and better auditing does not produce better financial statements or better internal controls. That is not what happens. What happens is that over dependence on auditing leads to a weakened ability of the people inside the corporation to do everything that is needed of finance. We become fixated on reporting and internal controls and less focused on being business partners, growing the business, growing profits while ensuring compliance. So the term 'accountant' is increasingly narrowly defined in the United States and leaving folks with a mixed bag of education to do the work in finance and accounting departments. These are not professionally certified.

It is our belief that the opportunity for the accounting profession is to broaden its purview from being primarily compliance oriented. It is necessary to focus on the people who work inside corporations and say, 'We need to educate those people in a way that is meaningful to them.' Today the accounting firms need to hire 25,000 young people a year with an undergraduate degree in accounting to work for them for two to three years, because most people do not want a long-term career in auditing. Am I being a bit rough? Let me tell you that 50,000 people every year leave the accounting schools: 40 per cent go into industry



directly; about 10 per cent go elsewhere; 50 per cent go into audit firms; and within three to five years, 80 per cent of them leave the accounting firm and go to industry, which is where they wanted to be in the first place. Eighty per cent of all young people with an undergraduate degree in accounting are in industry within three to five years of graduating. Why did they not go there in the first place? Because somebody said, 'You have to get your ticket stamped.' Society seems to accept that, 'You are not an accountant if you are not a CPA.' What is that about? It is not the same anywhere else in the world. Well, where do you get US\$100bn of revenue if you do not have a labour pool? Since most people aren't going to stay in the accounting firms, the firms have to get the kids while they are young. Am I being unreasonable?

If only the accounting firms could increase the tenure of their young people from two or three years to 10 or 20 years, we could redesign the accounting profession in the United States. We could actually educate and prepare people for the work they are going to do in their actual career. The CMA, which is the Certified Management Accountant certification, is a four-part examination programme — many hours of testing. It is a curriculum that is rich and that addresses the needs of business, of finance people in business — not so much audit, tax, or financial reporting. Those subjects are what we need for public accounting. They are not what you need for industry. I talk to CFOs around the country, and I ask, 'Okay. How many accountants do you have?' Assume they tell me 100. 'How many of those people have a CPA?' They say, 'Well, maybe four or five.' 'What proportion of their time do they spend using the education and the experience they have in the accounting firm?' What is the answer?

**Male voice:** Zero.

**Paul Sharman:** Zero. It is slightly bigger. Maybe 10 per cent — very little. All the time I get people saying to me, 'No. The two years in the accounting firm is a great experience.

These kids learn about business. They get a broad view of the world. And then they go into industry, and they learn on the job what they need to know because they got the accounting training'. Baloney. They have been educated on some things that, really, they will never use again in their lives. It is good to know what an auditor does, but virtually none of them do auditing in industry. It is good to know you have to pay your taxes and how they are calculated, but they do not do that work in industry either. When it comes to financial reporting, do they really need to know everything in all 12,000 pages of GAAP? No. They know the few things that are important to them, and they are going to get an expert when they have questions. Correct? 'But they can learn all the stuff about industry on the job' is what some people say. How ridiculous is that? Why is that the case? The real reason we need 25,000 young people to go work for accounting firms every year and stay for two to three years is to produce US\$100bn a year of revenue. Let's expand that to ten years' tenure, and let's change the accounting profession and the education system to focus on what society really needs.

Okay. All this leads us to Sarbanes–Oxley 404. In 1986, Alfred Rappaport produced a book, *Creating Shareholder Value*. Have you read that book? He introduced the idea of discounted future cash flow as the performance measurement of merit. Why is that important? It changed the measurement system from ROI and ROS. They changed the market's valuation method to assessments of future cash flows. At that point, our entire world of accounting was changed. Then we get stock options. Then we get greed. 'Oh, my God,' an unethical executive might say. 'I can say what I like, and I can get the analysts to say, "Buy."' Then we jack up the share price in the marketplace based on fluff assertions, and we get to sell out and make US\$150m dollars. That was how we got WorldCom.

So we say, 'Oh, my gosh. We have to have internal controls.' Well, Enron was about fraud. WorldCom was about fraud. So let's create

PCAOB. Let's establish AS2. Let's produce something that works absolutely inefficiently. It does not address fraud. It does not address the key risks. Everybody whines about it \$35bn later. Accounting firm partners are now driving Porsches and Bentleys — a great deal for them. Lobbying. 'No, let's keep that as a 404. Let's keep the main tenets of 404 because that is good for us.'

