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Audit Overseer Cited Problems In Previous Post

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Shortly before William H. Webster was appointed to head a new board overseeing the accounting profession by the Securities and Exchange Commission last Friday, he told the commission's chairman, Harvey L. Pitt, that he had until recently headed the auditing committee of a company that was facing fraud accusations, Mr. Webster recounted today.

Mr. Pitt chose not to tell the other four commissioners who voted on Mr. Webster's nomination that day, according to S.E.C. officials. White House officials said they, too, were not informed about the details of Mr. Webster's work for the company.

The small publicly traded company, U.S. Technologies, is now all but insolvent and it and its chief executive, C. Gregory Earls, are facing suits by investors who say they were defrauded of millions of dollars. The suits contend the misconduct occurred in late 2001 and this year. That was after the three-person audit committee, headed by Mr. Webster, had voted to dismiss the outside auditors in the summer of 2001 after those auditors raised concerns about internal financial controls.

Mr. Webster, the 78-year-old former director of the C.I.A. and F.B.I., said he told Mr. Pitt and Robert K. Herdman, the agency's chief accountant, about the investor lawsuits before he was approved last Friday.

"I told them that people are making accusations," Mr. Webster said of his conversation with Mr. Pitt before he was appointed last Friday. "I said if this is a problem, then maybe we shouldn't go forward. I raised it because I didn't want it to become an issue."

Mr. Webster said he was assured by Mr. Pitt that the staff of the commission had looked into the issue and that it would not pose a problem. Mr. Pitt had urged Mr. Webster to take the job.

But U.S. Technologies' former outside accounting firm, other members of the audit committee, company executives, and investors and their lawyers who say they were defrauded say they were never called by anyone at the commission about Mr. Webster's candidacy for the new oversight board.

Last Monday, three days after Mr. Webster was appointed, he called Mr. Pitt again to say he had heard over the weekend from another former director that a government investigation had recently begun to examine possible fraud by the chief executive of the company, Mr. Webster said. Lawyers involved in the case say the inquiry, by federal investigators in Manhattan, is actually examining whether Mr. Earls, who recruited Mr. Webster, used the company to violate criminal fraud laws. Mr. Webster is not a target of the investigation. Mr. Pitt did not tell the other commissioners about the Monday conversation either, S.E.C. officials said.

Mr. Pitt declined to discuss the selection of Mr. Webster or U.S. Technologies. Christi Harlan, a spokeswoman at the S.E.C., said that Mr. Webster informed the commission's accounting staff, headed by Mr. Herdman, about his service on the board of the company and that the staff concluded that there was nothing worthy of passing on to other commissioners or that would disqualify Mr. Webster.

"What matters is we believe Judge Webster will be a fine chairman of the Public Companies Accounting Oversight Board," Ms. Harlan said.

Claire Buchan, a White House spokeswoman, referred calls about the selection of Mr. Webster to the S.E.C.

The accounting oversight board is the centerpiece of legislation approved this summer in response to the wave of scandals at companies like Enron, Arthur Andersen and WorldCom. It was created to supervise an array of professional issues, including disciplining accountants and inspecting the largest firms.

The commissioners split bitterly over the qualifications of Mr. Webster and his selection over John H. Biggs, who was considered by some in the profession to be too aggressive. In his dissent, one S.E.C. commissioner, Harvey J. Goldschmid, said the selection process had been flawed and inept and had failed to vet the candidates properly. Mr. Goldschmid declined to comment.

Mr. Webster stepped down from the board of U.S. Technologies in July after he said he was told that it could no longer provide liability insurance for directors and officers against claims from investors.

The company invests in young Internet companies and runs a contract labor company using prison inmates. It has had a variety of legal and regulatory difficulties. While Mr. Webster headed the audit committee, it was delisted from trading on Nasdaq for failing to make timely filings with the S.E.C.

