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Financial Literacy after Sarbanes-Oxley: Building It; Sustaining It

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Abstract

The core theme of the article is that financial literacy is a challenging goal, but an achievable one. Contrary to popular belief, finance is a diverse subject and the meaning of "financial literacy" varies on a business-by-business, job-by-job basis. Practically speaking, "financial literacy" is interwoven with "business literacy", *i.e.,* understanding the transactions, processes, markets, stakeholders, etc., that together comprise a business. This makes it hard to deploy generic educational solutions. Some managers need more than others. Some need different than others. My recommendation is not to look for a universal definition of literacy, but rather to treat your company as a collection of communities, each with its own need for financial knowledge and education. Using this approach, financial literacy programs can then be developed pragmatically, efficiently, and economically.

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Suddenly Literacy is Hot

There are two ways to look at the Sarbanes-Oxley Act of 2002.[1] One is a burdensome regulation. Viewed this way, corporations[2] will tend to frame their response as "compliance." They will respond narrowly, focusing mainly on implications for their boards

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[1] The Sarbanes-Oxley Act, which consists mostly of amendments to the Securities Exchange Act of 1934, became law on July 30, 2002. Summaries of the Act are available on-line, *e.g.,* at the website of the American Institute of Certified Public Accountants, http://www.aicpa.org/info/sarbanes_oxley_summary.htm, at the website of the American Bar Association, http://www.aba.com/aba/pdf/sarbanes_oxley_2002.pdf. The legislative process and ultimate enactment of Sarbanes-Oxley was widely covered front-page news in the U.S. press. *See, e.g., Bush Signs Bill Aimed at Fraud in Corporations*, NEW YORK TIMES (July 31,2002), and came on the heels of a series of financial scandals, corporate bankruptcies, law enforcement investigations, hearings, and proposals for reform, that most people know simply as "Enron" and trace back to the fall of 2001, when Enron Corp., then a large, widely admired, publicly traded corporation, collapsed into bankruptcy. Worth noting though is that, Sarbanes-Oxley was really the culmination of a reform process that began before "Enron." That process began in the late 1990s against to background of a stock market that seemed to have lost touch with fundamentals, raising concerns about the quality and integrity of corporate financial reports, audits, and governance. By the end of 1999, the SEC and the major stock exchanges had adopted rule changes focused mainly on audit committee practices and financial disclosure rules. Ultimately, Sarbanes-Oxley was heavily influenced by the changes adopted by the NYSE and NASD.

[2] This article focuses on the implications of Sarbanes-Oxley for corporations ("issuers" in the parlance of Sarbanes-Oxley and the securities laws it amended), their boards, and executives. Besides these groups, the Act also addressed accountants, attorneys, analysts, stock exchanges, and others.

and top management. Their boards and execs will meet more often, tune up controls, adjust procedure, hire financial expertise, publish more footnotes, ask tougher questions of their subordinates and advisors, and perhaps project sterner persona to their employees, stakeholders and governmental watchdogs.[3]

Compliance with the letter of the law, obviously, is obviously a good idea and nothing in this article should be construed to discourage it. Sarbanes-Oxley, however, might also be treated as an educational wake-up call: as a turning point in managerial responsibility; one which demands financial training, not only for board members and executives,[4] but for much of the managerial population.

Understand that, to a degree, this wake-up call *is* embedded in explicit provisions of the Act. For example, the Act requires that corporate boards have at least one "financial expert" on their audit committees.[5] Also important to note is that, shortly before the Act was passed, all of the major U.S. stock exchanges adopted rules requiring at least some board members of listed companies to be financially literate.[6] Both the "financial expert" rule and the "financial literacy" rules have their origins in the work of the SEC-sponsored Blue Ribbon Committee on the Effectiveness of Board Audit Committee, which in turn had a major impact on the content of Sarbanes-Oxley.[7]

These explicit expertise and literacy requirements, however, only apply to audit committee board members.[8] The broader wake-up call, the one directed at general management – is more implicit than explicit. Companies who are only concerned with narrow compliance, who

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[3] After Sarbanes-Oxley was passed, many law firms, accounting firms, and consulting firms published letters and other "how to comply" advisories for the benefit of their clients and potential clients. An example of these advisory letters is the August 2, 2002 letter to "Our Friends and Clients" by the Fried, Frank, Harris, Shriver & Jacobsen (New York, NY). It was republished by the Sloan Project on Business Institutions at the Georgetown University Law Center in the materials for its *Restoring Trust in America's Business Institutions* conference held in November 2003. An updated version of the article also available on-line at http://www.ffhsj.com/cmemos/030709_corp_gov_non_us.pdf. A key concern of this and other compliance advisories were the Act's provisions concerning "financial experts" on the audit committees of corporate boards of directors See generally footnote 4. .

[4] See notes 5 for discussion of financial expertise requirements for members of board audit committees.

[5] Sarbanes-Oxley requires that companies disclose the identity of the board audit committees who serve as their financial experts. Practically, it is treated as a requirement that company's actually have such an expert. A troublesome issue in implementing Sarbanes-Oxley has been qualification: in effect, what is "financial expertise." On January 26, 2003, the SEC clarified, providing a fairly flexible, multi-factor definition. The American Institute of Certified Public Accountants in turn has used the SEC rule to create a downloadable tool to help determine whether a particular invididual meets the qualifications. *See* http://www.aicpa.org/audcommctr/guidance_resources/improve_function/achieving_financial_literacy/02.htm.