Did anybody watch the Robin Williams *Golf Skit*? He is playing the drunk, and he goes, 'Let's make these 18 holes. Great. Let's have a good time'. That is what we have here. We have created a level of silliness around the interests of people who benefit hugely. SOX 404 implementation was not designed properly. AS2 was awful. As for AS5, there is no evidence that it is much better.

I spoke to a friend of mine who is responsible for implementing Sarbanes–Oxley. She was in a meeting with the auditors about a month after the release of the management guidance and the release of AS5. She has been involved with the same process now for a couple of years. I messaged her on BlackBerry and asked, 'Have the auditors briefed you about the changes that they are going to implement as a result of the shift from AS2 to AS5?' She answers: 'No.' I asked, 'Have they briefed you on the implications of the management guidance from the SEC and the new choices you have available to you?' She answers: 'No'. These new rules have slipped in and slipped by. Have the auditors reduced their billings? Probably not — that would be contrary to billing needs.

Where is proper risk management? Why are we not adopting international standards for risk? They are well known. Why are we not insisting that accounting firms train their partners and their auditors on international standards for top-down risk management? Why are we not doing that? Because lobbying makes it unnecessary. An SEC stacked with former accounting firm staff and high-flying future accounting firm partners. It is a very interesting problem.

You all know the history of Sarbanes–Oxley Section 404 and how the implementation cost is 20 times greater or more for corporations than the SEC originally estimated. It was an embarrassment. Some people made a lot of money from it though, which is a bit of an issue. So the costs were greater. It was torture for many people. I know many people who still have to suffer this on a daily basis. There are stories about small companies delisting. If you take a look at the number of IPOs that were launched over the last ten years in New York versus Hong Kong or London, you will see that there has been a considerable shift away from New York to London and Hong Kong. One could argue that with the growing economy outside the United States, that was a natural phenomenon; it had nothing to do with Sarbanes–Oxley. But have you heard of companies and people who said, 'I'm going to delist. I'm going to list in countries other than the United States'? If you take a look at this information from Thomson Financial, in 1999 the vast majority of listings were in the United States, in New York. And look how that has shifted to the year 2006. Is it not interesting to note how the change began in 2002? Does that suggest there is a correlation? I know that there are lots of people who argue that it has nothing to do with SOX 404 at all. It is interesting as to when the decline began.

When you take a look at the stats, 90 per cent of all finance function workers work inside corporations where the most logical certification is the CMA, and they should be management accountants. There should be ten times the number of management accountants in the United States. But it is almost heresy in the United States to say that the folks inside corporations should be called accountants. We have narrowed the word 'accountant' to mean somebody who does tax, audit, or financial reporting. Yet, the massive role of real finance function people is building businesses.

So IMA decided that it really was time that we said, 'Preparers have rights, too.' Often when I am involved with heavy duty financial



reporting people they talk about preparers as if the only purpose of a financial accounting staff in corporations is to prepare financial statements in order to serve the tax and the financial reporting requirements and the investors. I'm thinking, 'Oh my goodness. All the emphasis on financial reporting ignores the fact that there is no financial reporting without business.' That the bread and butter, the daily grist of the mill, is finance function workers who our institutions think are of limited importance. We call them preparers; they are like kitchen staff. We are there to serve the great casino of the capital markets. How wrong is that? Should we not actually say, 'If you want good financial reports, if you want good internal controls, let's make sure people inside the corporations are properly educated and certified. Let's make sure they are properly represented.'

Can you imagine, I had an accounting career inside corporations. I never did an audit in my life. Can you imagine that? I did the odd tax return for myself. Financial reporting — I referred to GAAP when I needed to find a way to solve a problem. But mostly I had the day-to-day excitement of running businesses, and that is what every young person in America going into an accounting programme really wants to do. It is a very different perspective from doing tax returns and checking other people's work. We need to make sure folks inside corporations are represented. We need to make sure they are properly educated and certified. We need to make sure that we have proper education on risk management so that we get the right perspective on society.

We hear our institutional leaders stating that we have now addressed risk in the AS5, but is anybody familiar with the Basel II rules for banks? If you do a word search on Basel, you will find the word 'risk' 1,200 times. If you do a search on AS5, it is about 30 or 40.

**Mark:** Thirty or 40?

**Paul Sharman:** Thirty or 40, right. Huge order of magnitude difference. There is no appreciable focus on risk in the US regulations. Changes to the definition of the term 'material

weaknesses' in AS5 are an improvement over AS2. So we got some things we like, but we do not see sufficient change in AS5 either to make internal control assessments more effective or efficient.

