Watching the Watchdogs: Political Economy Public Accounting Oversight

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Contents

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Political Economy of Public Accounting Oversight

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Introduction

Professions are seen in terms of their economic monopolies, their professional work and skills, and their ideologies. Following these three lines of thought, critics trace the potential economic effects of a decline in professional status, the potential effects of loss of professional control over auditing practices and standards, and the likely public interest effects from changes in professional ideology. The work of two particular socio-logical theorists forms the framework for this analysis. Abbott [1988] theorizes professions as groups with jurisdiction over professional tasks-a jurisdiction that is based in economics, negotiated with other groups, and in a constant state of change. Freidson [1986; 2001] bases his analyses on the characteristics of an ideal profession with emphasis on understanding the key interactions between those characteristics. The characteristics are seen not so much as traits but as functional building blocks for professions. For example, professional control over practitioner qualifications is important for maintaining professional control of work. While some see the public accounting (auditing) profession as distinct from other accounting professions, such as education, private enterprise, not-for-profit and governmental [Handrikson 1986], some define the accounting profession more broadly and see the various segments as internal differentiation within a profession. Histories of the early days of the accounting profession in various countries detail struggles to define which occupational groups would and would not be included in the profession associations [Willmort 198;Lee 1995; Chua and C. Poullaos 1998]. In the U.S. and elsewhere the premier event leading to professional status for accountants was the franchise given to public accountants by the securities legislation of the 1930s [Merino and A. G. Mayper 2001]. This legislation both requires publicly traded companies to purchase independent audits of their financial statements and defines public accountants as the sole providers of such audits. The professional status of accounting is therefore dependent on the public wing of the profession, however even the American Institute of Certified Public Accountants has only a minority of its members currently in public practice. Both in the UK and the US the profession is fragmentary with many sub- specializations. Roslender [1992] notes that aside from auditing, the accounting profession is not exclusive and does not depend on a government supported monopoly. One does not have to be a CA to provide taxation, statement preparation, and other services.

Abbott [1988] and Freidson [2001] explain that once a profession has achieved professional status, they then begin to bring various related functions under the umbrella of that professional distinction. So, for example, accountants in the US have provided taxation and information services as an adjunct to audit practice and these activities are clothed in the ideological mantle of the profession for a marketing advantage when supplied by CAs—although both services can be bought as well from non-accountants. This is precisely the type of situation theorized by Abbott [1988] where a number of related functions rely on the professional status of the core function in competition for professional jurisdiction or work.

Key Aspects of Professionalism: Public accountancy, is generally viewed as a profession both by academics and the public. [Friedson,2001] notes five interdependent elements of the ideal type professionalism: 1) Specialized work in the officially recognized economy that is believed to be grounded in a body of theoretically based, discretionary knowledge and skill and that is according given special status in the labor force; 2) Exclusive jurisdiction in a particular division of labor created and controlled by occupational negotiation; 3) A sheltered position in both external and internal labor markets that is based on qualifying credentials created by the occupation; 4) A formal training program lying outside the labor market that produces qualifying credentials, which is controlled by the occupation and associated with higher education; and 5) An ideology that asserts greater commitment to doing good work than to economic gain and to the quality rather than the economic efficiency of the work [Friedson,2001 p. 127]. These elements are interdependent for example, professions maintain exclusive jurisdiction, in part, by promoting their ability to perform specialized work. The three key elements of professions are the existence of a "labor market shelter" by which the profession is shielded from competition, retention of professional control (as opposed to client or state control) over judging and evaluating professional work, and maintenance of a public interest ideology [Friedson, 2001].

A labor market shelter represents "occupational control over supply and the substance of demand" for particular work and effective formally negotiated labor market shelters are always based on some public claim of specialized training and skill that secures a state sanction for an exclusive right to supply certain kinds of labor [1994, pp. 82-83]. As Freidson [1994, p. 173] explains, "an occupation can fend off control by individual or corporate consumers of their work only by having power delegated to it by the state." He explains that "Ideal-typical professionalism is always dependent on the direct support of the state and some degree of tolerance of its position by both consumers and managers" [Freidson 2001, p. 122]. The statutory requirement for audits by certified public accountants for publicly listed firms is an example of a state supported labor market shelter. If the state did not require audits for publicly traded corporations and did not re- quire that audits be performed by a certain set of people as defined by the public accounting profession, it would be very difficult for the auditing profession to maintain their market share in face of true competition. However, this requires the profession to convince the State that only they have the skills, training, and commitment to provide these essential services, and that they accept an obligation to act in the underlying public interest even while pursuing their own profit motives.

Another key characteristic of professionals is that they have technical autonomy and some degree of discretion in performing work that must be conducted in accordance with a personal, schooled judgment [1986, p. 141]. Even though professional work is often employed within bureaucratic setting and control, supervision of the professional work and judgment of its quality is the purview of skilled professionals. For example, in accounting it is the peer review process, not the opinion of the client, that determines the quality of an audit. Freedom from the authority of others over their work is one of the defining characteristics of professions [1994, p. 115] and one that has been lost by the US auditing profession and elsewhere in the world with the current accounting scandals like Enron, World Com, Syatom, Parmalaot and many others since 1940s and more seriously in 1990 onwards..

Objective and structure of the paper

Professional accountancy bodies and firms under their umbrella are perceived to be non- performer in delivering their professional responsibilities towards the stakeholders. In every economic turmoil, stock market crash, Bank failures and economic downturns the accountants are criticized whether this failure originated from wrong economic theory or not. Objective of this paper is to identify the different steps that needed accountancy profession to bring under more scrutiny and surveillance to avoid the conflict of interest and protect the stakeholder interest and independence of public accountants. This paper tries to identify the causes of oversight on accountancy profession in general and, in particular, and highlight the developments in the United States, Scandinavian country Sweden, Denmark, EU and Middle Eastern and Asian countries. Finally, provide a brief sketch of oversight on accountancy profession in Bangladesh. Given the objective the paper is divided into- sections. ***Section-I:*** Provides a literature review on the foundation of the public accountancy profession on its existence. ***Section-II:*** Open discussion on the justification oversight with details on the causes of the failure of public accounting profession with stress and scandals, lawsuits, and criticism and reforms in regulation process including oversight of the profession. ***Section-III:*** Mainly deals with emerging need of oversight on the Accountancy profession in particular, enactment of Sarbanes-Oxley Act and establishment of public company accounts oversight Board in the USA. ***Section IV:*** Attempts to display the updates on the implementation Sox Act and process development for implementation also the impact on auditing profession. In particular, this section provides an insight on how PCAOB started functioning and the accountancy firm inspection process followed. ***Section V:*** Provides a sketch on Public Company Oversight Board in 15 countries which covers 7 Middle East and 8 EU countries. ***Section VI:*** details a brief on International Forum of Independent Audit Regulators with 39 members. This includes 10 country survey results on accounting oversight Board and the regulation process. A brief sketch on the regulation process is provided in this section with a brief on the current state of oversight on Accountancy Profession in Bangladesh and ***Section VII***: document the summary of the paper.