[6] Following the report of the so-called Blue Ribbon Committee, see footnote 7, the NASD and NYSE, as well as AMEX and the PCX adopted rules requiring at least some members of corporate board audit committees to be financially literate. For a discussion of this history, see *Proposed Rule: Disclosure Required by Sections 404, 406 and 407 of the Sarbanes-Oxley Act of 2002,* SEC Release Nos. 34-46701; IC-25775 (October 22, 2002). The SEC, on the other hand, has neither proposed or adopted any explicit rules concerning financial literacy.

[7] The so-called Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees was formed in 1998 by the NYSE and NASD at the behest of then-SEC Chairman Arthur Levitt. Its recommendations were made in a report in 1999.

[8] For a discussion of how companies have been wrestling with their new financial literacy requirements, *see* Financial Executives International, *Audit Committees and Financial Literacy: Three Steps to Meet Higher Standards* (2002), downloadable available at the FEI web-site, www.fei.org. The general perception is that the compliance burden of these requirements has fallen mostly on smaller companies. In general, large companies are already equipped with board members who met the qualifications. One clear result, though, has been the bloom of small industry in "finance for board member" crash courses. *See Board-ing School: A Growing Number of Programs are Being Offered to Teach Board Member Skills,* CFO MAGAZINE (October 2003).

perhaps disagree with the overall policy thrust of Sarbanes-Oxley-- won't hear the wake-up. Or, if they do, they will resist it. Good corporate citizens, though, will hear it and respond.

Consider, for example, the Act's requirement that chief executive and financial officers certify their companies' financial statements.[9] Basically, the CEO and CFO must state to the SEC that their company's financial statements are a fair presentation of financial condition and performance. Obviously, this requirement implicates the financial acumen of two top executives. The practical impact, however, is broader. In order to comply responsibly with this certification provision, most companies need a sub-certification process.[10] Basically, in order for the top executives to certify the corporation's financial statements, subordinate managers must certify to them that their respective areas of responsibility are fairly presented. And, of course, in large companies, the subordinates will require subcertification from their subordinates. The point is, unless sub-certifications are made by financially literate managers, there may not be much value, either to top management or to investors.

Similarly, consider the Act's whistleblower provisions,[11]: Explicitly, these provisions mainly provide new procedures, penalties, and protections, and are designed to encourage more corporate employees to come forward with knowledge of improper financial activity. What companies and their educators have to consider, though, is that, unless those with whistles have the competence to know when to blow, they will become less like whistles and more like loose cannons. Not only will the law's expanded protection be poorly utilized, but scarce resources, both governmental *and* corporate, will be wasted on false-alarms.

Ultimately, though, the idea that the Sarbanes-Oxley legislation should be construed as a broad call for financial literacy in management is based not so much on the law's explicit language, or even on practical issues of compliance and implementation. Rather, the wake-up call is in the law's history, spirit and penumbra. In this regard, it may helpful to recall the obdurate testimony of Jeffrey Skilling, former Enron CEO, before the Senate Commerce Committee in February 2002, about ten weeks after Enron entered bankruptcy.[12] For Congress and the public, Skilling's appearance before the Senate may have been the most memorable moment in the events that spurred the passage of Sarbanes-Oxley. Skilling's testimony was that he had not been deeply involved in the company's bookkeeping, accounting, and financial reporting processes; that it was neither his job nor his competence to make decisions in these arenas, thus had no knowledge of whatever fraud had been committed. "I am not an accountant," he said over and over again. In defense of his ignorance, he said that he "like many other people relied on the advice of Arthur Andersen," *i.e.,* Enron's outside accountant and auditor. Several Senators, desperate to put a face on Enron's villainy, responded to Skilling, wunderkind from Harvard Business School and former McKinsey consultant, with dismay and disbelief.[13]

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[9] Section 302, Sarbanes-Oxley Act of 2002.

[10] *See generally,* Association for Financial Professionals, *Subcertification: Financial Professionals Taking the Lead on Sarbanes-Oxley* (Report of Survey Results: July 2003); S. Taub, *Many Companies Ask for Subcertifications, Study Says,* CFO.com (July 30, 2003).

[11] Section 806, Sarbanes-Oxley Act of 2002. The section provides both civil and criminal remedies, and includes both OSHA and SEC in the enforcement regime. *See generally,* A. Ebeling, *Blowing the Sarbanes-Oxley Whistle,* FORBES (June 18, 2003)

[12] Testimony of J. Skilling before the Senate Committee on Science, Commerce and Transportation (February 26, 2002).

[13] For a good account of Skilling's testimony, and the reaction of Senators and others to it, see L. Beltran, Skilling Blames Others, published on-line at http://money.cnn.com/2002/02/26/news/enron_hearing/

Probably, most of the Senators' skepticism regarding Skilling's "know-nothing" defense[14] was pretense: theatre for the public. What is almost certain, though, is that their skepticism, genuine or not, would not have been shared by the majority of practicing executives and managers. Few if any of them would have had experience with the complex transactions at issue in Enron. Most would probably have considered Skilling's testimony plausible: probably true. They would have said that, regardless of rank, MBA or not, most non-financial executives and managers eschew "bean-counting;" that *at best* the typical manager can mobilize only a casual understanding of financial accounting; that their responsibilities rarely if ever require more than a passing involvement or interest in the auditing and financial reporting process. In candor, some might admit that managers sometimes have pressed accountants for more crowd-pleasing results, lower taxes, and the like, but most would also say that *whether and how to achieve those results* were the accountants' decisions, not theirs.

