

# Corporate Accountability and Public Perception, A New Zealand Perspective

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# Abstract

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Deficiencies in accountability, transparency and corporate governance across the globe have contributed to a loss of confidence in the corporate culture. An investigation of a selection of failed corporations shows that 60% of these firms failed owing to factors 'other' than accounting irregularities, the collusion of directors, auditors and chief executive officers or their high remuneration. The three New Zealand cases of misleading reporting (Air New Zealand, Fletcher Challenge and Tranz Rail) have reduced public confidence and created a negative perception. To ensure a robust corporate accountability regime, restore investor confidence and achieve a positive public perception, the framework of an interactive accountability system is proposed. The motivation for this exploratory study was to identify the gap between the public perception and the actual factors attributing to collapse or failure. This study of 35 corporations compares the factors that contributed to their collapse or failure with the public perception that accounting and auditing were the main causes of corporate collapses. It is the contention of this paper that notwithstanding a high number of failures, many countries may need only to use the lessons, experiences and morals of the stories of failed corporations to strengthen their financial reporting standards and corporate value dimensions and move towards a global GAAP. In New Zealand there is little evidence of poor financial reporting but there is a distinct loss of investor confidence. The paper finds that 'other' factors, rather than accounting and auditing factors, were the major cause of the collapse of this group of companies.

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# Corporate accountability and public perception, A New Zealand perspective

## Introduction

Recent developments have alerted the New Zealand government, the Institute of Chartered Accountants of New Zealand (ICANZ) and the Securities Commission because a lower standard of corporate accountability could ruin New Zealand's 'clean green' image. New Zealand's 'clean green' values and image are embedded in the Statement of Concepts (SOCs), which form the basis of the New Zealand Financial Reporting Standards (FRSs). They are the simple and indispensable values of responsibility, obedience, duty, and adherence to rules, honesty and truthfulness. They are consistent, universal and trans-cultural, and they inform and direct a Kiwi accountant's ('Kiwi' is a colloquial name for a New Zealander) actions and attitudes.

By the year 2000, the Y2K monster of the 1990s that threatened the historical evolution and success of the greatest boons to global economies, education and communication systems, finally did no damage. Instead, some of the strongest global economies have been gripped by a corporate culture dangerous for its lack of accountability. The emergence of this dangerous corporate culture in Western countries has put world economies on the alert. Some smaller economies are also on the alert and focussing on a drive towards corporate compliance and internal accountability that will provide an overall culture of stronger corporate accountability.

There are strategic moves directing accountability efforts at a wider range of external stakeholders than stockholders alone, as has been recent practice. While attention appeared to be focused on stakeholders in the past, in practice, the wealth of stockholders was the priority.

Since 2000, too many big and important Fortune 500 companies (which are supposed not to collapse) have fallen with a heavy thud. In 2001, 257 public companies, with US\$258 billion in assets, declared bankruptcy, shattering the year 2000 bankruptcies' record of 176 companies and US\$95 billion in assets. Sixty-seven companies collapsed in the first quarter of 2002<sup>4</sup>. Accountants and auditors have been blamed for collusion, leading to collapses, while directors, CEOs and CFOs have been blamed for corporate manipulation.

Each CEO and CFO has their own reasons for company failures. The CEOs in some of the cases in this study believe that companies fail mainly because of

- a slow economy
- market turbulence
- currency oscillation
- deception and fraud
- terrorism.

A close study of corporate failures suggests that, acts of God aside, most companies founder simply because of managerial error<sup>4</sup>. This analysis of some major collapses and failures reveals that corporate collapses and failures are attributable to many other reasons besides accounting manipulation and fudging of accounts.

Publicity about accounting bodies, standards and rules needs to be looked into and the reasons for their existence examined. The adherence modalities (the ways people understand and interpret standards) require changing, in the knowledge that accounting and auditing factors are only two of the indicators of a public company's health or lack of health. In New Zealand, the smallest of the four economies investigated, faith in the large corporates has been waning in the last two years, owing to the failure of a few giant companies on both sides of the Tasman Sea through accounting irregularities and corporate managerial errors.

## Research objective

Recent studies show that audit failures are not contributive causes of corporate collapse and that many collapses have occurred because of failure to comply with international best practice guidelines<sup>11</sup>. Notwithstanding the above, there is a widespread public perception that auditing and accounting have been the main causes of corporate collapse. While this paper examines the common factors contributing to the collapse of the companies under study, the primary objective is to investigate whether the following perception holds for any or all the four Western countries under study: the United States (US), the United Kingdom (UK), Australia and New Zealand.

The perception is that the main causes of corporate collapses and failures are

- accounting irregularities
- accountants' and auditors' collusion
- directors', CEOs' and CFOs' remuneration.

The secondary objective is to investigate new factors that will contribute to improving corporate accountability and governance in the Kiwi culture.

## Data and methodology

In this exploratory study the 35 corporates investigated, from the four Western countries, failed in the recent past. The number of failures in the recent past has been large (over 600 listed large companies, Fortune 500 type, since 2000) This sample is sufficiently large for the qualitative exploratory research undertaken.

The sample was selected from the *Critical Perspectives on Accounting*, *Interdisciplinary Perspectives on Accounting* discussions, popular published journals, business magazines, newspapers, Internet websites and other media, such as the BBC, CNN and CNBC. Most of these 35 companies raised concerns about financial reporting models, auditors' and directors' independence, and unethical corporate behaviour. The companies selected have been of special interest to *Critical Perspectives on Accounting*, especially those in the US and Australia.

Context-related criteria for the four sampled countries have included social, economic and environmental factors. The four countries were selected because of similarities in their financial and economic indicators, accounting standards and influences such as political environment, capital markets and financial reporting methods (Appendix 1).

The age of the companies selected was 10 years or more. A few had been established for a much longer period than ten years, but had merged or amalgamated with bigger groups in recent years (for example, Salomon Brothers, which is now Citigroup).

Data on websites was the main source of investigation and analysis, owing to limitations of money, time and access. A search was carried out on the websites of the recently collapsed companies and factors to find causes of failure. The exploratory technique of qualitative research is suitable to the subjective nature of the initial analysis. The analysis is applicable to the selected group of companies in the four countries.

Quantitative analysis of the qualitative data about the investigated firms was carried out. Besides the companys' websites, the qualitative data used was from published academic analysis, articles from business journals (*The Accountant*, *Management*, *Fortune 500*), and findings of accounting and consultancy firms (for example, KPMG and PWC). Wherever possible, relevant

financial statements and annual reports were used to validate published information in newspapers and magazines.

The case analysis, combined with the exploratory qualitative research used, enables appreciation of context and the participants' perspectives. The content and context-related criteria for analysis, if further developed and researched, might apply to most companies in terms of 'other' factors, (for example, ineffective and fraudulent management) being the main cause of collapses and failures.

Table 1 lists recently failed companies and the factors or reasons responsible for their failure. These American, British, Australian and Kiwi corporates include Enron, WorldCom, Global Crossing, Equitable Life, Trans Tec, HIH, One.Tel, Fletcher Challenge and Tranz Rail.

I have converted the qualitative information into quantitative data by analysing relevant cases and stories on the websites to find out:

- which category of factors (for example, accounting, auditing or corporate) is responsible for the failure of the investigated firms and to what extent
- the extent to which the three most likely claimed causes (according to public perception) hold true for all four selected countries
- some new factors that can help to make the corporate accountability culture more transparent.

Project case-type analysis has been applied to find out whether there was any 'truth' in the general perception. Secondly, project-related criteria have been used by considering the length of involvement in projects, that is, whether the companies have been running long enough to have made an impact as 'successful companies'.

The available information has been used to gain a preliminary understanding. The case study methodology was used because the experiences of subjects and the contexts within which they operate are important. The results of the analysis of factors causing collapses (see Tables 1, 2 and 3) indicate the difference between these and public perception as to which factors caused this group of 35 companies to collapse.