Section I: Literature review on Public Accounting Profession

1.1 Issues in the Accounting Profession

While the Sarbanes-Oxley legislation was a response to a particular set of market scandals, a number of unresolved issues had been developing surrounding public accountancy for years. If these underlying problems remain un- resolved, they will continue to affect the ability and willingness of the accounting profession to meets its public interest obligations. Several recent accounts trace the factors that led to the failure of profession to retain its full professional status. Zeff [2003, pp. 189-205] places the pinnacle of status of the US accounting profession in the 1940s to mid 1960s. However, the subsequent movement of the profession into information-based services triggered an internal differentiation that would ultimately erode the public interest ideology of the profession [2004, pp. 45-53]. As the markets gained increased prominence and importance in the 1960s, activities surrounding the markets became more visible. The late 1960s ushered in an era of "scandals, lawsuits, and criticism of the profession" [2003, p. 196]. In the 1970s accounting standard setting passed from the profession to a private standard-setting body and Zeff notes a decline in interest by the profession in taking public positions on accounting standards. Congressional hearings in the late 1970s resulted in the first of a series of reforms in the self-regulation process of the profession. In addition, growth of controversial management advisory services continued despite the concern of regulators. Zeff [2003, pp. 267-286] notes a deterioration of professional values and professional climate in the 1980s on due to increases in the competitive environment. Economic pressures in turn led to an increasing move into provision of consulting services and changes in expectations of partners from delivering high quality audit services to bringing in revenue growth.

The profession responded weakly to the Savings and Loan crisis, other scandals and additional congressional hearings. Pressure from clients for favorable accounting treatments that showed continual growth also escalated in the 1980s and 1990s. While the SEC and others increase Zeff [2003, pp. 267-286] concludes that the auditors themselves became even less involved with professional issues or identification, focusing more on growth of their consulting businesses. Zeff notes that the concerns of regulators were opposed or ignored by audit firms and the work climate and business model of accounting practice became even more oriented toward consulting work.

1.2 Economic Differentiation

Wyatt [2004, pp. 45-53] provides in insider's view of the change from a professional and firm culture based on ethics to the primacy of consulting practice and business concerns. Factors identified with the decrease in professionalism include an increased tendency to hire non-accounting graduates such as information specialists, the pressure created by the success of consulting practice for in- creased profitability in the audit practice, and the rise of profitability.

In sociological theories of professions [Friedson 2001, Abbott 1988 , Larson 1977], economic interests are at the core of the professional project. When the perceived economic value of a peripheral activity, such as information technology consulting, begins to surpass the perceived economic value of the profession's core monopoly activity (auditing), problems are bound to result. The motivation of the profession to protect the value of its core product is diminished. In the case of auditing there are further problems because pursuit of the peripheral activity arguably has implications for the ability of the auditor to maintain a vestigal degree of independence from the client. If the business model is such that required audits are seen as platforms to compete effectively for lucrative consulting business, then auditors may not be in a position to interpret accounting and auditing standards in a fair and objective. There was considerable debate about whether there was empirical evidence that independence had been impaired by client pressure, however there can be no doubt that the business model of using audit work as a platform for selling other services embodied serious conflicts of interest.

The "fall of the accounting profession" can be seen as a situation where perverse economic incentives associated with the consulting culture overwhelmed positive economic incentives to preserve the integrity of audits [Larson 1977] or as a situation where internal differentiation of the profession resulting from the precipitous rise of information services/consulting played havoc with the ability of the profession to remain committed to its core business of auditing [Abbott 1988]. For either of these two explanations, the solution is to revitalize the economic incentives associated with auditing—and ironically the internal control certification requirements associated with Section 404 of the Sarbanes-Oxley act appear to have just that effect. Douglas Carmichael, Chief Auditor of the PCAOB, presents the goal of the auditing profession in economic terms. He relies on the theory of inspired confidence, an economic theory wherein the goal of auditing is to meet society's needs and states that auditing standards will be set with a goal to "perform enough work to meet the expectations the auditor has aroused in society" [13, p. 129].

In the short term Sarbanes-Oxley provisions, particularly in relation to internal control requirements, may have the effect of revitalizing the economic value of audit practice. Furthermore, Sarbanes-Oxley legislation severely restricts the ability of firms to provide consulting services to audit clients, therefore changing the business model that has dominated accounting practice. However, in the long term, economic conflicts between the value of auditing and consulting are bound to reappear. The internal differentiation of the profession will continue to pose problems for the profession. While the public accounting profession, particularly the large firm segment engaged in audits of publicly traded companies, is directly affected by Sarbanes-Oxley, other segments of the accounting profession are affected as well. Abbott [Abbott 1988] explains that the different segments of professions and the other work groups with whom they compete are all inter-related. Abbott's "system of professions" is always in flux, with different work groups competing for jurisdiction.

1.3 Professional Character

Zeff [2003] and Wyatt [2004] describe the decline of the accounting profession to a turning away from the central ethical commitment of professionalism. This situation is not unique to accounting. Wolfe [1989] asserts that there has been a change in the moral sensibility of American society from reifying moral or character-based traits to admiring economic traits. Reiter and Williams [2004] ex plain how the narratives of legitimation of the profession have changed over the years from emphasis on the professional character on accountants to emphasis on the judicial neutrality of accountants to promotion of accountants as economic characters upholding audit independence because it serves their self-interest. While the SEC and the government seek to restore public confidence in CAs and audited financial statements by taking over regulation of auditing standards and practices and enhancing the role of corporate governance, particularly audit committees, in overseeing the actions of management, the accounting profession is seeking to reestablish trust in CAs. Melancon [2002] calls for a return to a culture built "upon the profession's traditional values". PWC [2003] exhorts auditors to rebuild trust through rededication to core values such as integrity, re-activation of professional judgment, and adoption of clear codes of conduct and corporate cultures emphasizing integrity. Likewise Wyatt [2004] sees the redemption of CPAs in the reestablishment of professional character.