Stand back for a moment from the details of Sarbanes-Oxley, and look instead at its broad strokes. What you see is a Congressional conclusion that too many people have been at liberty to ignore or disown the processes and responsibilities of financial reporting. Sarbanes-Oxley aims to change that. The meta-message of Sarbanes-Oxley is that more corporate stakeholders need to take longer, more educated, more proactive looks at financial reports and their underlying processes and transactions. Boards are told that they need to have financial expertise, financial literacy, and financial resources. CEOs and CFOs are told they must certify – subordinates are effectively told they must sub-certify -- that financial statements are accurate. Employees are told that they shouldn't be scared to blow a whistle if they learn of financial hanky-panky. Even attorneys are told to tell the truth if they see it. The zone of tolerable ignorance is shrinking. Basically, Sarbanes-Oxley is saying that accounting isn't going to be just for accountants anymore.

Unfortunately, today, most companies will likely find that many of their executives, managers, and other key people lack the financial acumen demanded by the evolving Sarbanes-Oxley environment.[15] Recently, in a seminar for the top executives of a Fortune 500 company, I challenged participants to explain how accounting added value to their company's operations. When pressed, the *only* value proposition they could muster was regulatory compliance and consequent access to financial markets. No one in the group could extol any other practical purpose or function, *e.g.,* timely and useful management information, competitive analysis. I don't fault their narrow view. I think it

[14] Privately, several staffers called Skilling's testimony the "Seargeant Schultz defense". "Seargent Schultz" was a character in "Hogan's Heroes", a popular TV-comedy-series situated in a German prison camp during World War II, produced and broadcast in the 1960s. "I know nothing," was Schultz's signature line.

[15] For purposes of assessment, note that there are several instruments that have been published and are generally available. *See, e.g.,* Financial Executives International, *Financial Literacy Quiz,* which can be downloaded at http://www.fei.org/download/finlitquiz.pdf; K. Schipper and R. Weil, *Financial Literacy Quiz*, which can be down-loaded at http://gsbsurvey.uchicago.edu/survey/parshantgoenka/Financial Literacy Quiz.poll.html. (The authors of the latter quiz report that the pass rate for members of board of director audit committees is about 60%.) Be aware though that most of the published tests for financial literacy are aimed at consumers and investors, not corporate managers, and address very different topics than management-oriented instruments. *See, e.g.,* the financial literacy quizzes offered at Bankrate.com and Creditcard.com. For an overview of financial literacy efforts in the consumer and investor arenas, Furthermore, as discussed *infra* in the text accompanying footnote 23, it is probably best to treat "financial literacy" as job-specific. Short generic instruments like the FEI quiz will probably not address the financial knowledge required by a particular managerial population.

says at least as much about the opacity of accounting's methods and work product as it does about the managers' background and training. But set that issue aside. The experience certainly demonstrates how alienated management has become from the system that, not only is very expensive, but in theory, provides the most important, most objective description of the condition and performance of their enterprise.

Presumably, there was a time when the rules of both business and accounting were simple, when educated managers had a fairly clear understanding of accounting's rules and methods, when management took a deep interest in financial reports for their content and not merely as a bureaucratic hurdle in the marketing of the company's debt and equity. After all, accounting didn't originate as a regulatory requirement. Certainly, there are reasons why management yielded, and the accounting profession assumed, intellectual responsibility for the rules of financial reporting. Possibly, one of those reasons is that those rules become so technical and complex that the general manager could no longer sustain any useful expertise in the discipline. Possibly, another reason is the legal and moral cover that management when professionals take responsibility for risky decisions.[16] This, however, is not an article to explore how financial reporting might be reworked to become more relevant or why managers have become financially illiterate. Nor is it one to speculate on the implications of financially literate management. In the long run, Sarbanes-Oxley may re-shape the incentives of managers. It may change the relationship between them and the corporation's finance department, top executives, and outside auditors. The main purpose here, however, is not to project or speculate about that future.

Rather, the goal here is only to be practical. The Sarbanes-Oxley environment challenges corporations to improve their management's financial literacy and acumen. Increasingly, the expectation is becoming that executives and managers will exercise informed, independent, and proactive judgment with respect to the financial reporting activities of their companies. Increasingly, the expectation is that they will be able to perform competent financial analyses and make competent financial decisions. Increasingly, at least as concerns financial matters, corporate executives and managers are becoming more like high professionals, imbued with a sense of public and fiduciary responsibility.[17] Responsibility

[16] In the U.S. under federal and state laws, "good faith reliance on an accountant" is a recognized defense to certain criminal prosecutions, *e.g.,* tax evasion. Perhaps needless to say, neither prosecutors nor courts like the defense. The courts are typically skeptical and tend to construe the requirements strictly. *See, e.g.,* U.S. v. Bishop, Case No. 01-50195, 01-50266 (9th Circuit: 2002). Still, the defense exists in theory, and, if shown, eliminates criminal responsibility for otherwise criminal acts. Meanwhile, so long as an accountant's involvement can be characterized as a matter of opinion or judgment, and not as intentional fraud or aiding and abetting, criminal prosecution of the accountant is unlikely. Moreover, its malpractice exposure, which is only civil, not criminal, will be tested, not as to whether the advice offered was right or wrong, but rather, against generally acceptable behavior in the profession. In short, if "aggressive accounting" is the intent, management tends to be safer if it acts on an accountant's advice.