Again, despite Stephen Jacques'<sup>11</sup> study pointing out that audit failures were

not the cause of corporate failures, I have included the auditing factor as one of the causes of collapse/failure for this sample under study. In the cases selected, the broad categories of factors/reasons causing collapse or failure in the four Western countries, United States, United Kingdom, Australia and New Zealand, were analysed.

The factors are classified thus:

- accounting
- auditing
- corporate
- management
- fraud
- other.

For the purposes of this paper, the following description and definitions have been developed from the case studies and stories (see list of websites for stories) of the companies under investigation:

- *Accounting factors*
  - irregularities
  - failure to meet accounting standards
  - misclassification of revenue expenses
  - artificial increases in profits
  - other types of manipulation.
- *Auditing factors*
  - failure to disclose (keeping relevant information from stakeholders)
  - making cursory reviews
  - failure to inform directors or company management when off-balance sheet transactions are found
  - failure to meet financial reporting standards

- mixing non-financial consultancy services (such as product and company information)
- shredding documents
- ignoring relevant financial deficiencies.
- ***Corporate factors***
  - directors serving on too many boards
  - CEOs' and CFOs' high remuneration
  - overlapping audit committee memberships
  - failure to comply with regulations (especially company law regulations)
  - lack of experienced, skilled and suitably qualified directors or senior managers
  - high remuneration for complicit auditors
  - groups' and boards' failure to comply with the law.
- ***Management factors***
  - lack of appropriate training
  - lack of values and ethics education
  - lack of measurable accountability
  - cultural issues
  - inadequate planning of business
  - poor decision making
  - lack of vision
  - over-reliance on 'old boys' networks'.
- ***Fraud***
  - in-house fraud (by employees and managerial staff)

- accountants' and auditors' collusion
- CEOs' and CFOs' collusion
- embezzlements
- technology theft
- theft of intellectual property, inventory and plant.
- *Other factors*
  - risk
  - insufficient market research
  - inaccurate market perception and lack of understanding of market complexities
  - lack of responsibility and accountability
  - over-ambitious targets and standards
  - expanding too soon
  - negative public perception
  - ineffective fraud controls
  - terrorism
  - economic downturns.

# Corporate Accountability: Review

For a corporate culture of accountability to work, corporates must be transparent (be willing to provide information), senior managers must be accountable (be willing to take responsibility or demonstrate commitment to accountability), and staff must possess a high degree of integrity (be honest or do the right thing). Since a 'corporate' is a metaphor and it is people who make decisions, integrity becomes an issue of personal accountability.<sup>3</sup>

As long as risk is taken, people will have to be relied on and held accountable and responsible in order to achieve the expected return.

Besides practising transparency, accountability, integrity, and sound and relevant financial reporting, a company still has to formulate workable strategies for risk management, corporate governance and performance measurement. Everywhere, business failures and poor corporate performance and governance are possible by-products of business 'risk and return' concepts. Risk and return are the core elements of investment activity. Low returns and poor management can also lead to failure. The Concord Ensemble risk management application addressed the three factors that led to corporates' failure – too much risk, information hidden from executives, and ineffective communication.<sup>20</sup> Too high a risk appears as the highest contributing factor towards failure (60%), with 10 out of 15 corporates sampled failing for this reason, besides other factors.

If a culture of corporate accountability—dating back to 1601 in the UK ('A brief history of Corporate Accountability,' *The Stakeholders Alliance*, [www.stakeholdersalliance.org](http://www.stakeholdersalliance.org)) when Queen Elizabeth chartered the East India Trading Company – is in place, combined with integrity, commitment and adherence to rules, it is argued in this paper that New Zealanders need not be over-concerned at having to face grief-stricken situations like those of Enron and WorldCom.

This, however, does not imply in any way that New Zealand is immune to financial reporting manipulation or that there is any room for complacency.

No degree of regulation will overcome the certainties that corporate failure is inevitable and the auditors will be blamed. The reality is that financial difficulty, financial collapse and the temptation to hide or distort reports of poor financial performance are natural consequences of the market system.<sup>18</sup>

As long as accountants, auditors and executives collude, there will be failures. Yet, despite the dot. com or tech bubble burst and recent global collapses reflecting the downside of internet/virtual firms, corporate collapses are not a universal phenomenon.

In most cases it is difficult to pinpoint exactly who or what is responsible for the failure – the accountant, auditor, management or a combination. Corporate collapses in the new millennium, more specifically in the Western world, have triggered calls for compliance and governance structures in order to increase the accountability of corporate boards to stockholders.

Ethically conscious organisations are increasingly claiming that the most important reform is to follow a simple set of rules based on principles and disclosure and a culture of commitment and corporate accountability. However, under both rules and standards, there is scope to misrepresent a corporate's financial position and under the principles-based approach it is easier to misrepresent a corporate's financial position<sup>10</sup>. Commitment to the spirit of corporate governance and legal compliance, by both groups of companies and boards of directors, is important. The number of boards on which directors can serve and their levels of education and training have been questioned in recent years.

Some background issues that have emerged as a result of the recent **global** corporate debacles are listed in the bad news and good news sections. What has been bad news for some firms has been good news for others, the industry and the accounting profession, and vice-versa.

## The bad news and the good news

### *The bad news*

- Some of the fraudulent and corrupt corporates have been found out and tossed out (see a list of websites for corporate failure stories).
- An Australian analysis of the major collapses in Australia in 2002 found that failed companies HIH, One.Tel, Pasminco and Harris Scarfe exhibited 'gross violations' of corporate governance standards<sup>17</sup>.
- The failed companies in Australia were characterised by fewer independent

directors, an above-average number of former audit firm personnel as employees and a much higher number of dealings with people related to the company.

- 'Old boys' networking and their lack of education and training has done a lot of damage
- Some of the directors have overlapping roles and excessive remuneration
- There is collusion among CEO, chairman and auditor in some cases
- Rules-based standards have not proved effective.
- Adherence to company law has been lacking.
- There is very little detection of fraud and anti-fraud training available.

*The good news*

- Passing of the Sarbanes-Oxley Act 2002, which focusses on
  - the corporate responsibilities of management and audit committees
  - financial disclosure
  - the independence of auditors and audit committees
  - the role of public companies' Accounting Oversight Board.
- A movement towards global Generally Accepted Accounting Practices (GAAP).
- A transition to International Accounting Standards (IASs).
- A realisation that principle-based standards are more coherent than a rule-based approach.
- A realisation that adherence to the spirit of a conceptual framework is more important than sticking to the letter.
- The emergence of consistency, compliance and commitment to the cultural values of transparency, accountability and integrity.
- Acknowledgement of the importance of the role of education programmes in

implementation and compliance as critical to the achievement of a corporate accountability culture and proper corporate governance.

- The realisation that consultative processes need to be put in place.
- The realisation that integrity, credibility and reputation are key issues.
- The requirements that directors serve on fewer boards, meet specified skill requirements, monitor finance processes and auditor engagement and that CEO and chairperson roles be separate.
- A more active watchdog role by boards
- The collection of stories to tell, examples to cite to the accountants, auditors, leaders and educators, each containing a moral.

## What is 'failure'?

Failure doesn't necessarily mean bankruptcy. A dramatic fall from grace qualifies, too<sup>4</sup>. Failure and corporate debacles date back to the 17th century, when the 'tulip mania' collapsed. Whether the collapse was the result of rumours of a government clampdown or just market forces has never been quite clear. What is relevant is that disasters in the corporates are not a new phenomenon. Corporate histories can be traced from flowers – Tulips of Amsterdam – to academics – Adelphi University – to telecoms – Enron. When companies lose a high percentage of their market value, this is failure.

Failures usually involve factors unique to a company's own industry and culture. What Tolstoy said of families applies also to companies. 'All happy families are alike; every unhappy family is unhappy in its own way.' Companies even collapse in their own way.<sup>4</sup> Until recently, the often-quoted figure of a 50% failure rate for mid-size and small businesses was applicable, although, depending on conditions and the industry, the rate could increase dramatically.