However, sociological theory would prompt us to ask whether professionalism is really about character, or always about economic interests. Freidson [1994, p. 124] explains that "the notions of dedication to service and of craftsmanship are more usefully treated as elements of an ideology than as empirical characteristics of individual and collective professional behavior". Also, one should expect that economic interests and professional ideology will always be in conflict. As Larson [1977] notes, "…at the core of the professional project, we find the fusion of antithetical ideological structures and a potential for permanent tension between 'civilizing function' and market orientation, between the 'protection of society' and the serving of a market…" (p. 63). Therefore, recent professional commitments to re-establish the character of public accountants may have more to do with strengthening others' beliefs in the ideology of the accounting profession than with a profound change in the underlying economic values of the profession.

Furthermore, the profession may find it difficult to develop or change character. Character is based on actions and the internal culture of the profession is formed through actions. If the criteria for reward and promotion for years have been based on salesmanship or commercial values, how easy is it to switch to a culture based on ethical values?

Section II: A Chronology of stress on Accountancy Profession

All was not rosy as the three decades from the 1940s through the 1960s came to a close. Threatening clouds began to form over the accounting profession in the middle and latter 1960s. Financial scandals burst on the scene, raising questions about the performance of auditors. Trailing in the wake of the scandals, auditors found themselves as defendants in a number of highly publicized lawsuits. And the accounting profession lost its prized authority to pronounce on generally accepted accounting principles (GAAP) to an independent body, with unfortunate ramifications for the vitality of professional discourse.

Accounting scandals are political and/or business scandals which arise with the disclosure of financial misdeeds by trusted executives of corporations or governments. Such misdeeds typically involve complex methods for misusing or misdirecting funds, overstating revenues, understating expenses, overstating the value of corporate assets or underreporting the existence of liabilities, sometimes with the cooperation of officials in other corporations or affiliates.

In public companies, this type of "creative accounting" can amount to fraud, and investigations are typically launched by government oversight agencies, such as the Securities and Exchange Commission (SEC) in the United States. It is fairly easy for a top executive to reduce the price of his/her company's stock – due to information asymmetry. The executive can accelerate accounting of expected expenses, delay accounting of expected revenue, engage in off balance sheet transactions to make the company's profitability appear temporarily poorer, or simply promote and report severely conservative (e.g. pessimistic) estimates of future earnings. Such seemingly adverse earnings news will be likely to (at least temporarily) reduce share price. (This is again due to information asymmetries since it is more common for top executives to do everything they can to window dress their company's earnings forecasts). There are typically very few legal risks to being 'too conservative' in one's accounting and earnings estimates.

A reduced share price makes a company an easier takeover target. When the company gets bought out (or taken private) – at a dramatically lower price – the takeover artist gains a windfall from the former top executive's actions to surreptitiously reduce share price. This can represent tens of billions of dollars (questionably) transferred from previous shareholders to the takeover artist. The former top executive is then rewarded with a golden handshake for presiding over the fire sale that can sometimes be in the hundreds of millions of dollars for one or two years of work. This is nevertheless an excellent bargain for the takeover artist, who will tend to benefit from developing a reputation of being very generous to parting top executives.

Similar issues occur when a publicly held asset or non-profit organization undergoes privatization. Top executives often reap tremendous monetary benefits when a government-owned or non-profit entity is sold to private hands. Just as in the example above, they can facilitate this process by making the entity appear to be in financial crisis – this reduces the sale price (to the profit of the purchaser), and makes non-profits and governments more likely to sell. It can also contribute to a public perception that private entities are more efficiently run, thereby reinforcing the political will to sell off public assets. Again, due to asymmetric information, policy makers and the general public see a government-owned firm that was a financial 'disaster' – miraculously turned around by the private sector (and typically resold) within a few years.

Not all accounting scandals are caused by top executives. Often managers and employees are pressured or willingly alter financial statements for the personal benefit of the individuals over the company. Managerial opportunism plays a large role in these scandals and public accountants through certification process become part of these scandals. For example, managers who would be compensated more for short-term results would report inaccurate information, since short-term benefits outweigh the long-term ones such as pension obligations.

2.1 List of reported accounting scandals

Company	Year	Audit Firm	Country	Notes
Associated Electrical Industries, after being acquired by General Electric Company plc	1967		United Kingdom	
Pergamon Press	1969		United Kingdom	
Lockheed Corporation	1976		United States	
Nugan Hand Bank	1980		Australia	
ZZZZ Best	1986		United States	Ponzi scheme run by Barry Minkow
Barlow Clowes	1988		United Kingdom	Gilts management service. £110 million missing
MiniScribe	1989		United States	
Polly Peck	1990		United Kingdom	
Bank of Credit and Commerce International	1991		United Kingdom	
Phar-Mor	1992	Coopers & Lybrand	United States	mail fraud, wire fraud, bank fraud, and transportation of funds obtained by theft or fraud
Informix Corporation	1996	Ernst & Young	United States	
Sybase	1997	Ernst & Young	United States	
Cendant	1998	Ernst & Young	United States	
Waste Management, Inc.	1999	Arthur Andersen	United States	Financial misstatements
MicroStrategy	2000	PWC	United States	Michael Saylor
Unify Corporation	2000	Deloitte & Touche	United States	
Computer Associates	2000	KPMG	United States	Sanjay Kumar
Lernout & Hauspie	2000	KPMG	Belgium	Fictitious transactions in Korea and improper accounting methodologies elsewhere
Xerox	2000	KPMG	United States	Falsifying financial results
One.Tel	2001	Ernst & Young	Australia	
Amir-Mansour Aria	2011	IAO (Audit organization) and other Audit firms	Iran	Business Loans Without Putting any Collateral and financial system
Bank Saderat Iran	2011	IAO (Audit organization) and other Audit firms	Iran	financial transactions among banks and Getting a lot of Business Loans Without Putting any Collateral
Enron	2001	Arthur Andersen	United States	Jeffrey Skilling, Kenneth Lay, Andrew Fastow
Swissair	2001	PricewaterhouseCoopers	Switzerland	
Adelphia	2002	Deloitte & Touche	United States	John Rigas
AOL	2002	Ernst & Young	United States	Inflated sales
Bristol-Myers Squibb	2002[20][26]	PricewaterhouseCoopers	United States	Inflated revenues
CMS Energy	2002[20][27]	Arthur Andersen	United States	Round trip trades
Duke Energy	2002[20]	Deloitte & Touche	United States	Round trip trades
Dynegy	2002	Arthur Andersen	United States	Round trip trades