[17] Worth noting is that several countries, *e.g.,* Great Britain, New Zealand have institutes to certify board directors, and that some wonder whether, in the U.S., financial literacy requirements for directors may be a step in that direction. See *Editorial: Director Certification – To Be or Not to Be,* BOARDROOM NEWS (Vol. 11, No. 3: May/June 2003). Although the concept of professional has been diluted and broadened in recent years, classically, it referred to occupations that required extensive education, high skill, and a commitment to public service. For the classic definition, many point to Justice Louis Brandeis, who in a 1912 commencement address at Brown University, addressed the question of whether business management ought to be considered a profession. His definition had three parts: "First. A profession is an occupation for which the necessary preliminary training is intellectual in character, involving knowledge and to some

requires education. Many companies, executives, and managers aren't ready. This article asks what educators should do to prepare them.

Offered in the next several sections is a three-step process for corporate education professionals to follow in the development of financial literacy programs for their executives and managers. At the outset, though, it is absolutely essential for corporate education professionals to understand what "financial literacy" really means. Or, more accurately, to come to terms with the fact that *there is no universally-accepted definition.* Sarbanes-Oxley certainly doesn't offer one. Nor has the SEC or any other official agency of the U.S. government provided a definition. [18]

extent learning, as distinguished from mere skill. Second. It is an occupation which is pursued largely for others and not merely for one's self. Third. It is an occupation in which the amount of financial return is not the accepted measure of success." Measuring business management against these standards, his conclusion was lawyerly and mixed. Basically, he said that eventually, the "exceptional methods" of his day would be become the "accepted methods" of a later day, and that, when they did, big business would become "professional" business, lose its "sinister" character, and become "great in service" and "grand in manner." Is business management more professional today than in 1912? Probably yes. Even so, Brandeis, if he were alive today, would probably still be looking to the future.

[18] The SEC-approved rules of the New York Stock Exchange, which require that certain board members be financially literate, provide no definition, stating instead that "business judgement" should be used in applying the qualification. *See* NYSE Rulemaking: Notice of Filing of Proposed Rule Change Amending Audit Committee Requirements of Listed Companies, SEC Release No. 34-41980 (October 6, 1999). In testimony before the Senate, one expert called the term "nebulous at best." O. Kirtley, Testimony before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate (March 14, 2002). *But see* footnote 15, identifying several financial literacy quizzes. The term "financial literacy" seems to have originated in the late 20th century as a public and household education concept: the X- and Y-generation's updated version of the "home economics" courses that their mothers had suffered when they were in high school. *See generally,* S. Braunstein and C. Welch, *Financial Literacy: Overview of Practice, Research and Policy,* FEDERAL RESERVE BULLETIN (November 2002). As direct investment in stocks became increasingly popular in the 1990s, "financial literacy" became increasingly investor-oriented. Today, there are a number of organizations sponsoring "financial literacy" programs of these kinds. Financial literacy as applied to business and corporate management seems to have first emerged as the SEC began to concern itself with the acumen and composition of corporate audit committees. See footnotes 4 through 8 *supra.*

Three Steps to Financial Literacy

- Identify your company's *financial literacy communities* (literacy is not generic)
- Describe each community's *literacy gaps* (the difference between literacy and current state)
- Develop and Deliver

Conventionally, financial literacy is often defined, particularly by those who lack practical experience in finance, as the "ability to read and understand financial statements."[19] Unfortunately, that definition is simplistic, somewhat misleading. Even if it were an acceptable definition, it would understate the educational problem. Imagine trying to teach a person without any knowledge of anatomy how to "read and understand" an x-ray or cat-scan. In the same sense, the ability to "read and understand" financial statements is somewhere between moot and absurd without substantial understanding of business and investments.

In other words, even if reading and understanding financial statements is an appropriate definition of financial literacy – I'll argue below that it is insufficient -- educational professionals must realize that a lot of "content" is buried in the seemingly simple phrase of "reading and understanding." Financial statements are quantitative, rule-driven, far-from-

[19] Nasdaq, for example, in its rules requiring financial literacy for certain board members of listed companies, describes it as the ability to "read and understand financial statements.

perfect abstracts of dynamic, complex organizations. They may be used in various ways by a wide variety of groups, including investors, lenders, professional analysts, regulators, tax authorities, managers. Furthermore, to a much greater extent than most people realize (and some accountants care to admit), they are imbued with opinion, estimates, and judgments. Practically speaking, what this means is that "reading and understanding financial statements" is not a skill that "everyone can learn." Prerequisite to financial statement understanding is business understanding; perhaps understanding a *particular* business. In the highly-specialized and functionalized compartments of large corporations, it will be a mistake for educators to assume that all executives and managers have the necessary background.[20] Indeed, some companies may find it more useful to frame the learning goal as *business literacy* rather than *financial* literacy.