In the current depressed economic conditions in the US, a new study shows 67% of new ventures are successful after four years. The study of 12,185 companies found that 17% were wrongly considered failures because they had

closed. Instead, owners had closed them after retiring or had sold them after their deemed success<sup>9</sup>.

The varying failure rates (between 50% and 90%) quoted by different agencies and researchers make it difficult to settle on reliable estimates. To add to this, business owners today are facing new threats:

- results of the dot. com shakeouts
- an already slowing economy
- effects of the 9/11 terrorist attacks
- the war in Iraq
- the SARS virus.

These threats are crippling businesses and setting off a chain reaction. Combined with lack of experience and education and inadequately trained senior management personnel, they increase the chances of failure and/or collapse. Businesses that have been through the recession of 1991, suffered the Gulf War in 1990, overcome the crash of 1987 and fought the battle of unemployment of the 1980s have a better appreciation of what companies can and should do in depressed or uncertain economic times.

Kiwi accounting professionals think it unlikely that New Zealand will experience anywhere near the level of financial reporting manipulation now being practised in the US.<sup>10</sup> However, no market is immune to this behaviour. Kiwi corporate 'giants' Tranz Rail, Fletcher Challenge and Air New Zealand have shown signs of accounting, auditing, corporate, management and other deficiencies<sup>17</sup>. The fact that all the Kiwi corporates (Table 1) are still in existence does not mean everything is as it should be: for example, Tranz Rail has been on the brink of disaster since July 2002. Their managements have all needed to apply their skills in creative and strategic manoeuvring to avoid complete collapse.

Present-day economic conditions are presenting a challenge to most businesses. It is generally in these difficult times that creative accountants and manipulative, unethical and unscrupulous directors apply their creative skills

to line their pockets. Its really a matter of being found out and dealt with. Besides, the rewarding by corporates of non-performing CEOs and CFOs while stockholders suffer losses, combined with poor or misleading disclosure tactics and improper accounting methods, has recently made boardroom and Stock Exchange reforms necessary. Some 'winners' avoid tax payments by living offshore<sup>17</sup>. One.Tel paid Australian \$15 million to two senior executives, the CEO of BIL was paid NZ\$4 million, and a short-term CEO of Air New Zealand was given a golden handshake (or 'severance payment' as interpreted by the exiting CEO) of NZ\$4.2 million.

# Results

Results of analysis of the case data identifying major underlying reasons for failure, collapse and making an exit in recent years are shown in Table 1. **What is or was the business of the companies investigated?** (See list of websites for corporate stories and Table 1).

The firms investigated are involved in a wide range of businesses and trades. Telecom, network and mobile companies together form only 18% of the total number, and investment and financial businesses, 20%. Insurance business accounts for almost 11%, airlines 5% and retail business 9% (both physical and online retailing). All other businesses form 37% (Table 1).

The following data is extracted from Table 1.

| Percentage of total sample (35 firms) |     |
|---------------------------------------|-----|
| Investment & Financial (7)            | 20% |
| Insurance (4)                         | 11% |
| Telecom (3)                           | 9%  |
| Network/Mobiles (3)                   | 9%  |
| Airlines (2)                          | 5%  |
| Retail* (3)                           | 9%  |
| Others (13)                           | 37% |

(\*Retail includes supermarkets or online retailing)

Of the percentage of reasons for the failure of the 35 investigated firms, the total attributable *solely* to accounting, corporate, management, fraud and others is as follows:

| Percentage of factors allocated to failure |     |
|--|-----|
| Accounting                                 | 8%  |
| Auditing                                   | 0%  |
| Corporate                                  | 11% |
| Fraud                                      | 3%  |
| Management                                 | 5%  |
| Other                                      | 17% |

(Tables 1 & 3)

'Other' as listed in Tables 1 to 3 includes

- too much risk or poor risk management
- inexperienced boards
- cultural issues
- self-interested and unethical managers and advisers
- the increasing complexity of markets
- negative market perception
- corporate technology theft
- inadequate business planning
- insufficient initial capital and lack of understanding of future requirements
- mistaken estimate of market demand
- the inability to market the product or service effectively
- expedient rather than deliberated decision making
- lack of appropriate education and training at senior management level
- lack of social and environmental sustainability of the business.

Some of the factors stated above are market-related. Others relate to ineffective and fraudulent management, inappropriate staff resourcing and other issues of organisational behaviour. There is considerable overlap of the corporate and managerial reasons as well. Therefore, pinpointing a single reason is difficult. The corporate and management categories have a wide range of reasons, from the 'old boys' network; complicit auditors' remuneration; lack of compliance, diligence and skill; mismatch of roles and workloads (the list is not exclusive). Fraud includes fraud committed by both employees and management. A KPMG survey (2002) on employee fraud analysed 361 responses. Fraud was frequent among large firms (those with more than 10,000 staff) and more serious when perpetrated by management.<sup>12</sup>

The three major factors that, according to public perception, are responsible for

corporate collapse are analysed below by country. The analysis reveals a significant difference between perception and fact. The factors are not mutually exclusive.

## The accounting factor

Analysis of the 35 firms reveals that *accounting* is a contributing factor to failure in all four countries. Accounting alone accounts for 40% of the failure of the firms in the UK (in two out of five firms), and 27% in Australia (in three out of 11 firms) (see Table 2).

Accounting as a major factor accounts for 44% of the failure of firms in the US (in seven out of 16 firms), 40% in the UK (in two out of five firms), 27% in Australia (in three out of 11 firms), and 67% in New Zealand (in two out of three firms) (Table 2). Within the US, accounting reasons were the second highest in percentage terms (at 44%), the highest being 'other' factors (at 69%). In Australia, accounting reasons were the third highest (at 27%) and the highest was 'other' factors (at 64%). In New Zealand, as in the US, accounting reasons were second highest (at 67%) and 'other' factors the highest (at 100%). Therefore, in three of the four countries (the US, Australia and New Zealand) accounting factors contributed less to collapses than 'other' factors.

## The auditing factor

None of the 35 investigated firms collapsed or failed owing to *auditing* factors alone. Among the investigated firms, Enron of the US was the only company that failed because of *auditing*, *accounting* and *corporate* factors. Sunbeam Corporation of the US failed owing to *auditing*, *accounting*, *fraud* and *other* factors.

In both cases, the auditing component was in combination with accounting and the other categories listed in Table 1. Within the US, auditing, as a major factor, accounted for 13% (in 2 out of 16 firms) (Table 2). The auditing factor was the lowest contributor to failure in the US.

## The corporate factor

*Corporate* and any or all *other factors* in combination for all four countries accounted for 44% of corporate failure in the US (in seven out of 16 firms), 60% in the UK (in three out of five firms), 27% in Australia (in three out of 11 firms) and 33 % in New Zealand (in one out of three firms) (Table 2).

In the US, *accounting* and *corporate* factors, along with *other reasons*, each account for 44% (in seven out of 16 firms). However, the seven firms were not the same for the *accounting* and *corporate* factors (Table 1). A similar trend was found in Australia, where *accounting* and *corporate* reasons were each responsible for 27% of corporate failure (in 3 out of 11 firms). Again, the three firms that suffered because of these two factors (*accounting* and *corporate*) were not the same.

Managerial errors were quite significant in New Zealand. *Accounting* and *management* factors contributing to failure were both significant at 67% (in two out of three firms). The *other* factors contributing to failure in all three firms in New Zealand reached 100% (Table 2). Therefore, *other* factors played a strong role in corporate collapses: 69% in the US (in 11 out of 16 firms), 64% in Australia (in seven out of 11 firms) and 100% in NZ (in all three firms) (Table 2).

