

# Pensions & Investments®

THE INTERNATIONAL NEWSPAPER OF MONEY MANAGEMENT

crain

## Schapiro takes right path on market reform

But auditors, lawyers and shareholders need better tools

By Lawrence A. Sucharow

If there is a silver lining to the securities, financial and credit sector catastrophes of the last two years, it is that not since the 1930s has there been a better opportunity and greater appetite for meaningful reform of those markets. The question is what form these changes should take.

Discussion over proposed reforms is split between two competing views. One camp points to failures of the laissez-faire policies of the last 10 years, and advocates increased governmental regulation and supervision of the markets. The other warns that, in the midst of our current economic woes, massive spending on new government regulation and intervention could not have worse timing.

In recent remarks, Mary L. Schapiro, chairman of the Securities and Exchange Commission, sought a middle ground — a way to increase the policing of the markets without imposing additional strains on scarce federal resources. She suggested such a step-up in oversight could be accomplished through self-regulatory organizations and other third parties such as auditors who can do compliance reviews.

Indeed, there are non-governmental actors who can play larger roles in ensuring the transparency and integrity of our securities markets. Auditors, lawyers and shareholders are all sure to play a role. To enable them to take up this challenge, however, we must be prepared to make some changes.

### More clarity for auditors, accountants will help

Auditors have long had a vital role in ensuring that company management is accountable to shareholder interests. However, this responsibility can only be exercised so long as the auditors are able to maintain independence from management. Because auditors often derive large fees (usually many times larger than audit fees) from non-audit-related services they provide to the companies they also audit, their independence is often in doubt. Indeed, some auditors have been questioned for providing so called “lowball” bids for auditing services, deliberately offering auditing for below-market rates in hopes that they can make up for lost profits in the non-audit services they provide. Some have suggested that to ensure auditors maintain a degree of independence, companies should be required to submit their choice of auditor to independent review committees, or to periodically rotate their selection of auditors. While not a perfect solution, presenting the selection of a firm’s auditor to shareholder selection or ratification, as some companies do, at least introduces an element of uncertainty in their continued employment, so an auditor could not simply rely upon a comfortable relationship with management to assure its continued engagement.

Recent controversy over changes to rules for mark-to-market

accounting highlight the important role that accountants will play in any meaningful private sector reform. The central task of accounting is to accurately record a company’s financial transactions and then report its financial condition. However, responding to legislative pressure, the AICPA has recently weakened rules requiring that assets be recorded at fair-market value, injecting a cloud of doubt into financial reporting. For accounting to lead the way in the non-governmental policing of dubious financial transactions, accounting rules should call for more clarity about the true value of the assets, not less.

### Shareholder rights need to be strengthened

Revitalized private litigation under the securities laws can also be among the answers to Ms. Schapiro’s call for private-sector solutions. The enforcement of strong securities laws has resulted in U.S. capital markets that are stable, transparent and secure. Accordingly, private securities litigation has become an essential component to the attraction those markets hold for international investors, as noted by Craig Doidge et al., in “Has New York Become Less Competitive in Global Markets? Evaluating Foreign Listing Choices Over Time” (Fisher College of Business, Ohio State University, Working Paper Series, Paper No. 2007-03-012, 2007)

In spite of the important role that private litigation plays in policing market behavior, the last 10 years have seen a dismantling of key shareholder protections. A recent Supreme Court decision has significantly restricted investors’ ability to sue those who play an essential role in the success of a company’s effort to deceive its investors, either as an aider and abettor or as a primary participant in securities fraud. Until Congress acts to restore shareholders’ ability to hold actors liable for such conduct, efforts to weed misconduct from the market will be significantly hobbled.

Ms. Schapiro is right to call on the private sector’s aid in protecting U.S. markets, but the success of these efforts will turn in large part on whether non-governmental actors such as auditors, lawyers and shareholders are given the tools necessary to achieve this goal. ■

*Lawrence A. Sucharow is the chairman of Labaton Sucharow LLP, a New York-based securities litigation law firm.*



**Lawrence A. Sucharow, chairman of the law firm of Labaton Sucharow, says private-sector auditors, lawyers and shareholders can play larger roles in ensuring the transparency and integrity of securities markets.**