Whether or not the learning goal of financial literacy is re-framed as business literacy, my very strong recommendation is to *reject* the notion that basic, generic financial statement understanding is the definition of financial literacy. Roman Weil, a highly-regarded professor of accounting at the University of Chicago, believes that financial literacy needs to be defined contextually and practically. He was one of several experts called to the Senate to shed light on what happened at Enron. Reflecting on that experience, his view is that financial literacy means "that you both understand the *transactions* your company undertakes and the accounting *issues* surrounding those transactions." (italics added)[21] Financial literacy, to Weil, is not the passive digestion and analysis of straightforward, purely objective data. At Enron, as elsewhere, the problem wasn't that the numbers "didn't add" or were hidden from view. Nor was it that by-standers to the corruption had never taken Accounting 101. The core problem was that many didn't understand the underlying business transactions, and so they had no idea whether the accounting was good or not. They didn't understand the business purpose, the content, the risks; didn't understand whether, how, and why the relevant transactions might (or might not) create value for the company and its investors. Without such understanding, it shouldn't be surprising that some might not have discriminated between financial *fraud* and financial *engineering.*

Companies and educators reaching for financial literacy need to consider that, in some cases, financial literacy must mean *more* than a passing acquaintance with financial statements and a few ratios. Besides some understanding of the immediate business, financial literacy will occasionally mean understanding control systems, disclosure requirements, and audit practice and procedure. It may include ability and confidence to pursue the "red flags" that lurk

[20] To provide a workable understanding of financial statements to a person with substantial business experience can be almost trivial. The hardest part tends not to be teaching them what financial statements *don't* mean. For example, many people wrongly believe that balance sheet value for a company's equity is is based on its current market value. Explaining why those two values may not even be close can be unsettling. Many believe wrongly that the income statement tracks cash flow. Others understand there is a difference between cash and accrual accounting, but have never confronted its far-reaching practical effects. Again, people with long-held misconceptions tend to resist the truth. And so on. Even so, my experience is that the basics of *using* financial statements can usually be taught to experienced managers and executives in 4-8 hours of class time. The arithmetic is no more difficult than multiplication and division. And the new vocabulary is likely to be fewer than 25 words. On the other hand, teaching financial statements to students who have never thought much about how a business works, about how a business gets money and spends money, about markets, about economics…. Well, let's simply call the effort challenging, time-consuming, and a bit sterile: akin to teaching seamanship without the benefit of a boat.

[21] R. Weil, "17 Minutes of Fame" (2003), available on-line at http://www2.aya.yale.edu/classes/yc1962/weilview.html.

in the lines of suspect transactions. It will sometimes include sensitivity to the issues and nuance in alternative approaches to esoteric accounting issues. It will often, particularly for companies whose stock and other securities are traded in public markets, include understanding and appreciating the financial community at large – its members, its expectations, its markets, its motives, its laws. Literacy, in other words, even for experienced corporate managers, may not be an eight-hour seminar anymore: not for some anyway.

This article is aimed at companies who see something more than a need for narrow compliance in Sarbanes-Oxley, who believe financial literacy is important, who want it for their management, but need help with implementation. Unfortunately, while the aspiration for literacy has grown, few companies are moving diligently toward it. Faced with a complex skill-set and a sense that the usual fare of financial education doesn't seem to be especially helpful or relevant, companies often balk, asking "who *really* needs to know?" and then fall into analysis paralysis. My purpose is to help avoid that.

The core theme driving the three steps is that financial literacy is a challenging goal, but an achievable one. They are premised on the idea that finance is a diverse subject; financial literacy has many meanings. This makes it hard to deploy generic solutions. Some need *more* than others. Some need d*ifferent* than others. My recommendation is not to look for a universal definition of literacy, but rather to treat your company as a collection of communities, each with its own need for knowledge and education. Using this approach, financial literacy programs can then be developed pragmatically, efficiently, and economically.[22]

Step 1: What are Your Company's Literacy Communities?

The first step toward implementing financial literacy is to describe your company's required financial skill-sets.[23] This should be done broadly, conscious of Sarbanes-Oxley, but *not* purely in response to it. Understand, Sarbanes-Oxley and the corporate scandals preceding it have brought some key areas of literacy into focus. But the need for financial literacy isn't new. And it wouldn't disappear if Sarbanes-Oxley were repealed.

Note the use above of the plural: "skill-*sets"* not "skill-*set*." Literacy should be described on a business-by-business, job-by-job, basis. Although the term "literacy" may suggest a single broadly shared competency, a more workable approach for most companies will be to think about several communities, perhaps overlapping and intersecting, but each with its own literacy requirements. In effect, the company should be

22 For simplicity, the assumption in articulating the three steps that literacy for all parts of the company is the immediate, simultaneous goal. In practice, it will usually make sense to focus and sequence the effort. In general, except perhaps for financial professionals, upper management (*i.e.,* directors, executives, senior managers) should be viewed as having the most urgent and often the highest level of financial literacy requirements. Lack of it can endanger the company financially and legally. That would be reason enough to focus on its needs first. However, it's also probably the case that evaluating and educating upper management, as compared with mid-management and others, because of the small size of the population, can proceed quickly and won't be expensive. As a practical matter, top-level executives and board members might be difficult to include in a broader program of literacy education. Meanwhile, the effort put into a literacy program for upper management may provide a platform for a more efficient effort in other corporate populations.

23 *See* Appendix A, which contains a list of financial skills. As explained there, the list is intended as a strawman, not a model. Furthermore, if taken as a description of literacy, it's a very ambitious skill-set, probably more inclusive than it would have to be for anyone except your company's most senior financial officers. But it *could* be a definition of financial literacy for a particular community, and so I offer it as an example. Note that finance is not just about accounting and reading financial statements.

treated as having several "literacy communities." People within the same literacy community are those who need more or less the same skills, the same knowledge, the same acumen.

Unfortunately, there is no one right way to draw lines between communities. Also, there is no magic number of literacy communities in an organization. In most companies, it will make sense, at least as a starting point, to divide a company's population into *at least* four communities:

- directors, officers, and top executives ["upper-management"]
- managers, senior staff, and other key employees ["mid- management"]
- financial professionals and employees
- other employees

But, again, avoid presumptions. Resist the temptation to rely on pre-existing organizational divisions. Don't assume that "all managers" or "all executives" or "everyone in risk management" needs the same financial acumen.