The UK is the only country where none of the five firms failed owing to *auditing* or *fraud* or *other* reasons, either singularly or in combination. In the case of the UK, *accounting*, *corporate* and *management* were the three main reasons. *Auditing* reasons played no role in the corporate collapses in the UK for the five investigated firms. Table 2 shows that, on the whole, 40% of the corporates investigated failed owing to a combination of *accounting* irregularities, *corporate*, *managerial* and 'other' factors, with 60% of the failures being due to reasons other than *accounting*. *Accounting* irregularities and non-compliance with *accounting* standards was a common factor in the 40% block.

Table 3 shows, on a percentage basis, factors/reasons for failure for the 35 companies investigated. The extent or percentage of *accounting* irregularities occurring in the firms investigated is not assessable owing to a lack of information. *Corporate*, *management*, *fraud* and *other* factors represent 6% of the reasons for failure of the investigated firms. *Management*, *fraud* and *other* factors account for only 3% when taken as a sum of the three categories for the 35 firms (Table 3).

*Auditing* did not emerge as a sole reason for the failure of any company. Combined with *accounting* and *corporate* reasons it represented only 3% (1 firm) of the failure of investigated firms (Table 3). For Sunbeam Corporation, *auditing* in combination with *accounting*, *fraud* and *other* reasons was responsible for failure, but *corporate* irregularities were excluded. Auditing firm Arthur Andersen, currently under trial on obstruction of justice charges for shredding Enron documents, had earlier paid \$110 million to settle a shareholder lawsuit for fraud in its Sunbeam audit. Arthur Andersen and Providian Financial Corporation both failed owing to *corporate*, *management*, *fraud* and *other* reasons (6% of the total number of firms).

Many of Andersen's offices including those in New Zealand have merged with other accounting firms. Andersen lost one third of its public company clients in the first six months of 2002. This is an example of one of the recent consequences of firm failures and not the issue. Alison Lansley, a corporate partner at Mallensons Stephens Jacques, cited recent studies that show

Audit failures were not the cause or even a substantial cause of corporate collapses – rather, in many cases the collapses arose because of a failure of the board of directors to comply with national and international best practice guidelines and standards on corporate governance.<sup>11</sup>

The Howarth (NSW) report showed that, amongst Australia's top 250 companies, 73 had corporate governance structures that were deficient, 108 followed standards that were generally good, and nine demonstrated outstanding standards.<sup>11</sup> On the international scene for the sample under study, the following symptoms were diagnosed:

- Accounting factors alone contributed to the collapse or failure of three firms, two in the UK and one in Australia. In the UK and Australia, accounting factors alone account for 6% and 3% respectively of the total sample.
- Auditing factors were responsible for failure in combination with other factors only in the US.
- Corporate factors alone contributed to the failure or collapse of a total of four firms out of the 35 investigated, two in the UK and two in the US.
- For the total sample (Table 2 & Exhibit I), accounting and corporate factors combined with one other or all others accounts for 40%, whereas 'other'

factors is the highest at 60% and auditing (in combination) the lowest at 13%.

- For the four developed countries (the US, the UK, Australia and New Zealand) investigated, only 40% of corporates failed because of accounting irregularities, often combined with corporate, managerial or fraud factors. On the other hand, 60% of corporates failed for reasons other than manipulation, fudging of accounts, misinterpreting or non-compliance in following the accounting standards (Tables 1 & 2).
- Public perception partially holds for the UK, where the factors contributing (not mutually exclusive) to failure were accounting (40%) and corporate (60%). However, the number of firms sampled for the UK is relatively small, and the public perception may not hold true for a larger number of firms.

Table 4 examines the correlation amongst the factors contributing to collapse. The range of six factors contributing to corporate collapse as seen in the correlation matrix relates as follows:

- the closest correlation is between accounting and auditing at (+) 0.3.
- the strongest negative correlation is between accounting and management at (-) 0.22.

However, none of these correlation coefficients are statistically significant.

By using the correlation coefficient analysis we can conclude that there is no linear relationship amongst the six factors contributing to collapse.

Before considering the New Zealand perspective, the technical and cultural reasons for the collapse of the global giant 'Enron' require reiteration.

## The case of Enron: Wake-up call

The failure of global giants Enron and WorldCom has made corporates more aware of the importance of corporate accountability and good governance. Enron's failure in December 2001 related to corporate governance.

The number of implications and consequences are huge and serious. The reasons for Enron's failure in December 2001 are factors of corporate governance.

Specifically, the following reasons led to Enron's failure:

### Technical reasons<sup>6</sup> (adapted)

- Reporting and auditing requirements did not reveal the economic impact of decisions made in 1997.
- Enron effectively added to its leverage by using off-balance sheet debt in Special Purpose Entities (SPEs).
- Enron's obligations as a guarantor of SPEs debts were not reflected in Enron's consolidated statements at appropriate times.
- Triggering of debt covenants forced the firm into bankruptcy.

### Cultural reasons<sup>14</sup> (adapted)

- Ethical standards were not applied in judging potential business transactions. Vice President Sherron Watkins alleged that Enron culture was 'arrogant' and 'intimidating'.
- Partnerships were not closely monitored.
- Enron's audit committee depended on information from managers, lawyers and accountants involved in the troubled partnerships.
- Rewards were given to achievers without finding out how they achieved their results.
- The compliance and ethics signals did not reach employees, especially senior

managers.

- Audit committees were not given background on the risks the company was exposed to: company conflicts, earnings management and securities law issues, and the failure to raise compliance concerns and to react to government investigations. Therefore, steps needed to address or combat the risks were never discussed in the open.
- Arthur Andersen was the internal auditor, consultant and external auditor, all in one.
- No disciplinary action was taken against staff who threatened other staff for questioning inappropriate conduct.
- Partnership investigations were conducted by the same firm that had advised the partnership in the first place.

The onus of Enron's failure lies with three main groups: Enron executives, the board of directors and the external auditors. First, Enron executives set up financial structures that circumvented accounting rules and internal and external controls. Second, basic internal controls either failed or were so flimsy that they were easily circumvented. The board of directors waived the corporate code of conduct to permit transactions and then undertook only cursory reviews. Third, the external auditors failed to inform the board of their misgivings and the potential problems associated with many of the SPEs.

The SPEs set up by Enron's board of directors allowed conflicts of interest between the company, employees and general partners and use of off-balance sheet debt in SPEs to add to its leverage. In addition, strict covenants in SPE debts for which Enron was guarantor made the company vulnerable to market forces<sup>6</sup>.

## Relevance to New Zealand

The New Zealand Financial Reporting Standards (NZFRSs) in all probability would not have required a company of the size and type of Enron to consolidate its SPEs. In New Zealand, although it is covered in the statement of Concepts (SOCs), we do not have a Standard on revenue recognition. According to the GAAP Convergence 2002 (see list of websites), in New Zealand there are no specific rules requiring disclosures of segment liabilities and earnings per share. Currently NZFRSs do not have standards on the following:

- measurement and recognition of financial assets and liabilities
- hedge accounting
- revenue recognition
- accounting for share-based payments.

All these standards are emphasised through SOCs and NZFRSs. These also reiterate the basic difference between New Zealand, international and US reporting standards. However, we are now moving towards aligning with International Accounting Standards (IASs) as early as 2005/2007. New Zealand is contributing to the development of a range of IASs, and New Zealand accountants can apply them on a 'need' basis once IASs are in place.

The ICANZ (Institute of Chartered Accountants New Zealand) in their discussion document *Corporate transparency – Making markets work better* (Aug 2002) state:

- New Zealand does not have corporates of the same size and complexity as those in the US.
- New Zealand does not have the same level of share option performance schemes for senior executives as the US.
- Under rules-based accounting standards (US), it is possible for a corporate's accounts to be technically correct yet not accurately or clearly reflect the corporate's financial performance and position. In New Zealand, our reporting standards are principle-based, which requires above all else that a true and fair view be presented.<sup>10</sup>

The problem of non-compliance with accounting standards renders New Zealand businesses open to accounting manipulation and questionable financial results and may result in unintentional mistakes in companies' financial reporting. Human error can happen anywhere at any time.