Company	Year	Audit Firm	Country	Notes
El Paso Corporation	2002	Deloitte & Touche	United States	Round trip trades
Freddie Mac	2002	PricewaterhouseCoopers	United States	Understated earnings
Global Crossing	2002	Arthur Andersen	Bermuda	Network capacity swaps to inflate revenues
Halliburton	2002	Arthur Andersen	United States	Improper booking of cost overruns
Homestore.com	2002	PricewaterhouseCoopers	United States	Improper booking of sales
ImClone Systems	2002	KPMG	United States	Samuel D. Waksal
Kmart	2002	PricewaterhouseCoopers	United States	Misleading accounting practices
Merck & Co.	2002	Pricewaterhouse Coopers	United States	Recorded co-payments that were not collected
Merrill Lynch	2002	Deloitte & Touche	United States	Conflict of interest
Mirant	2002	KPMG	United States	Overstated assets and liabilities
Nicor	2002	Arthur Andersen	United States	Overstated assets, understated liabilities
Peregrine Systems	2002	KPMG	United States	Overstated sales
Qwest Communications	2002	1999, 2000, 2001 Arthur Andersen 2002 October KPMG	United States	Inflated revenues
Reliant Energy	2002	Deloitte & Touche	United States	Round trip trades
Sunbeam	2002	Arthur Andersen	United States	Overstated sales and revenues
Symbol Technologies	2002		United States	Overstated sales and revenues
Tyco International	2002	PricewaterhouseCoopers	Bermuda	Improper accounting, Dennis Kozlowski
WorldCom	2002	Arthur Andersen	United States	Overstated cash flows, Bernard Ebbers
Royal Ahold	2003	Deloitte & Touche	United States	Inflating promotional allowances
Parmalat	2003	Grant Thornton SpA	Italy	Falsified accounting documents, Calisto Tanzi
HealthSouth Corporation	2003	Ernst & Young	United States	Richard M. Scrushy
Nortel	2003	Deloitte & Touche	Canada	Distributed ill advised corporate bonuses to top 43 managers
Chiquita Brands International	2004	Ernst & Young	United States	Illegal payments
AIG	2004	PricewaterhouseCoopers	United States	Accounting of structured financial deals
Bernard L. Madoff Investment Securities LLC	2008	Friehling & Horowitz	United States	Massive Ponzi scheme.[44]
Anglo Irish Bank	2008	Ernst & Young	Ireland	Anglo Irish Bank hidden loans controversy
Satyam Computer Services	2009	PricewaterhouseCoopers	India	Falsified accounts
Lehman Brothers	2010	Ernst & Young	United States	Failure to disclose Repo 105 transactions to investors
Sino-Forest Corporation	2011	Ernst & Young	Canada-China	
Olympus Corporation	2011	Ernst & Young	Japan	*tobashi* using acquisitions
Autonomy Corporation	2012	Deloitte & Touche	United States	Subsidiary of HP.

The Enron scandal turned in the indictment and criminal conviction of one of the Big Five auditor Arthur Andersen on June 15, 2002. Although the conviction was overturned on May 31, 2005, by the Supreme Court of the United States, the firm ceased performing audits and is currently unwinding its business operations. The Enron scandal was defined as being one of the biggest audit failures. The scandal included utilizing loopholes that were found within the GAAP (General Accepted Accounting Principles). For auditing a big sized company such as Enron, the auditors were criticized for having brief meetings a few times a year that covered large amounts of material. By January 17, 2002, Enron decided to discontinue its business with Arthur Andersen claiming they had failed in accounting advice and related documents. Arthur Andersen was judged guilty of obstruction of justice for getting rid of many emails and documents that were related to auditing Enron. Since the SEC is not allowed to accept audits from convicted felons, the firm was forced to give up its CPA licenses later in 2002, costing over 113,000 employees their jobs. Although later the ruling was overturned by the U.S. Supreme Court, the once-proud firm's image was tarnished beyond repair, and it has not returned as a viable business even on a limited scale.

On July 9, 2002 George W. Bush gave a speech about recent accounting scandals that had been uncovered. In spite of its stern tone, the speech did not focus on establishing new policy, but instead focused on actually enforcing current laws, which include holding CEOs and directors personally responsible for accountancy fraud. In July, 2002, WorldCom filed for bankruptcy protection, in what was considered the largest corporate insolvency ever at the time.

These scandals reignited the debate over the relative merits of US GAAP, which takes a "rules-based" approach to accounting, versus International Accounting Standards and UK GAAP, which takes a "principles-based" approach. The Financial Accounting Standards Board announced that it intends to introduce more principles-based standards. More radical means of accounting reform have been proposed, but so far have very little support. The debate itself, however, overlooks the difficulties of classifying any system of knowledge, including accounting, as rules-based or principles-based. This also led to the establishment of Sarbanes-Oxley.

On a lighter note, the 2002 Ig Nobel Prize in Economics went to the CEOs of those companies involved in the corporate accounting scandals of that year for "adapting the mathematical concept of imaginary numbers for use in the business world".

In 2003, Nortel made a big contribution to this list of scandals by incorrectly reporting a one cent per share earnings directly after their massive layoff period. They used this money to pay the top 43 managers of the company. The SEC and the Ontario securities commission eventually settled civil action with Nortel. However, a separate civil action will be taken up against top Nortel executives including former CEO Frank A. Dunn, Douglas C. Beatty, Michael J. Gollogly and MaryAnne E. Pahapill and Hamilton. These proceedings have been postponed pending criminal proceedings in Canada, which opened in Toronto on January 12, 2012. Crown lawyers at this fraud trial of three former Nortel Networks executives say the men defrauded the shareholders of Nortel of more than $5 million. According to the prosecutor this was accomplished by engineering a financial loss in 2002, and a profit in 2003 thereby triggering Return to Profit bonuses of $70 million for top executives.