In particular, be especially attentive to the needs of anyone involved in a financial reporting, auditing, budgeting, or business review process, regardless of title or department. Members of this community will probably need skills in accounting, controls, disclosure, and audit practice. Also be attuned to those with responsibility for public, customer, employee, or regulatory relations, again, regardless of organizational position. This community will have some need to interpret financial statements and communicate knowledgeably about the company's financial performance and condition. Also, look for anyone who plays an important role in establishing or managing relationships with partners, long-term suppliers, or sales and marketing channels. Citizens of this community should probably know how to assess the financial strength of other companies and quantitatively evaluate deals. And, of course, watch for anyone who has lead responsibility for managing a business or involvement in acquisition, divestiture, or merger decision-making. This group probably should have a sophisticated understanding of financial markets, business valuation, securities laws, and many other financial topics.

In any case, in detailing a community's required skill-set, try to avoid using any preconceived or academic notion of what finance includes. Try not to be influenced by vendors, who will tend to define your problem so that it fits their pre-existing solutions. At the outset, you don't really want a description of what someone else is prepared to teach. What you need is an accurate description of what your corporate communities need to know and do with respect to finance. To get that, talk to executives and other key people in the company. Also talk to the company's lawyers and accountants. Ask them what are the practical financial skills that people need to fulfill their jobs and managerial responsibilities. Try not to ask them what literacy is or what it means.

Step 1 needs executive-level closure before proceeding to later steps. Step 2 will largely be a comparison of the desired skill-sets, *i.e.,* your Step 1 work product, against your current skill inventories. Step 3 will be the education effort that tries to fill the gaps. Step 2 will be muddled, inefficient, and unduly controversial if the product of Step 1 is still unsettled. And Step 3 will be guesswork if Step 2 isn't accurate. Thus, before beginning step 2, there ought to be a clear and accepted articulation of who should know what: of what the communities are and of what literacy means in each of them. There should also be a broad understanding of who belongs in what community. And there should be a re-commitment to go forward with the financial literacy effort.

To get this sort of closure and re-confirmation of mission, the champions of the literacy effort --

let's call them the "Lit Champs" for short -- should encourage top management discussion of the Step 1 work product. In these discussions, the Lit Champs should strive to keep the company's goals realistic and practical. The temptation, I think, when corporate education champions meet with corporate executives is to seek broad charters. In this case, I think top management, once focused on the issue, will tend to become overzealous, too ambitious. Ultimately, the literacy effort, and the company, will benefit more from clear direction and conservative goals than an unsustainable burst of managerial enthusiasm.

Step 2: What are Your Company's Literacy Gaps?

The second step in building a financial literacy program is to identify your company's shortcomings. *Who needs what kind of education?* Basically, the current skills of the company's communities need to be compared with the Step 1 descriptions of what is required. The gaps determine the substance of the education your company will need to develop and provide.

Initially, of course, the question is who belongs in which community. In many cases, these assignments will be straightforward, more or less a by-product of Step 1. Consultation with the board, executives, and managers might be helpful. Expect some, perhaps many, managers to be members of several communities.

Having made those assignments, the next question is how to figure out whether people "measure up"? My main advice is, *ask.* Ask the members of the community. To some extent, ask those around them. If the population is large, this can be done selectively or randomly. But, to the extent possible, ask face-to-face rather than through instruments.

Furthermore, be careful to ask specific questions with objective answers. Ask *do you know?* Ask *do you know how?* Ask *can you?* The work product of Step 1 can be used more or less as a checklist. If in doubt*, explore confidence levels.* Finance is an area where many people know a little, few people know anything with confidence, and vague, uncertain beliefs don't count for much. Ideally, the person conducting the interviews will be knowledgeable regarding the skills at issue.

Usually, a few well-done interviews will provide enough information to make decisions about what kind of education programs will be useful and who should be included. In some cases, though, it will make sense to test more formally. If so, the instruments must be carefully crafted. They will probably have to be created anew, ideally in consultation with top management or financial management of the company. To my knowledge, there are no broadly available instruments that aim to test financial literacy generically. And, even if there were, my recommendation would be to reject any instrument that is not carefully tailored and validated to the literacy requirements of a particular community. Again, literacy isn't generic. It needs to be assessed company-by-company, job-by-job.

If selective interviewing isn't enough – again, I think in many cases, it will be -- and testing isn't practical, Step 2 might require candid self-assessments, 360-degree assessments, or confidential interviews throughout the target community. For a small community (*e.g.,* the audit committee of the board of directors) personal interviewing is not an overwhelming work order, and ought not to be resisted. In financial professional communities, financial skill evaluation and continuing education is probably ongoing. If so, unless there is reason to think that the ongoing programs are inadequate, there shouldn't be a need to duplicate these activities. On the other hand, in large mid-management and general employee communities, a massive acumen assessment project is something companies should probably try to avoid. It is probably going to be too substantial to be done economically or well. For these communities, the company should think seriously about a testing program.

The work product of Step 2 is a description of what education is necessary in the company's several literacy communities: not *how* it should be done, but what needs to be done. It is a description of the gaps between literacy and the current levels of acumen.

Again, as with Step 1, it will make sense to share, review, and confirm the findings with top management. Here though, as compared with the conclusion to Step 1, some effort to rally management may be necessary. Top management will likely be taken aback by the dimensions of the gaps identified and for the first time truly appreciate the cost and effort of its commitment to financial literacy.