If a small case like Tranz Rail in New Zealand (big for New Zealand) is compared with that of the giant WorldCom, there is sufficient evidence to introduce in New Zealand radical reforms in compliance with accounting standards. WorldCom misclassified their revenue expenses and treated them as capital additions. Lack of corporate governance was the key issue in WorldCom.

In July 2002, Tranz Rail in New Zealand revealed that it had capitalised \$186 million of track renewals since 1993 and that it had depreciation of \$45 million, whereas before 1993, the cost of track work was treated as an expense. This led to serious doubts about the value of the assets. However, Tranz Rail has defended its accounting policy on the value of its track network. Professor Alan Robb from the University of Canterbury has admitted that the commonsense approach does not exist in many standards, by suggesting 'there should be an acid test of whether the capital spending improved the asset to increase revenues and profits'.<sup>24</sup>

Notwithstanding the above statement, recognition and valuation requirements are spelt out in NZFRS 3, and it is a matter of interpretation and compliance.

The case of Tranz Rail has clearly demonstrated that there are several things wrong. If there are changes in accounting practice with material effect on results, then these should be clearly disclosed. If loopholes exist in the accounting standards, then the standards themselves are at fault. However, an isolated case like Tranz Rail should not become the reason for doubting the will to implement and comply with FRS in New Zealand.

## The New Zealand perspective

New Zealand has a small and strong economy that has shown tremendous resilience in recent times of turbulence and global crisis. The country boldly transformed the public sector by applying private sector management and measurement approaches to core government functions.

New Zealand was transformed from a highly protected and regulated economy, with an extensive range of intrusive and expensive interventions, to an open and deregulated economy with a lean and efficient public sector.<sup>23</sup> Capital charges and accrual accounting were introduced in the public sector to enable the determination of the real cost of government resource use, by providing managers with a more comprehensive picture of financial operations and with better information for decision-making and reporting on results.

In 1991, through the Employment Contracts Act, New Zealand made all public sector positions contractual, based upon an agreed set of measured objectives. Even the Reserve Bank governor was required to enter into a contract with Parliament, and his objectives were linked to keeping the inflation rate within a target of a maximum 3% per annum, performance measurement and accountability being the essence of the contract.

Around the world, there is the view that New Zealand has accomplished this deregulation and privatisation better than most other countries. *The Economist* regularly cites New Zealand as an example of the benefits of economic reform. Monetary economists pay significant attention to the Reserve Bank Act 1989. The Act emphasises responsibility, independence and making the goals of monetary policy public.

Recently, New Zealand has decided to make a transition to IASB by the year 2005/2007 and adopt the global GAAP. This decision occurred after Australian accounting authorities decided to adopt IASs, which was surprising to the New Zealand Accounting Standards Review Board: 'New Zealand has been left out in the cold by Australian accounting authorities, which have decided unilaterally to adopt international accounting standards.'<sup>15</sup>

Foster, the then Managing Director of New Zealand Stock Exchange (NZSE),

while expressing his views on harmonisation in accounting standards, stated in 1998: 'As a small country New Zealand should adopt IASs directly, rather than waste time reinventing the wheel. Additional information can always be provided by issuers'.

He further argued that if local requirements needed to be met, this approach would be more effective in the use of resources and time, and in avoiding conflict, which may arise in a small market like New Zealand.<sup>21</sup> However, nearly 15% (around 1200) of all New Zealand lawyers are now working as corporate counsel<sup>17</sup>, which may highlight the importance of corporate culture and governance in New Zealand.

New Zealand follows principle-based accounting standards. The lack of standards on measurement and recognition of financial assets and liabilities, hedge accounting and revenue recognition increases the potential for creative accounting. A study pursuant to section 108(d) of the Sarbanes-Oxley Act 2002, on the adoption by the United States Financial Reporting System of a principles-based accounting system (see list of websites), found that imperfections exist when standards are established on either a rules- or principles-only basis. New Zealand cannot afford to be seen as too different because the efficiency and integrity of New Zealand capital markets, to a large extent, depend on international investors. Therefore, there is a need to ensure that New Zealand corporate accountability is consistent with international best practice.

## Recent developments

New Zealand regulatory bodies have found from comprehensive investigations that transparency, accountability and integrity are generally practised, even though a small number of corporates, are 'running through tight economic conditions'.

In New Zealand, a large telecommunication company, Telecom, was the first Kiwi corporate to review its governance/audit policy and in 2002 incorporated audit independence by

- adopting a revised audit independence policy in July 2002
- placing constraints on the ability of Telecom's external auditors to provide

non-audit services

- replacing PriceWaterhouseCoopers (PWC) with KPMG as Telecom's auditors for 2002/03
- having PWC rendering only consultancy services.

Warwick Hunt, a PWC leader, believes that Telecom's practice is unlikely to be followed by other New Zealand companies. He believes that the reason for the change in its audit independence policy was to keep its US investors happy (Telecom is listed on the New York Stock Exchange).

Whether it is to keep its US investors happy or to reduce costs, Telecom's strategic move towards ensuring independence is maintained in practice and in public appearance. Telecom's auditors, PWC, were earning \$5 million from non-audit services in comparison to \$1 million from audit fees (see list of websites for stories:

<http://www.accountingeducation.com/news/news3106.html>). Besides the pricing of services issue, the separating of the audit and consultancy services implies the need for practical reviews of the multinational audit firms in New Zealand in order to ensure transparency and accountability.

In New Zealand the following issues have emerged as important:

- commitment to stakeholders
- the independence of directors (not *interdependence* and not the old boys' net work)
- timely and more complete reporting
- adequate penalties for auditing failure
- reporting of and accountability for deficiencies in financial reporting
- higher financial reporting standards
- adoption of IASs as a basis for corporate reporting.

A number of these issues have been addressed in the report of the Institute of Chartered Accountants of New Zealand Working Group on Corporate Reporting: *Improving Corporate Reporting: A Shared Responsibility* (May 2003).

The list created by the working group is quite exhaustive, including proposed changes to Accounting Standard Setting Bodies, audit committees, in-house counsels and the crucial issue of values. Values are an integral part of corporate governance. The new accounting culture emerging reiterates the importance of including the Accounting profession's traditional values as formal measures.

The traditional values need to be emphasised through stories, with each story having a moral associated with failure or collapse. The use of stories has always been a favourite strategy of the world's greatest moral teachers.

According to Paul Vitz, stories

- teach by attraction rather than compulsion
- invite rather than impose
- capture the imagination and touch the heart.<sup>20</sup>

For these reasons literature is at the heart of the cornerstone values<sup>7</sup> of the New Zealand values initiative. *A New Zealand Values Education Initiative* is the name of the concept in practice in New Zealand since the 1998 UNESCO summit, *Values in Education*. The values initiative aimed to encourage schools to review their charters in terms of values education.

In New Zealand, the objective values were already in existence, but the approach became more meaningful with the 'cornerstone values' definitions and assumptions. The cornerstone values are those on which the New Zealand educational curriculum is formed and grounded. The fundamentals are integrity, responsibility, duty, consistency and adherence to rules. Different countries have different priorities; for example, US secondary school education is focussed more on rationalist values and less on commonplace societal ethics.

The case studies and stories of collapsed or failed firms reflect the importance

of the following to Kiwi business:

- commitment to integrity
- commitment to rules (not just their letter but their spirit)
- commitment to the spirit of the conceptual framework or SOC in New Zealand
- compliance with principles based on GAAP that have global acceptability and applicability
- combating of fraud and effective, relevant education
- consistency in application of accounting principles
- customer, employee and public accountability
- consultative processes that improve confidence in the market
- research into new ways of combating fraud.