In 2005, after a scandal on insurance and mutual funds the year before, AIG was investigated for accounting fraud. The company already lost over 45 billion US dollars' worth of market capitalization because of the scandal. Investigations also discovered over a billion US dollars worth of errors in accounting transactions. The New York Attorney General's investigation led to a $1.6 billion fine for AIG and criminal charges for some of its executives. CEO Maurice R. "Hank" Greenberg was forced to step down and is still fighting civil charges being pursued by New York state.

Well before Bernard Madoff's massive Ponzi scheme came to light, observers doubted whether his listed accounting firm—an unknown two-person firm with only one active accountant in a rural area north of New York City—was competent to handle a multi-million dollar operation. Ultimately, Madoff's accountant, David G. Friehling, admitted to simply rubber-stamping Madoff's filings with the SEC. He also revealed that he continued to audit Madoff even though he had invested a substantial amount of money with him. Accountants aren't allowed to audit broker-dealers with whom they're investing. He agreed to forfeit $3.18 million in accounting fees and withdrawals from his account with Madoff. His involvement makes the Madoff scheme the largest accounting fraud in world history.[

2.2 Scandals, Lawsuits, and Criticism of the Profession

The collapse of Westec (1965) and National Student Marketing (1969), which were notorious practitioners of what Abraham J. Briloff, an acerbic critic of unprincipled accounting, called dirty pooling. (Briloff 1967, 1970), as well as the bankruptcies of Penn Central and Four Seasons Nursing Centers (both in 1970), visited huge losses on investors and raised questions about the performance of their auditors. The Westec case eventually animated a serious concern that its auditor's independence was compromised by rendering certain consulting services to the audit client. During the second half of the 1960s, criticism of the accounting profession was on the rise. John L. Carey, the Institute.s administrative vice president, said in 1967 that .the accounting profession is going through a most unusual and difficult period. On some days it seems as though we were being attacked from all sides. He was concerned over .a feeling that CPAs are not quite the stalwart protectors of investors and creditors that the public had assumed they were. (Carey 1967, 15). It was, he said, a time of rising expectations of auditors (Carey 1967, 18). Carey.s colleague at the Institute, Leonard M. Savoie, a former research and education partner in Price Waterhouse (PW) and, since 1967, the Institute's executive vice-president, bluntly criticized the .opinion shopping that was beginning to pit firm against firm:

> *competition to obtain a client for the lowest fee or to obtain or retain a client at the expense of technical standards is debilitating. It will weaken and, if unchecked, destroy the profession. Competition for a client based on accounting principles must be stopped. (Savoie 1968, 112).*

The second half of the 1960s witnessed a series of important federal court decisions: *Fischer v. Kletz* (1967), also known as the Yale Express case; *Escott v. BarChris* (1968); and *United States v. Simon* (1969), also known as the Continental Vending case (see Isbell 1970), triggered a litigation explosion against auditors in the 1970s (Jaenicke 1977, 1). After decades of comparative calm, the profession was coming under attack by the plaintiff.s bar. .By the mid-1970s,. Jaenicke (1977, 1) wrote, .hundreds of suits were filed against auditors.. In a speech given in 1970, John C. (Sandy) Burton, an accounting and finance professor at Columbia Business School, took a dim view of developments in the profession:

> *In recent years, there is little evidence that the public in public accounting has been emphasized. In its zeal to protect itself from liability, the profession has given every impression of attempting to avoid responsibility. In the professional literature pains have been taken to assert what the auditor does not do, and to indicate that auditors attest only to the general acceptability, rather than the desirability, of management's choice of accounting principles. It is not at all surprising that articles critical of the accounting profession are beginning to appear more and more frequently in the business press. (Burton 1971, 49).*

2.3 Tribulations of the Accounting Principles Board:

In the mid-1960s, under pressure from the SEC and from the Big Eight firms and at a time when the accelerated pace of corporate merger activity focused increased attention on the earnings measure, the APB began to issue longer and more prescriptive Opinions. Several of these pronouncements attracted significant numbers of dissenting votes from board members. In two instances (on inter-period tax allocation in 1967 and on business combinations/goodwill in 1970), a board member from a Big Eight firm infuriated his colleagues in the majority by rescinding his vote on a contentious Opinion after the board had, in a final vote, approved a position that had secured a bare two-thirds majority. In 1967, the reversal occurred after the Opinion in 1967 was printed and ready for distribution. In both instances, the board met in emergency session to rescue the pronouncement. Thus was the intensity of pressure on board members, probably brought, directly or indirectly, by a firms important clients. Burton alluded to complicity by audit firms in helping their clients escape the adverse effects of the APB.s pronouncements: .By writing precise rules, . [the APB] has made it possible for people to observe the letter and avoid the spirit, with the blessing (and often the assistance) of their auditors. (Burton 1971, 50), a state of affairs that continues today.

Although the APB received praise from some quarters for narrowing the areas of difference. on such contested subjects as pensions and inter-period tax allocation, other Opinions, especially Opinion No. 15 issued in 1969 on earnings per share, were criticized by leading accounting professionals for being laden with detailed rules. Ernest L. Hicks (1969, 60), a technical partner in Arthur Young & Company, complained that .much of the difficulty the Board has experienced resulted when it yielded to pressure to move too fast, with less than an adequate exposure of the issues. No less an exalted figure than Professor *Emeritus* William A. Paton, who served for 11 years on the old Committee on Accounting Procedure, reviled Opinion No. 15 as an illustration of obscurity and unnecessary detail. He also criticized the board for its dictatorial tendencies. in recent Opinions (Paton 1971, 42), a view echoed by retired PW senior technical partner Paul Grady, who had served as the Institutes director of accounting research in 1963.64 (Grady 1971, 24). PW executive office partner A. Carl Tietjen derided the APB for issuing .cookbooks. (Tietjen 1970, 10), as Hicks (1969, 60) did earlier. George R. Catlett, senior technical partner of Arthur Andersen & Co. and a longtime APB member, contended that the APB, like its predecessor, has been so busy putting out fires. And dealing with a large and ever-increasing backlog of current problems that it has never established an adequate basis upon which to build. (Catlett 1969, 62).