Step 3: Design, Develop, and Deliver Carefully Tailored Education

Step 3 is the design, development, and delivery ["D3"] of programs that close the Step 2 gaps. Unfortunately, it's *easy* to enter Step 3 with a pretty fat work order. That should not have been the goal. Without compromising the mission, the literacy advancement effort ought to be resisting that result from the beginning of Step 1.

Ideally, the Step 3 work order is lean and clear. A company's efficiency in meeting its literacy goals will turn largely on the precision of its needs analysis. If it has been clear in defining literacy communities and their needs (Step 1), if it has been astute in identifying the gaps between situation and aspiration (Step 2), the D3 of educational solutions (Step 3) can proceed efficiently.

Pragmatism, cost-consciousness, and creativity should be treated as essential to successful D3. Scores of seminars are not necessarily the answer to the company's needs. Learning doesn't have to take place in a classroom and financial acumen doesn't grow only from classes dubbed "financial." Books are cheaper than seminars, and managers, particularly upper-level managers, tend to be good self-learners. Meetings led by communicative executives who are alert to the value of business education can do much to promote financial literacy.

Even within a seminar framework, there are opportunities for flexibility and creativity that often are not adequately explored. Companies should think about ways to mix communities with overlapping needs. Executives, managers, and professionals don't need to be segregated. Mixing, in fact, is usually beneficial in business acumen curricula, especially if the agenda provides a lot of opportunity for participant interaction. Often in financial literacy education, the spontaneous sharing of experience, insight, and know-how across departments, functions, and jobs is at least as valuable as the planned learning points of a formal agenda.

Try hard to engage the company's internal expertise in D3. This will be difficult, especially in small companies, but it will be especially important in the topic areas of budget process, auditing, and control, which tend as a practical matter to be highly company-specific. In D3, the contribution of in-house expertise is often the difference between a sterile lecture and a high-impact exchange.

On the other hand, don't rely exclusively on internal faculty. Plan to blend the use of internal and external resources in D3. The reason isn't only economic. Exposure to independent, outside perspectives is essential if the literacy effort is going to achieve the Sarbanes-Oxley mission. Lit Champs need to make sure that the literacy effort doesn't become the next convenient outlet for top management's spin on the company's practices and performance.

Implementing these themes at the upper management level, companies should plan to build literacy mainly by teaching and learning from one another; to some extent, from subordinates. I call this practice "ALRT": active learning and reciprocal teaching. ALRT is different than a "collegial atmosphere." ALRT demands proactive curiosity, dialogue, and debate, and collaborative, generous efforts to fill any key knowledge holes that might be discovered. ALRT asks that every officer and board member adopt the role of both teacher and student, and asks each to be persistently candid in assessing themselves and one another.

At its discretion, upper management can reinforce ALRT with more traditional educational offerings. If ALRT will clearly fall short -- this will probably be more common in small companies than large ones -- the company should be quick to bring in outside advisors and experts. External advisors include the company's confidential advisors and professionals, *e.g.,* its attorneys, accountants. Bankers and consultants might also be viewed as educational resources, though somewhat more cautiously because of the limits of legal confidentiality. Immediate subordinates, *e.g.,* the Controller, Director of Shareholder Relations, Corporate Counsel should also be treated as educational resources. They, in turn, should accept responsibility for ALRT, and treat their superiors, to some extent, as their students.

For mid- and lower-level corporate populations, the educational package-of-choice will probably be the perennial favorite of corporate learning: the customized seminar. In this venue, the most important thing for companies to realize is that true, practical financial literacy will not necessarily be found in a seminar labeled 'finance." More important than the labels of the courses, or any buzzwords that they use, is how their content stacks up against the gaps identified in Step 2.

In particular, be aware that, under the guidance of academics, finance courses, particularly the introductory courses, tend to dwell on financial statements and accounting. My own experience is that practical financial literacy tends to have more to do with what might be called "whole-business perspective" ["WBP"] than accounting. WBP is the outside-in view of the company: a view that many managers and employees don't have. It is what shareholders see, what creditors see, what the regulators see, what the Board of Directors sees; what top management usually sees; and what most managers should see if they are going to understand and appreciate the role of finance in an organization. It's the notion of a fragile business entity working hard to provide investors with a financial return.

With WBP education comes appreciation of fiduciary responsibility, securities laws, and government regulation. With WBP also comes understanding of what motivates investment banks, security analysts, and brokers. WBP education, in other words, lines up well against the broad goals of Sarbanes-Oxley and the new vision of managerial responsibility. For most communities, effort spent on WBP will provide more return than lessons in the vocabulary and arithmetic of basic accounting.

Beyond the fact that WBP is a more common denominator in financial literacy than accounting acumen, it tends to be more engaging subject matter and the product of more interactive educational activities. In seminars, for example, it may be delivered using role-plays, case discussions, competitive computer simulations, and other games. Brown-bag lunches, with speakers from the banking community, are also a commonly used method for delivering WBP and thus elevating financial literacy.

In fact, especially if a company is alert to the value, there are many opportunities for WBP education outside the formal classroom and in conjunction with other business activities. I've heard the practice called "just-in-time learning." More simply, it might be regarded as "seizing the opportunity," and might include anything from spontaneous explanatory digressions in the middle of a meeting to assigned readings carefully selected to dovetail with issues that will be presented in upcoming business decisions. The point is, there are many events -- corporate town meetings, business reviews, planning sessions, organizational newsletters -- that present opportunities to teach and learn. The company's leaders mainly need to look for those opportunities with a view that literacy improvement and maintenance is now part of the job.