The way we see the PCAOB rules is rather like conducting a health inspection in a restaurant in Manhattan. What you do is send in a health inspector, and they are going to check high-level things. Is the food fresh? Is it being washed properly? Is it being handled properly? Are preparers washing their hands? But AS2 and AS5 are like — well, they send in an inspector with a toothbrush to scrub the cracks between the tiles on the floor; it is unnecessary. The emphasis is wrong, it is on audit-centric logic. Our audit professionals do not know anything about risk management, so they stick to scrubbing the floors, making sure we have signatures on pieces of paper that have no particular material value. And auditors still control everything with their responsibility to attest to the adequacy of internal controls over financial reporting. Because corporations do not have sufficient properly educated people working in them to analyse risk management themselves so they have to listen to the auditor. And are auditors all the same in terms of capability? I had four CFOs sit around a table recently to talk about their purchasing process and their travel expense process, and one of them said, 'Our auditors conducted a high-level assessment and signed off that our processes were fine. Off course we already knew that.' Another said, 'No. We had to completely redesign our expense process and get signatures on almost everything. Previously, we had abandoned most of the signatures; had electronic filing and trust in our folks. Of course in the scheme of things there was not a lot of cost exposure there anyway.' 'Random audits were not deemed sufficient by the outsiders. It is not good enough. We have gone back to pieces of paper and signatures and collection of receipts in the same old way. It has taken us back ten years.' So, apparently, different auditors have different perspectives.

We are very concerned about the implications of this heavy-handed implementation of SOX 404 on nonaccelerated filers over the next 24 months. Suddenly, thousands of corporations are going to be subject to this toothbrush process when, in the past, they have not had that level of attention. It is going to be expensive and could lead to corporate failure. Certainly it will lead to critical managers and executives being distracted from the most important job of producing profits for investors, innovative products, and services for customers, more jobs for employees. We do not expect any help from Congress to defer nonaccelerated filer implementation. So there is no relief coming.

It really seems odd to me that a regulator would establish rules and some guidance, and then four years later they basically acknowledge that they got it wrong, so you make a few changes but can't actually model the implementation process or calculate the cost of doing so. That really is scary. Should you not work out how you are going to do it before you decide that it is a good rule? Implementation process and cost-benefit should be substantial considerations for regulatory agencies. It did not happen with SOX 404.

Will these new committees on complexity — the SEC committee on financial reporting and the Treasury committees on audit — get it right? I do not know. When you take a look at the environment, the amount of lobbying — do you know how much money the accounting firms spent on lobbying last year? Maybe US\$135m.

In the United States, society has been led to believe that compliance is the main accounting story — that public accounting is accounting. Our institutions like the SEC and FASB are systematically biased without knowing it. The price of success is failure. Our institutions are focused on accounting being about compliance; they cannot imagine a different image. No one is willing to take a holistic view of the entire accountancy information system from the very creation of value provided by folks

who perform finance function work in industry (they're accountants, too, but by a broader definition). Society needs accounting professionals in different roles and responsibilities. We need appropriate education and certification for all those hundreds of thousands or millions of people who work inside corporations.

What is the implication of that to Treasury and to the SEC committees? Why would they think anything different? *All of the members are products of the existing model. I do not believe we will see step function change. I think we will see some minor changes, so I'm not particularly hopeful. But you can be sure they will make a big fuss about it.*

What IMA is doing, however, is recognising that there are four million finance function workers in industry — the folks inside the corporation who absolutely need to know how to implement and manage internal controls that not only satisfy financial reporting but also serve the needs of their businesses as they continue to create value. To us, process management is a continuum. You cannot say that financial reporting is the only thing that is of importance in a corporation. You have to say producing value and being compliant with the law is the real purpose. So, consequently, we are in the process of creating and releasing what we call finance governance, risk, and compliance (FRGC) training. IMA will provide education and a diploma of some kind for employees of corporations so that they can design, implement, and manage internal controls over financial reporting. It will address the needs of corporations in their efforts to comply with Sarbanes-Oxley Section 404. It will also address the needs of understanding risk and how to run a business within the context of the needs to do financial reporting.

Tim Leech, a Canadian, is a world-class specialist in risk management and internal controls of financial reporting. He is our practice leader. We are in the process of doing focus groups, defining the best learning mechanisms, there will be online components, simulation



modelling, and in-person training sessions. We continue to do research studies. We did a great one last year with Parveen Gupta on the effectiveness of COSO in the context of Sarbanes–Oxley and 404. We will continue to have new research products.

Anyway, I appreciate your tolerance of my perhaps somewhat obtuse and nonstandard

views of the accounting profession. But I also ask you to open your minds, step away from the notion that compliance is what accountancy is about, and take a look at the role of accountancy in building businesses and democracy and thus being a true enabler of society. That is what IMA is all about. Thank you.