Also, the ferocity with which Corporate America lobbied against APB proposals that limited companies flexibility in matters of accounting choice, most notably between 1968 and 1970 on business combinations and goodwill as the conglomerate merger craze was losing steam, led to a widespread loss of confidence in the boards effectiveness after the board issued a highly compromised Opinion No. 16, with six dissenting votes. The press followed every step in the board's tortured deliberations with relish (Zeff 1972, 212.216; Olson 1982, 3). Critics from both inside and outside the profession inveighed against the organized professions body charged with establishing the norms of proper accounting practice.

In August 1970, the APB finally issued its two hotly contested Opinions, Nos. 16 and 17, on accounting for business combinations and goodwill; the two Opinions were regarded more as the result of intense lobbying by industry than the product of sound thinking and analysis. The Big Eight accounting firms themselves differed profoundly and even emotionally over the best solution, partly fueled by their clients. preponderant views. So strong were the firms. reactions to the pressurized process in which these two Opinions were developed that three of the Big Eight notified the Institute in November 1970 that they had lost confidence in the APB.10 The three firms recoiled at the powerful intrusion of self-interested lobbying and lamented the board.s lack of agreement on the objectives of financial statements. In August 1970, the American Accounting Association (AAA) became involved by appointing a special committee to inquire into the formulation of accounting principles. Acting swiftly, the committee urged the Institute and other interested bodies to cooperate with the AAA to convene a Commission of Inquiry to develop a better alternative to the APB. The Association's Executive Committee promptly endorsed its report (Report of the Committee on Establishment of an Accounting Commission 1971).

2.4 The Profession Loses its Accounting Standard Setting right

Declining to share the standard-setting stage with the AAA, the Institute itself appointed a Study Group to recommend a better way of establishing accounting principles. This Study Group, chaired by Francis M. Wheat, a former SEC Commissioner, recommended the establishment of the Financial Accounting Standards Board (FASB), which was to be an independent body, not a committee of the Institute. The Institutes Council promptly endorsed the Wheat recommendation in its entirety, thereby, for the first time, ceding the authority for setting accounting standards to a body outside the province of the organized accounting profession. Members of the FASB would hold full-time appointments, be supported by a large research staff, and could count on financial support to be provided by a newly established, broad-based Financial Accounting Foundation (FAF) (Report of the Study on Establishment of Accounting Principles 1972). This sea change disenfranchised the Big Eight firms from representation on the standard-setting body. As will be seen, this repositioning of the big firms from the center to the margin of standard setting soon served to dampen their interest in actively participating in the public dialogue on accounting principles, which should be a *sine qua non* of professional discourse. But the Institute did not surrender all of its influence over the new standard setter. The FAFs bylaws provided that four of the seven board members must be CPAs with experience in public practice and that the Institute's board of directors would be the sole elector of the FAFs trustees.

Yet, in 1977, the FAF.s trustees repealed both of these provisions (*Status Report No. 50* 1977, 1). In 1974, less than a year after the APB passed the standard-setting baton to the FASB, Leonard M. Savoie (1974, 64), the Institute.s principal spokesman on APB matters from 1967 to 1972, expressed his disappointment with the handover and the recent behavior of the big firms:

> *In abandoning its rule-making function the AICPA has lost its most conspicuous source of prestige and good public relations potential. At the same time, it has extricated itself from the center of dissent and turmoil caused by recalcitrant accounting firms that were more interested in pushing their own views than in working within the institutional structure and reaching a consensus.*

Even while the Wheat Study Group deliberated, the APB suffered another setback, again on the investment tax credit. In November 1971, when the Congress was about to enact a new form of the investment tax credit, the board, in its third such try, approved an exposure draft that required the deferral method, but the Treasury opposed it, as did the same large segment of industry as before. The opponents succeeded in persuading Congress to insert a provision in the eventual legislation that taxpayer corporations could use any method of accounting for the credit in their financial statements filed with the SEC. This denouement confirmed the inability of the Institutes standard-setting body to counter the self-serving forces arrayed against some of its more controversial Opinions (see Zeff 1972, 219.221). Three other setbacks occurred during 1971, when powerful industry pressures thwarted the APB from acting on accounting for marketable securities, leases, and oil and gas exploration (Zeff 1978, 14).

The FASBs relations with the SEC during its first five years were anything but smooth. From 1972 to 1976, during Sandy Burtons term as SEC Chief Accountant, the Commission issued 70 Accounting Series Releases (more than a third of which dealt with financial reporting), compared with 126 from 1937 to 1972.11 Arthur Andersen unsuccessfully challenged the propriety of one of the SEC.s Releases in court (Our Firm Files Petition with SEC 1976; Arthur Andersen is Set Back in Bid to Bar SEC Rulings 1976). An activist Chief Accountant, Burton surprised the FASB by declaring that, while the FASB was to take the lead on matters of accounting measurement, financial disclosures properly fell within the province of the SEC (Burton 1974). Additionally, Burton criticized the FASBs 1974 exposure draft recommending general price-level accounting, and two years later he pressed ahead with his own solution, a requirement that some 1,300 large registrants report replacement cost data in a supplementary disclosure. Burtons initiative forced the FASB to issue its own standard, Statement No. 33, on the disclosure of current cost and constant dollar information.

In 1978, the SEC again rebuffed the FASB, this time on accounting for oil and gas exploration. Under intense political pressure from small oil and gas exploration companies, with assistance from members of Congress, the SEC rejected FASB Statement No. 19s required use of successful efforts costing and instead proposed a kind of current value accounting for oil and gas reserves. The SEC.s decision took the FASB aback, yet the SEC made it clear that the oil and gas issue was a unique case and did not .represent any change in the Commission's basic policy of looking to the FASB for the initiative in establishing and improving accounting standards. (*Securities and Exchange Commission Report to Congress on the Accounting Profession and the Commission.s Oversight Role* 1979, 50). (Also see Gorton 1991; Miller et al. 1998, 125.127.)

2.5 Important Implication of the Loss of the Professions Standard Setting right

It was not long into the FASB.s tenure that the Big Eight firms began withdrawing from an active dialogue over accounting principles and standards, perhaps in the belief that their task had become one of persuading the FASB of their views and no longer persuading either academics or their brethren in the profession. Indeed, this was also a time when many accounting academics seemed to abandon interest in accounting policy issues as well. Another reason for audit partners withdrawing from this public dialogue was the increasing proliferation, complexity, and technical detail in the FASB.s pronouncements.