For some non-leadership communities, WBP education in combination with corporate leaders willing now and then to take a moment to teach, may be all that financial literacy demands. For others, WBP effort may be a good first layer and the centerpiece of continuing efforts to sustain literacy once it is initially achieved. Don't misunderstand, though. WBP is not a generic path to literacy. Many communities will require more or something different. Treat WBP education as a substitute for or supplement to the traditional fare of basic financial education, *i.e.,* simple accounting. But recognize that the real touchstone for literacy planning, D3, is the Step 2 work product.

Step 4: Do It Again

I know. There were supposed to be only three steps. I apologize. The fourth step is to do the first three steps again. And again. And again.… Not immediately, but regularly.

The three-step process is essentially a strategic plan for building and maintaining financial acumen. And, like all strategic plans, it ought to be treated as a cycle: study, analyze, plan, execute. My thought is that the cycle is worth beginning every three to five years. Over time, the work product of Step 1 should become fairly settled, and the gaps discovered in step 2 should become ever smaller.

Conclusion: Literacy is Important, Challenging, Achievable

In the wake of Sarbanes-Oxley, corporate leaders and educators have been quick to assume that executives and managers must “bone-up” on accounting rules and auditing practice. In effect, they seem to imagine themselves as auditors of the auditors. And, understandably, they are apprehensive of a world in which they must know everything that a CPA knows.

Already, and as I write, corporate training consultants, not to mention lawyers, accountants, and business schools, are busily positioning to catch this new wave of interest in financial education. Across the land, companies have been inundated with brochures, proposals, new products and services, many of them incorporating the buzzwords of the Sarbanes-Oxley era -- governance, compliance, audit, control, financial expertise. Frankly, this article belongs to the genre.

No doubt, many corporate leaders should meet or re-acquaint themselves with the rulebooks of accounting, reporting, and disclosure. On the other hand, no management team seriously considering financial literacy in the new era should assume that a brief reprise of Accounting 101 will save their sorry souls. If the lies of Enron represent the ills that Sarbanes-Oxley hopes to cure, be aware that those lies involved convoluted treatments of highly structured transactions, unconsolidated subsidiaries, and special purpose entities: more the material of 500- than 100-level courses.

So let's be clear. Sarbanes-Oxley itself says nothing directly about new financial literacy standards. Accounting 101 has not become a pre-requisite to corporate leadership and management positions. Nor is it the silver bullet. The legislation imposes some rules, demands some process and organizational change, in the way companies now do business.

The real import, though, of Sarbanes-Oxley and the corporate financial scandals that led up to it is a general redefinition of managerial responsibility. Harbor no doubt: the bar of financial literacy has been raised. And more executives, managers, and other key people will be expected to clear it. Its height and nature, as it always has, still varies on a community-by-community basis, and this complicates the challenge. The net effect though is that management education has become more important, even critical. In general, management must become more conversant with financial control, disclosure rules, audit process, and red flags on financial statements. They need to face up to the issues presented by accounting's grayer areas. They need to be more astute in evaluating proposed transactions and the businesses they run or review. They need to be able to communicate more effectively regarding financial performance, creditworthiness, and value. For companies thinking strategically, this is no time to bury heads in the sand.

In my opinion, most companies will find financial literacy to be a challenging, but achievable target. The place to start is with needs definition and the careful description of what financial acumens are required in your company's several literacy communities. The place to wind up is with design, development, and delivery of educational programs carefully crafted to meet your company-specific needs. Resist generic solutions. Focus on critical skills. Get internal expertise involved. Assure the inclusion of independent, external perspectives. The success keys throughout will be commitment, focus, realism, and flexibility.

Appendix A: Financial Skill List

The following is a list of skills that *might* be included in the definition of financial literacy. The main purpose of the list is to convey to those who have little or no financial background how diverse the topic of finance really is. It's important to realize that this list doesn't presume to *define* literacy. Most literacy communities don't demand *all* of these competencies. It's also important to realize that the list could easily be expanded or modified, and certainly should be in any practical effort to create and deliver a program. In other words, the list is a strawman: an invitation to criticism and modification.

- interpretation, analysis, use, and explanation of financial statements and ratios
- understanding GAAP and application of GAAP to real-world transactions
- interpretation and implementation of financial disclosure rules and philosophy
- earnings management -- methods and warning signs
- financial statement fraud -- methods and warning signs
- planning, budgeting and decision-making to support goals of profitability, creditworthiness, growth and/or value creation
- appropriate communication with investors, analysts, and other members of the financial community
- identifying and communicating concerns to employees, managers, and others regarding the performance and health of a business or business unit
- setting financial targets
- determining hurdle rates for purposes of investment selection
- rational, efficient investment selection
- budget-making
- negotiating price and terms of an asset sale, divestiture, a loan, *etc*
- understanding and influencing the factors, institutions and processes that drive credit ratings
- leading, monitoring, or participating in audit processes
- internal controls, especially in light of the new section 404 internal control reports
- cash management
- awareness of the advantages, disadvantages, and other practical consequences of alternative financial arrangements, *e.g.,* stock, bonds, mortgages, credit lines
- acquaintance with purpose and role of risk management, including the use of derivatives
- valuation of an investment, a business, a company, or a security
- compliance with securities laws