The New Zealand Stock Exchange (NZSE) has developed and publicly released its final recommendations for corporate governance (May 2003). According to Weldon, the key principle behind good regulation is to minimise uncertainty and risk for all market participants. The principles for the corporate governance framework for New Zealand are based on the recognition of differences in corporate size, culture and performance goals.

The following are key listing rule changes:

- The minimum number of independent directors is two, or one third of all directors.
- A director may not simultaneously hold the positions of CEO and Chairman.
- Issuers are required to establish an audit committee, with a minimum of three directors, a majority of independent directors, and at least one director with an accounting or financial background.
- The external auditor or lead partner should be changed every five years.<sup>25</sup>

Corporate governance is widely recognised as an important tool for improving accountability, transparency and certainty and if we are to be successful in attracting foreign investment back into the New Zealand market, we must be seen to uphold the appropriate standards (Weldon)<sup>25</sup>.

## The interactive accountability system

Exhibit II provides the framework of an interactive accountability system. It has been designed to use lessons from international and local collapses and failures, to stress the importance of values, to include the bad news and the good news, other issues from the Sarbanes Oxley Act and published stories and company cases. 'Interactive' here implies that each organisation or regulatory body will share and exchange information and consult on company management and accountability issues (whether directly or indirectly relevant). The sharing and exchange of information and consultation processes within defined boundaries must be made mandatory. A supervisory body or council consisting of ICANZ, ASRB and NZSE can administer this all-inclusive interactive accountability system.

There should be interaction among multinational auditing agencies, industry, education and research agencies, and other relevant corporate compliance organisations (such as the Register of Companies). The Securities Commission of New Zealand should at all times play a role in consultations.

A system of accountability working at different levels and in all directions can strengthen the existing standards, regulations and procedures. We need a system that requires companies to give more accurate and relevant information in a transparent and objective manner, a commonsense-based, transparent system that can reinstate and maintain a positive public perception, investor confidence and a culture of corporate accountability.

The framework of the system of interactive accountability suggested in Exhibit II can lead to a high degree of transparency and provide the combined outcome of good corporate governance and increased accountability.

The factors listed in Exhibit II can contribute to improving the fabric of corporate accountability and governance. If every person is responsible and

accountable at each level (A, B, C, D, E and F) and for each factor therein, we can further strengthen an already fundamentally sound accountability culture.

## Conclusions

Of the factors causing company failures, accounting and corporate factors constitute 8% and 11% respectively for the firms investigated. If reasons of fraud are added, these three categories form 22% of the total number of reasons for failures (Table 3). Contrary to the public perception, only 40% of corporate collapses and failures investigated showed evidence of accounting irregularities combined with corporate, managerial, fraud and 'other' factors, whereas 60% failed owing to non-accounting factors. Only three firms amongst the sample (two in the UK and one in Australia) failed because of accounting factors alone. Management factors alone accounted for the failure of 5% of the total 35 firms investigated.

'Other' factors alone account for 17% of firm failure, being a mix of managerial, ethical, perception, temporal, responsibility and decision-making issues. All are intrinsic to corporate accountability culture.

It is 'other' factors that are mainly responsible for company failure or collapse. Accounting, auditing and corporate factors are not the major cause of collapse or failures for this group of companies. Of the 35 corporates analysed, not a single company failed solely for auditing reasons. The result of the investigation of this group of companies supports Stephen Jacques' viewpoint: 'Auditing was not a cause of corporate collapses'.<sup>11</sup>

In fact, auditing, along with accounting and corporate factors, forms 3% of the total (that, too, only in the US). Corporate factors alone caused four firms to fail – two in the UK and two in the US. The UK was the only country of the sample where auditing, fraud and 'other' reasons were not factors contributing to collapses (Table 2). In New Zealand, auditing and fraud did not contribute towards failure. Among the three firms investigated in New Zealand, the predominant factors were accounting (67%), management (67%) and 'other' (100%): the factors were not mutually exclusive (Table 2). Further, there is no correlation amongst the six factors contributing to collapse, but there are co-occurrences (Table 4).

As in any other profession, 'Accountability is culturally determined'.<sup>13</sup> As in other disciplines, the accounting culture is based on stories, philosophies, values, science and logic. A culture is built upon the profession's traditional, moral and social values, such as rigorous commitment to integrity, a passion for getting it right, a commitment to governance and accountability rules – not just their spirit, but also their letter – including a zero tolerance for those who break them.

These values are the 'official' commitment of all CPAs who are members of AICPA across America, but they need to be enforced in order to restore the integrity and image of the accounting profession. Since a company is a metaphor, and it is people who make decisions and face consequences, the integrity issue is of utmost importance in a corporate accountability culture.

The New Zealand values-based education system is a useful vehicle for sensitising accounting and business students and professionals to moral, societal and cultural issues. The values-based education system is appropriately and sufficiently developed to meet the demands and expectations of corporate integrity, accountability and governance. The moral, societal and cultural values are reflected in the SOCs of the FRS. Therefore, if New Zealand reacts to the collapses and global crisis in a hurry or too aggressively, there could be compliance costs and lower returns owing to risk-averse investors, perceptive and conservative investors especially shying away from high debt: equity ratio companies.

Such actions of investors would lead to an overall negativity and gloomy economy as a result of

- lower business turnover
- conservative stakeholders
- insecure stockholders
- dissatisfied human resources
- lower consumer confidence
- lower profits and profitability.

However, as New Zealand depends to a large extent on the strength of its

overseas trading partners, we cannot always prevent lower returns. One remedial measure may lie in exploring new markets. In current times, to avert the consequences of the slow economy and hold corporates accountable for their actions and at the same time restore investor and public confidence, the New Zealand government, NZASRB, other accounting bodies, NZSE and the Securities Commission must coordinate their efforts. In addition, the decision to make a smooth transition to the IASs by 2005 and adoption of the global GAAP will make meeting the demands of the global corporate accountability culture easier.

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| <a href="http://www.dotcomscoop.com/article.php?sid=184">http://www.dotcomscoop.com/article.php?sid=184</a>   | (AT&T)   | (29/04/03)    |
| <a href="http://www.econodlink.org/lessons/index.cfm?lesson=EM391">http://www.econodlink.org/lessons/index.cfm?lesson=EM391</a>                                     | (Lucent, Enron,<br>Xerox, Global Crossing,<br>Kmart, Polaroid) ( |               |
| 07/05/2003)   |  |               |
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|   |  | (08/05/2003)  |
| <a href="http://www.nwfusion.com/edge/news/2002/1017Lyccis.html">http://www.nwfusion.com/edge/news/2002/1017Lyccis.html</a>   | (Lucent)   | (08/05/2003)  |
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|   | group)   |               |
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| Joyce   |  |               |
|   | Corporation, Dwyer Motor   |               |
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| One.Tel, HIH)   |  |               |
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| <a href="http://www.wsws.org/articles/2001/jun2001/ont-j208.shtml">http://www.wsws.org/articles/2001/jun2001/ont-j208.shtml</a>                                     | (HIH, One.Tel)   | (03/04/2003)  |
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[http://www.ifad.net/content/ie/gaap2001/ie\\_f\\_gaap\\_newzealand\\_2001.htm](http://www.ifad.net/content/ie/gaap2001/ie_f_gaap_newzealand_2001.htm)  
(GAAP Convergence2002)  
(05/09/2003)  
<http://www.sec.gov/news/studies/principlesbasedstand.htm> (Study Pursuant to  
section108(d) of Sarbanes-Oxley Act of 2002on adoption by the United States Financial  
Reporting System of Principles-Based Accounting System) (09/09/2003)