By the mid-1980s, speeches by Big Eight audit firm partners taking positions on controversial accounting issues had almost disappeared from the scene, and only a few audit partners in, at most, three of the Big Eight firms13 continued to write articles intermittently on such topics. Moreover, in 1982 the *Journal of Accountancy*, the Institutes journal, announced that it was encouraging the submission of practical. articles, code language for the avoidance of controversy (see Zeff 1986). As the audit market became more competitive, one inferred that the *firms did not wish to give prominence to their views on controversial issues, lest it might offend important clients, who* *might seek an audit firm with more accommodating views.* Opinion shopping, which began to occur in the 1960s, continued into the 1970s and 1980s, *as companies actively sought out more client-friendly audit firms.*

2.6 More Scandals, and Attacks from Congress

In 1973, the sudden collapse of Equity Funding, coming on the heels of the Stirling Homex bankruptcy a year earlier, jarred the accounting profession. (See Report of the Special Committee on Equity Funding 1975; Seidler et al. 1977). As the Institutes executive director later wrote. The huge losses by investors in [Equity Fundings] securities, *closely following a series of other business failures, dealt a shattering blow to the credibility of independent auditors* (Olson 1982, 87.88). Propelled by these embarrassments, the Institute in 1974 appointed a Commission on Auditors Responsibilities, headed by former SEC Chairman Manuel F Cohen. These celebrated collapses, coupled with the discovery of illegal and improper payments by major corporations that were not disclosed in their financial statements, prompted two Congressional committees to level criticism at the accounting profession and at the private-sector setting of accounting standards. The profession thus came under its first broad attack in the Congress.

Rep John E. Moss, Democrat from California, chaired his sub-committees investigation of federal regulatory agencies. The sub-committees report recommended that the SEC play a direct role in setting accounting and auditing standards (*Federal Regulation and Regulatory Reform* 1976, 51. 53) *and thus remove this authority from the private sector.* On the Senate side, a subcommittee headed by Sen Lee Metcalf, Democrat from Montana, launched a major investigation of the accounting profession. His subcommittees 1,760-page staff study, *The Accounting Establishment* (1976), consisted of an extensive factual examination of the Big Eight firms, the Institute, and the FASB, accompanied by a number of highly controversial conclusions and recommendations. Wallace E. Olson, the Institutes full-time chief executive, *characterized the staff study as almost as damaging to the profession as the Japanese attack on Pearl Harbor was to the U.S. Navy* in 1941(Olson 1982, 43).

Two of the staff study's conclusions were that the Big Eight firms lacked independence from their clients and that they dominated both the Institute and the process of setting of accounting standards. The study also asserted that the Big Eight firms, through their influence on the FASB, did the bidding of their corporate clients (*The Accounting Establishment* 1976, 1.24). Almost mirroring the course taken by the Moss subcommittee, the Metcalf sub-committees staff study recommended that the federal government set accounting and auditing standards for publicly traded corporations (*The Accounting Establishment* 1976, 20.24). Although both subcommittees held hearings and issued reports, they produced no legislation. Nonetheless, the two subcommittees lengthy and well-publicized investigations, which finally concluded in 1979, put the accounting profession on the defensive.

In April 1977, both the Institute and the FASB responded at length to the Metcalf staff study's findings and recommendations. The Institute issued a 40-page booklet, *The Institute Responds*, in which it countered the arguments in the Metcalf staff study. To the charge that the Big Eight firms compromised their independence when they advocated positions that were favorable to their clients, the Institute asserted that, by doing so, they are not tools of their clients (*The Institute Responds* 1977, 32). Yet, a scant six years later, Touche Ross & Co. issued a booklet, *Employers. Accounting for Pensions* (1983, 3), in which it offered to help clients prepare .an effective and persuasive response to the FASB by which the firm would .assist your company in evaluating the effects, developing empirical supporting evidence, and identifying the economic consequences of the positions your company supports and rejects. Thus, as the competition for the favor of clients intensified in the 1980s, at least one of the Big Eight firms Touche Ross was willing to become a blind advocate for its clients. In its 44-page reply, the FASB defended the integrity, independence, and objectivity of its process (FASB 1977).

2.7 Under the Gun, the Institute Reforms

The unwanted public attention led the Institute to adopt a hurried reform in September 1977: creation of a Division for CPA Firms, composed of an SEC Practice Section and a Private Companies Practice Section. Wm. R. Gregory, the Institutes board chairman in 1979.80, explained the move as follows:

Council created the division for CPA firms without seeking a vote of the membership because it believed that Congress would enact new legislation to regulate the profession if immediate steps were not then taken to bolster the professions system of self-regulation. That perception was borne out by the introduction by Congressman Moss on June 16, 1978 of H.R. 13175, which provided for a new federal statutory regulatory organization under the oversight of the SEC, to be known as the National Organization of Securities and Exchange Commission Accountancy. (Gregory 1980, 3)

The body proposed in Rep. Moss's bill, which died in committee at the end of 1978, foreshadowed in a striking number of respects the Public Company Accounting Oversight Board, established by the Sarbanes-Oxley Act of 2002.

The Institute also installed a *Public Oversight Board* (POB), composed of distinguished public servants, to oversee the activities of the SEC Practice Section, including the setting and enforcing of quality control standards and a newly established peer review process. The SEC, which had ordered several major firms to undergo peer reviews because of alleged audit deficiencies in early and middle 1970s, welcomed the Institute's new section and the POB (*Securities and ExchangeCommission Report to Congress on the Accounting Profession and the Commissions Oversight Role* 1978, 15.27). But pressure from Congress had clearly precipitated the Institute's restructuring.

2.8 Intrusions of Federal Antitrust Bodies that Fundamentally Altered the Professional Climate:

During the 1970s and 1980s, the Institute also felt unrelenting pressure from the Department of Justice and the Federal Trade Commission (FTC) over portions of its Code of Professional Ethics alleged to be in restraint of trade. In 1972, the Institute gave in to Justice by removing the ban on competitive bidding from its code of ethics. By 1979, Justice and the FTC compelled the Institute to drop its rules prohibiting direct, uninvited solicitation and advertising that is purely informational (see Bialkin 1987, 105.106). Many Institute members strongly opposed these forced concessions. During the 1980s, the FTC also pressed the Institute to remove its ban on contingent fees and commissions. In the end, the two bodies reached a compromise: to allow the receipt of commissions only from non-attest clients (Chenok 2000, 106). These amendments to the Institutes code of ethics, particularly on competitive bidding and direct, uninvited solicitation, profoundly changed the climate in which audit firms conducted their affairs. Competition among firms came to be signified more in the idiom of commerce. the aggressive pursuit of profit .thus, placing strains on professional values.