The suits filed by investors allege that fraud occurred after the company's auditor, BDO Seidman, says it notified the auditing committee in May 2001 that U.S. Technologies had several serious weaknesses in its internal financial controls.

The company initially reported to the S.E.C. that BDO Seidman auditors had been dismissed not because of any disagreements or qualifications but only because of "an explanatory paragraph that discusses factors that raise substantial doubt" that U.S. Technologies had the "ability to continue as a going concern."

But U.S. Technologies was forced to amend its filing a few weeks later, after BDO Seidman executives sent a letter explaining that their firm had found serious accounting problems at the company.

BDO Seidman accountants wrote: "In a letter dated May 9, 2001, issued on Aug. 31, 2001, and in a telephonic audit committee meeting on July 13, 2001, BDO Seidman L.L.P. communicated a material weakness in internal control to the audit committee and management relating to financial and accounting infrastructure including lack of an experienced C.F.O., deficiencies in recording material transactions timely, and in the organization and retention of financial documents and accounting records."

Mr. Webster said the company responded by hiring a more experienced chief financial officer. He said the auditing committee did not look into the other problems mentioned by BDO Seidman accountants. He said that executives at U.S. Technologies had been concerned about the auditing bills of BDO Seidman and about the lengthy time it had taken to perform the audits.

BDO Seidman, which will be regulated by the new accounting oversight board, declined through a spokesman to comment about its work for U.S. Technologies.

Lawyers involved in the criminal investigation said there was no evidence that Mr. Webster violated any laws and he was not the target of the inquiry. But critics of his selection to the oversight board said the audit committee's decision not to investigate thoroughly and make public its findings demonstrated that he lacked the qualifications to lead the board.

"Even if we find out that Webster was totally passive in this process, it is an indictment on his ability to run the accounting oversight board," said James D. Cox, a professor of securities and corporate law and author of a textbook on accounting who teaches at Duke. "To let something like this go shows really bad judgment, and I think is automatically disqualifying. At a minimum, the audit committee had an obligation to investigate. This is exactly the kind of situation that the accounting oversight board is supposed to change, and that the new law creating the oversight board is supposed to fix."

Mr. Webster said he did not think his experience at U.S. Technologies "would impair my ability to serve."

"But that is not for me to judge," he said. Speaking of the commission, he added: "I always made a point of telling them everything I knew. I'm sure they wouldn't have gone through with it if they didn't have confidence in me."

At the center of the investigation and the suits over U.S. Technologies is Mr. Earls, the company's chairman and chief executive, who recruited Mr. Webster and other prominent Washington figures to serve on its board and invest in the company. The board members included George Mitchell, the former Senate majority leader, and Beth Dozoretz, the former finance chairwoman of the Democratic National Committee.

Mr. Earls has recently suffered some court setbacks.

A decision two months ago in one of those cases by a Delaware judge concluded that there was significant evidence he had committed a pattern of misrepresentations "that may rise to the level of criminal conduct" in connection with USV Partners, which Mr. Earls controls and is a large investor in U.S. Technologies.

The judge also found "credible evidence" that Mr. Earls "has exhibited a pattern of defrauding investors" by using a variety of partnerships and other "special purpose entities" controlled by him.

After reciting a list of court cases against Mr. Earls, the judge, Vice Chancellor Jack Jacobs, said, "Although claims of wrongful conduct in unrelated cases certainly do not establish that Earls mismanaged USV, the ever-increasing pattern of fraud claims against Earls lends further credibility to the other evidence that does tend to establish that Earls has mismanaged USV."

In a separate civil case filed in July in federal court here, a few days after Mr. Webster resigned from the board, an investor accused Mr. Earls and U.S. Technologies of stealing for Mr. Earls's own benefit almost $2 million last year by diverting what were supposed to be investments. Mr. Earls's lawyers have denied the accusation.

Thomas Green, a lawyer who represents Mr. Earls, said that his client violated no laws and that the company had been a victim of the downturn in the economy.