## Appendix 1: Significant similarities between countries

|     | Indicators/factors   | US                               | UK        | Australia          | NZ   |
|-----|--|----------------------------------|-----------|--------------------|--|
| 1   | Capital markets  | best regulated                   | regulated | average regulation | average regulation   |
| 2   | Accounting standards issued by   | IASB                             | ASB       | AASB & AARF        | ICANZ  |
| 3   | Monitoring of financial reporting standards  | Securities & Exchange Commission | IAIS      | CPA Australia      | Registrar of Companies, Securities Commission, the NZSE, ICANZ |
| 4   | Corporate accountability   | medium                           | high      | high               | medium   |
| 5   | Role of education programmes   | Important                        | important | important          | critical   |
| 6   | GDP growth (avg. 1997-2001) difference <1  | 2.94%                            | 2.42%     | 3.06%              | 2.40%*   |
| 7   | Inflation (average 1997-2001) difference <1  | 2.06%                            | 2.01%     | 2.32%              | 2.63%*   |
| 8   | Inventory measurement  | FIFO & LIFO                      | FIFO      | FIFO               | FIFO   |
| 9   | Financial position to be reported  | total/overall summary            | same      | same               | same   |
| 10  | Financial performance must be reported (gains and losses are reported)                   | on an 'all-inclusive basis'      | same      | same               | same   |
| 11  | Supplement income statement with another statement for some items of financial reporting | Similar items                    | same      | same               | same   |
| 12. | Changing political environment   | Impact on systems                | similar   | similar            | similar  |

\* average of 2001.

Source: List of websites and references

## Appendix 2: Significant differences between countries

|    | Indicators/factors                            | US                                     | UK                  | Australia                 | NZ                       |
|----|---|--|---------------------|---------------------------|--------------------------|
| 1  | Size of economy                               | largest                                | medium              | small                     | smallest                 |
| 2  | Companies listed                              | 2800                                   | 1653                | 1480                      | 216                      |
| 3  | Capitalisation**                              | US\$ 10t                               | £1155bn<br>£2396bn* | A\$ 700bn                 | NZ\$ 44bn                |
| 4  | Use of share options                          | extremely active                       | active              | reasonably active         | negligible               |
| 5  | Financial reporting standards                 | Rule-based<br>'prescriptive'           | Principle-based     | Principle-based           | Principle-based          |
| 6  | Corporate governance standards                | average<br>(ticking the box)           | high to average     | satisfactory              | low                      |
| 7  | Transparency                                  | low                                    | medium              | high                      | high                     |
| 8  | Independence of auditors                      | low to negligible                      | high                | moderate                  | moderate                 |
| 9  | How boards are run                            | 'hands off'<br>approach<br>-complacent | inconsistently      | low attention to accounts | bordering on reluctance  |
| 10 | Reporting by listed companies                 | quarterly                              | half-yearly         | half-yearly               | half-yearly              |
| 11 | Regulatory approach                           | rigorous                               | dynamic             | active                    | laissez-faire            |
| 12 | Public or private sector accounting standards | separate standards                     | separate standards  | separate standards        | standards sector-neutral |
| 13 | Credit rating agencies                        | over confident & inaccurate            | mostly accurate     | not very accurate         | reasonably accurate      |
| 14 | Market designation                            | replacement cost                       | realisable value    | Net realisable value      | net realisable value     |

\* Capitalisation figures relate to end of 2002

\*\* Includes international companies capitalisation in UK

Sources: List of websites and references

**Recent corporate collapses/failures/exits and reasons**

**Table 1**

| Country/Company       |                        | Type of Business (main) | Factors/Reasons |          |           |            |       |       |
|-----------------------|------------------------|-------------------------|-----------------|----------|-----------|------------|-------|-------|
|                       |                        |                         | Accounting      | Auditing | Corporate | Management | Fraud | Other |
| <b>United States</b>  |                        |                         |                 |          |           |            |       |       |
| 1                     | Allfirst               | Banking                 |                 |          |           |            |       |       |
| 2                     | Arthur Andersen        | Auditing                |                 |          | *         | *          | *     | *     |
| 3                     | AT&T                   | Telecom                 |                 |          |           | *          | *     | *     |
| 4                     | Charles Schwab         | Retail brokerage        |                 |          | *         |            |       |       |
| 5                     | Enron                  | Virtual                 | *               | *        | *         |            |       | *     |
| 6                     | Global Crossing        | Telecom                 | *               |          | *         |            |       | *     |
| 7                     | Kmart                  | Retail                  |                 |          |           |            |       | *     |
| 8                     | Lucent Technologies    | Investment firm         |                 |          | *         | *          | *     | *     |
| 9                     | Provident Financial    | Credit card             |                 |          | *         | *          | *     | *     |
| 10                    | Polaroid               | Cameras                 |                 |          |           |            |       | *     |
| 11                    | Qwest                  | Network                 | *               |          | *         | *          |       | *     |
| 12                    | Salomon Brothers       | Investment bank         |                 |          | *         |            |       | *     |
| 13                    | Sunbeam Corporation    | Household products      | *               | *        |           |            | *     | *     |
| 14                    | TYCO                   | Multiple trades         | *               |          |           |            |       | *     |
| 15                    | WorldCom               | Telecom                 | *               |          | *         |            | *     | *     |
| 16                    | Xerox                  | Copiers                 | *               |          |           |            |       | *     |
| <b>United Kingdom</b> |                        |                         |                 |          |           |            |       |       |
| 17                    | SSL International      | Insurance               |                 |          | *         | *          |       |       |
| 18                    | Independent Insurance  | Insurance               | *               |          | *         |            |       |       |
| 19                    | Equitable Life         | Insurance               |                 |          | *         |            |       |       |
| 20                    | TransTec               | Aircraft equipment      |                 |          | *         |            |       |       |
| 21                    | Schroder               | Investment              | *               |          |           |            |       |       |
| <b>Australia</b>      |                        |                         |                 |          |           |            |       |       |
| 22                    | Australian Plantation  | Timber investments      |                 |          |           |            |       | *     |
| 23                    | Ansett                 | Airline                 |                 |          | *         | *          | *     | *     |
| 24                    | BIL                    | Investment              |                 |          | *         | *          | *     | *     |
| 25                    | Diamond Press          | Printing                |                 |          |           |            |       | *     |
| 26                    | Dwyer Motor Group      | Vehicles & machinery    |                 |          |           |            |       | *     |
| 27                    | Harris Scarfe          | Online Retailer         | *               | *        |           |            | *     | *     |
| 28                    | HIH                    | Insurance (& Airline)   | *               | *        |           |            | *     | *     |
| 29                    | Joyce Corporation      | Foam manufacturers      | *               | *        | *         | *          | *     | *     |
| 30                    | One.Tel                | Mobile network          |                 |          | *         | *          | *     | *     |
| 31                    | Pasminco               | Mining                  |                 |          |           |            |       | *     |
| 32                    | Market Holding Pty Ltd | Financial               |                 |          |           |            |       | *     |
| <b>New Zealand</b>    |                        |                         |                 |          |           |            |       |       |
| 33                    | Air New Zealand        | Airline                 |                 |          | *         | *          | *     | *     |
| 34                    | Fletcher Challenge     | Forestry & other        | *               | *        |           |            | *     | *     |
| 35                    | Tranz Rail             | Rails & Trains          | *               | *        |           |            | *     | *     |

Sources: List of websites for corporate stories

**Table 2**      **Collapsed firms by country: factors contributing to collapse/failure**  
**(By percentage and number of companies)**

