CPA Awareness

CPAs Beware:

Management Usually Shoots the Messenger, But the Sarbanes-Oxley Act Helps Level the Playing Field

By: Mark D. Walters

CPAs gain unique insights into their companies. CPAs staff internal and external auditing departments, tax departments and financial reporting departments, and many mid-level management positions such as comptrollers and division heads to name a few. Thus, CPAs are often the first to know if the company, senior management and their co-workers are breaking the rules. Some CPAs may have wanted to report wrongdoing in the past; but this is risky because senior management has often terminated and personally attacked people that report wrongdoing. Prior to the Sarbanes Oxley Act of 2002, no specific law protected employees who report illegal accounting practices. The Sarbanes-Oxley Act helped to level the playing field.

How Mid-Level Managers Commit Accounting Fraud

Most of the time, accounting fraud occurs without intentionally cooking the books. In 1987, the National Commission on Fraudulent Financial Reporting, commonly called the Treadway Commission, issued a report entitled the Report of the National Commission on Fraudulent Financial Reporting. In its report, the Treadway Commission found fraudulent reporting is frequently the cumulative result of a series of acts designed to smooth over operational difficulties that, over time, becomes fraudulent. In other words, accounting fraud is often the unintended result of the actions of someone with good but misguided intentions, who bends the rules too far – or, in accounting parlance, takes an aggressive but unsupportable position – to overcome a short-term problem.

Mid-level managers often participate in fraudulent schemes by following orders. The Security Exchange Commission ("SEC") recently published its Report Pursuant to Section 704 of the Sarbanes-Oxley Act of 2002, which examined enforcement actions brought by the SEC from July 31, 1997 to July 30, 2003. In this report, the SEC acknowledged that most enforcement actions against mid-level managers arose out of their participation in fraudulent schemes at the direction of senior management. Unfortunately, however, the "just following orders" defense is usually a poor one.

Whistleblowers Can Stop Corporate Fraud, But Management Usually Attacks the Whistleblower

Whistle blowing is an effective tool for detecting corporate wrongdoing. According to KPMG LLP's 2003 Fraud Survey, 63% of respondents reported that they detected fraud by employee notification and 41 % by an anonymous tip. Similarly, the law firm of Wilmer, Cutler & Pickering published the U.S.

Economic Crime Survey in July of 2003 reporting that 36% of participating American companies detected economic crime from whistleblowers.

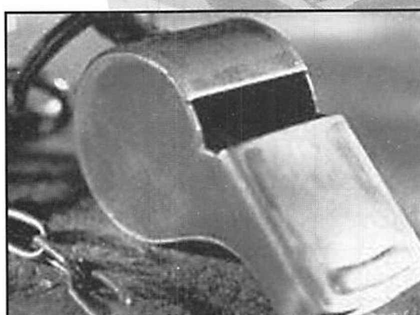
Corporate leaders, however, do not to want their employees blowing the whistle. In 1987, the Treadway Commission reported that:

> ...those making disclosures of alleged wrongdoing or illegality find little or no protection. Whistleblowers almost invariably pay a high price. With few exceptions, they are driven out of not only their jobs, but also their professions.

Joyce Rothschild, a Virginia Tech professor who did an eight-year whistleblower study, reached similar conclusions. Professor Rothschild found that 69 percent of whistleblowers were fired, even when they only reported wrongdoing internally. In addition, Professor Rothschild found that senior management often attempted to discredit whistleblowers.

The Sarbanes-Oxley Act Whistleblower Protection Clause

With the enactment of the Sarbanes-Oxley Act, would be whistleblowers received legislative protection. The Sarbanes-Oxley Act's whistleblower protection clause protects employees of publicly traded companies from retaliatory and discriminatory reactions from their employers. This applies when employees provide information they reasonably believe constitutes fraud or a violation of any federal law designed to protect shareholders from fraud to federal officials, their supervisors, or other persons working for the company with authority to investigate, discover or terminate misconduct.



There have been very few published Sarbanes-Oxley Act whistleblower decisions; however, several trends are emerging:

- Employees are not required to call the feds. The employee is protected if he or she reports a reasonable belief of wrongdoing to someone working for the employer with the authority to investigate, discover or terminate misconduct-statutory qualifications that appear to include a wide range of co-workers and the outside auditor.

- Employees need not be right. As long as the employee reports a matter he or she reasonably believes constitutes a violation of federal law designed to protect shareholders from fraud, the employee is protected, even if his or her report of wrongdoing is later determined to have been incorrect.

- The definition of whistle blowing is less than one might think. For example, in the first published Sarbanes-Oxley Act whistleblower case, the CFO engaged in protected conduct when he refused to sign the f inancials and told his boss that there were inadequate internal controls because too many non-accountants outside the finance department were making journal entries without the CFO's review or knowledge.

- Employees need not be fired. Employees are only required to show that he or she engaged in statutorily whistle blowing conduct and that this was a contributing factor – however small – to an unfavorable employment action – meaning action likely to deter others from making protected disclosures.

- Meet the 90-day jurisdictional filing deadline. Employees have only 90 days to file their complaints with OSHA, the federal agency assigned to administer these complaints. Miss this deadline, and you risk having the case dismissed on a statute of limitations defense. Importantly, this deadline begins to run on the date the employee has notice of the unfavorable employment action.

continued on page 17

CPAs Beware continued from page 15

What to Do When Asked to Break the Rules

Given that corporate management has generally treated whistleblowers as "Company Rats," CPAs should inform themselves of their rights and responsibilities under the Sarbanes-Oxley Act and be prepared to stand up for themselves when necessary. Therefore, pay attention to what you say to authority figures about financial and ethical issues; make contemporaneous detailed notes about these conversations when worried that others are taking the wrong path (keep these notes at home), and pay attention to how your supervisors and senior management treat you afterwards.

If the response is one that would deter others from speaking up in the future, immediately initiate a candid conversation with your boss or someone in authority about your concerns and explain why your conduct falls under the Sarbanes-Oxley Act whistleblower protection provision. Follow this up with a written memo to memorialize the meeting, and consider copying your memo to the General Counselor the audit committee. You may also need legal advice and assistance, and, if you do, you should immediately obtain legal representation from an attorney willing to go to school on the accounting issues and willing to fight aggressively for you and your career.

Because of their unique vantage point into the inner workings of their companies, some CPAs will find themselves in difficult situations; for example, when directed to "take another look at the issue to find a better position." When CPAs choose not break the rules, while reminding management that the Sarbanes-Oxley Act offers broad protection for their action not only will they avoid the loss of a hard-earned career, they may well help the company avoid shareholder fraud and an embarrassing public announcement that causes the stock price to plummet – all of which are in everyone's best interests.

[Note: Mark D. Walters is a Principal with Blank & Associates, P.S., a Seattle, Washington law firm. Mr. Walters recently prosecuted a Sarbanes-Oxley Whistleblower claim on behalf of a tax accountant against a major publicly traded company. He invites your comments bye-mail at markw@digital-legal.com.]

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