(Factors not mutually exclusive)

| Country                 | Accounting | Auditing | Corporate | Management | Fraud     | Other     | Total no. of Co.s |
|-------------------------|------------|----------|-----------|------------|-----------|-----------|-------------------|
| <b>US</b>               |            |          |           |            |           |           |                   |
| no. of companies        | 44         | 13       | 44        | 31         | 38        | 69        |                   |
| %                       | 7          | 2        | 7         | 5          | 6         | 11        | 16                |
| <b>UK</b>               |            |          |           |            |           |           |                   |
| no. of companies        | 40         | 0        | 60        | 20         | 0         | 0         |                   |
| %                       | 2          | 0        | 3         | 1          | 0         | 0         | 5                 |
| <b>Australia</b>        |            |          |           |            |           |           |                   |
| no. of companies        | 27         | 0        | 27        | 36         | 9         | 64        |                   |
| %                       | 3          | 0        | 3         | 4          | 1         | 7         | 11                |
| <b>New Zealand</b>      |            |          |           |            |           |           |                   |
| no. of companies        | 67         | 0        | 33        | 67         | 0         | 100       |                   |
| %                       | 2          | 0        | 1         | 2          | 0         | 3         | 3                 |
| <b>Total percentage</b> | <b>40</b>  | <b>6</b> | <b>40</b> | <b>34</b>  | <b>20</b> | <b>60</b> |                   |
| Total no. of companies  | 14         | 2        | 14        | 12         | 7         | 21        | 35                |

Source: Table 1

**Table 3 Factors/Reasons for failure: percentage allocation**

| Factors/reasons                       | No. of firms | only | Percentage of total | Cumulative |
|---------------------------------------|--------------|------|---------------------|------------|
| <b>I</b>                              |              |      |                     |            |
| Accounting only                       | 3            | 8    | 8                   |            |
| Accounting, auditing & corporate      | 1            |      | 3                   |            |
| Accounting , corporate & others       | 1            |      | 3                   |            |
| Accounting & Management               | 1            |      | 3                   |            |
| Accounting, fraud & others            | 1            |      | 3                   |            |
| Accounting, corporate, fraud & others | 1            |      | 3                   |            |
| Accounting, corporate & Management    | 1            |      | 3                   |            |
| Accounting , management & others      | 1            |      | 3                   |            |
| Accounting & others                   | 3            |      | 8                   |            |
| Accounting, Auditing, fraud & other   | 1            |      | 3                   |            |
| subtotal                              |              |      | 40                  | 40         |
| <b>II</b>                             |              |      |                     |            |
| Auditing only                         | 0            | 0    |                     |            |
| <b>III</b>                            |              |      |                     |            |
| Corporate only                        | 4            | 11   | 11                  |            |
| Corporate & management                | 1            |      | 3                   |            |
| Corporate, management & others        | 2            |      | 6                   |            |
| Corporate, management, fraud & others | 2            |      | 6                   |            |
| Corporate & others                    | 1            |      | 3                   |            |
| subtotal                              |              |      | 29                  | 69         |
| <b>IV</b>                             |              |      |                     |            |
| Fraud only                            | 1            | 3    | 3                   | 72         |
| <b>V</b>                              |              |      |                     |            |
| Management only                       | 2            | 5    | 5                   |            |
| Management & others                   | 1            |      | 3                   |            |
| Management, fraud & others            | 1            |      | 3                   |            |
| subtotal                              |              |      | 11                  | 83         |
| <b>VI</b>                             |              |      |                     |            |
| Others only                           | 6            | 17   | 17                  | 100        |
| <b>Total</b>                          | <b>35</b>    |      |                     |            |

Source: Computed from Table 1

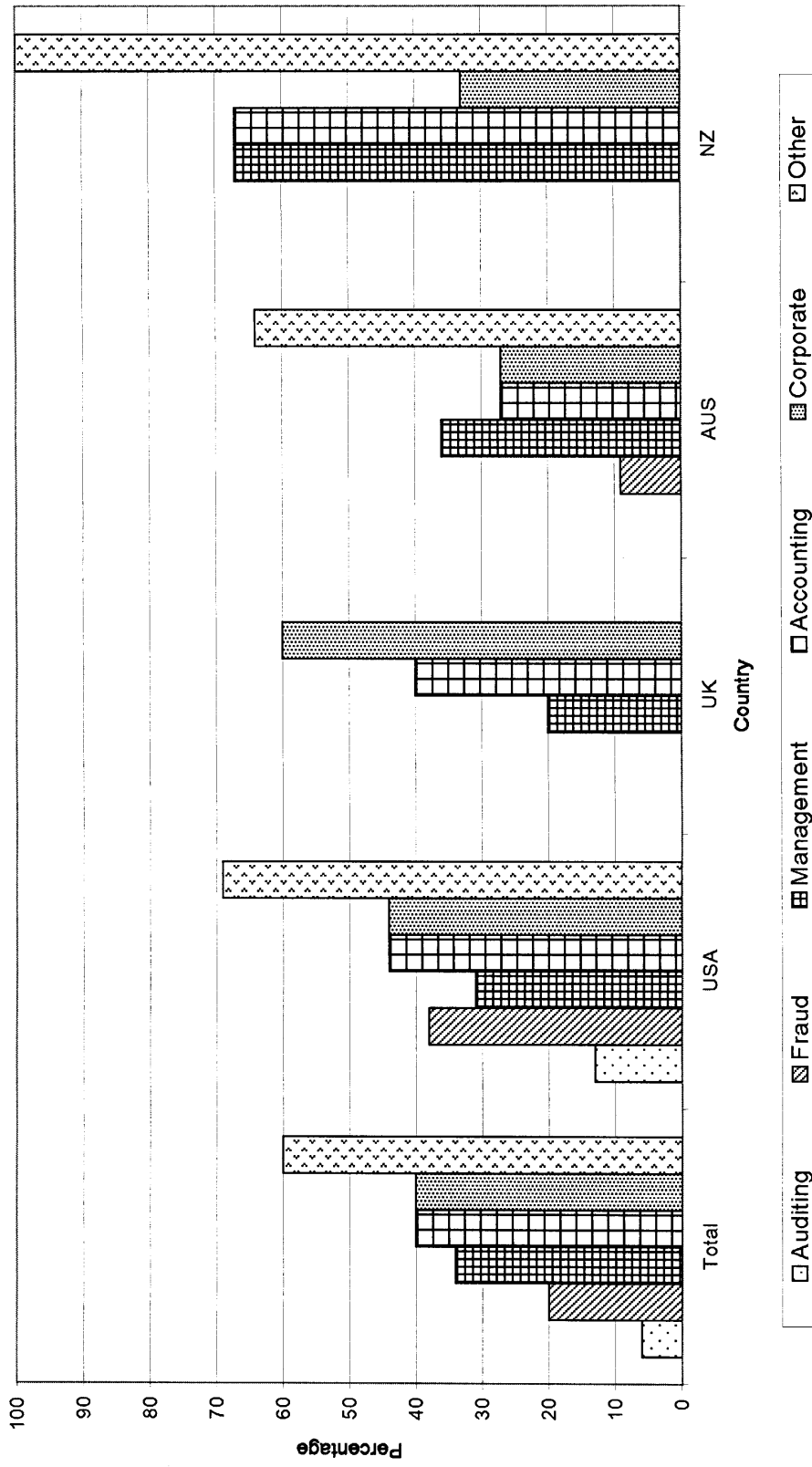
**Table 4**

**Correlation among factors contributing to corporate collapse**

|                   | <i>Accounting</i> | <i>Auditing</i> | <i>Corporate</i> | <i>Management</i> | <i>Fraud</i> | <i>Other</i> |
|-------------------|-------------------|-----------------|------------------|-------------------|--------------|--------------|
| <i>Accounting</i> | 1.00              |                 |                  |                   |              |              |
| <i>Auditing</i>   | 0.30              | 1.00            |                  |                   |              |              |
| <i>Corporate</i>  | -0.19             | 0.05            | 1.00             |                   |              |              |
| <i>Management</i> | -0.22             | -0.18           | 0.15             | 1.00              |              |              |
| <i>Fraud</i>      | 0.03              | 0.18            | 0.03             | 0.09              | 1.00         |              |
| <i>Other</i>      | -0.05             | -0.05           | -0.17            | -0.02             | 0.26         | 1.00         |

Source: Tables 1 & 2

# Exhibit I: Percentage of factors contributing to corporate collapse



Source: Table 1

% of reasons

## Exhibit II – Interactive accountability system