Whether because of the changes in the code of ethics or because of changing conditions in the practice of public accounting, allegations began to surface that competition among firms for clients was becoming more intense and vicious. In an article in *Barrons*, an editor who had long been a close observer of the accounting profession wrote as follows:

What has happened, essentially, is that the nation's top accounting firms some big, some smaller are locked in a fierce battle marked by vigorous price cutting. Some blame a growth-at-any-cost syndrome they say has afflicted some of the professions top firms. Others contend that it is an inevitable consequence of a slowing in chargeable hours as the pickings for new clients get slimmer (Anreder 1979, 9).

The Institute's Commission on Auditors Responsibilities also pointedly remarked. The practice of accepting an audit engagement with the expectation of offsetting early losses or lower revenues with fees to be charged in future audits is a threat to the independence of the auditor (The Commission on Auditors Responsibilities 1978, xxx).

The elimination of the Institute's bans on competitive bidding, uninvited solicitation, and advertising, coupled with the apparent topping out of the audit market, all fundamentally changed the character of CPAs relations with clients. Eli Mason, the managing partner of a medium-sized CPA firm in New York City who had long been a vocal critic of the big firms and the Institute, complained in 1985 that the practice of accounting was no longer a profession, but an industry: Today, the media describes public accounting as an industry, seldom as a profession and it does have all the earmarks of an industry including cut-throat competition, low-balling,.

cheap advertising, and open solicitation by one CPA of another CPA's clients.. Mason blamed the FTC and the Justice Department for creating this unprofessional and undignified atmosphere. (Mason 1985, 732; also see Mason 1994).

Arthur W. Bowman, the editor of *Public Accounting Report*, documented some of the deep cuts in audit fees that companies negotiated in the early 1980s, which pitted the major accounting firms against one another in the sharply competitive bidding process. He reported tenders of between 25 and 50 percent under the previous year's audit fee charged by a company's current audit firm (Bowman 1985, 705.713). (Also see Berton 1985a; Berton 1985c; Berton 1985d, 12.) In a disquieting remark, he said, .If [companies] can get an audit for 0 dollars, they would get them. (Bowman 1985, 720). Indeed, in 1991, Norman Lipshie, the president of the New York State Society of Certified Public Accountants, was quoted as saying. I have seen three recent instances where Big Six firms were bidding zero to do audits. (Brenner 1991). (Following two mega-mergers in 1989, creating Ernst & Young and Deloitte & Touche, the Big Eight became the Big Six.)

In an interview in 1984, incoming Peat Marwick deputy chairman and chief operating partner Robert W. Beecher complained that other firms. practice of cutting fees has dangerous implications (An Interview with Our New Management Team 1984, 5). Price competition between audit firms existed in earlier years, but the firms sold quality as well as price. Clients prized audit quality, before they began to view the audit as a commodity. Leonard Spacek, the architect of the modern firm of Arthur Andersen & Co., wrote in 1984, reflecting the values of an earlier era:

> *The competition [today] is in fees only. We always had such competition, but to offset it a firm can strengthen itself by the energetic position it takes to make it a leader outstanding service is equally an offset, and both characteristics are prime offsets to price. I know because I practiced it for 20 years say in publicly that we were the highest priced firm, but the higher price was more than matched by quality. Prospective clients seek these qualities to prove they risk the most thorough accounting tests.*

The heightened competitive climate in which the firms operated seemed to haunt partners conduct in audit engagements. A gradual development within the Big Eight firms during the 1980s was a significant shift in the posture of audit partners toward their clients, probably spurred by their perceived pressure to retain valued clients. In previous years, partners conveyed a firm position on the propriety of any borderline accounting and disclosure practices adopted by the client, but increasingly in the 1980s partners would be seen huddling with the firms technical specialists to find any means perhaps restructuring a major vehicle, reconfiguring a transaction, or straining to rationalize the application of a suitable analogy to enable the firm to approve the accounting treatment sought by the client. The accommodation or negotiation mentality fostered by this important shift in focus may have led many audit partners to incline toward compromise rather than invoke their principles even in routine discussions with clients. More will be said about this development later.

2.9 Management Advisory Services Come under SEC Fire

Consulting, then still known as management advisory services (MAS), increasingly became an issue in the 1970s. In 1969, *Business Week* reported the following anti-establishment view:

> *Some firms, says an unnamed senior partner of a big New York accounting firm, say they draw the line against consulting that involves them in management decision making. But don.t let anybody fool you. We take on any job (Accountants Turn Tougher 1969, 124).*

The term scope of services entered the professions vocabulary, referring to the range of consulting services that an audit firm could render without surrendering its objectivity or independence. In the SEC.s 1978 annual report to Congress submitted at the request of the Senates Metcalf subcommittee, Chairman Harold M. Williams wrote as follows:

> *Another important issue requiring immediate attention is the question of the appropriate range of services. other than the performance of the audit itself which accounting firms should be permitted to offer to their audit clients . In considering this issue, it will be necessary to resolve three basic questions: Are there situations in which the magnitude of the potential fees from management advisory services are so large as to affect adversely an auditors objectivity in conducting an audit? Are there some services that are so unrelated to the normal expertise and experience of auditors that it is inconsistent with the concept of being an auditing professional for auditors to perform those services? Are there, conversely, some services so closely linked to*

the accounting function that, for the auditor to perform those services for his client means that, the auditor will, in conducting the audit, be in a position of reviewing his own work? (Report to Congress 1978, 12)

Even though these three policy questions were raised at the threshold of the era of the giant diversified services firms, they are still being raised today.

In June 1978, the SEC issued Accounting Series Release (ASR) No. 250, which mandated the disclosure in a company.s proxy statement of the percentage relationship to audit fees of (1) aggregate non-audit fees, and (2) the fee for each specific nonaudit service. A year later, the SEC promulgated ASR No. 264, Scope of Services by Independent Accountants, a strongly worded document that was issued .without prior warning or discussion with the AICPA. (Olson 1982, 218). The Release had an unmistakable target:

> *the growing array of non-audit services offered by some independent public accountants and the growing importance of management advisory services to the revenues, profits, and competitive position of accounting firms are a cause for legitimate concern as to the impact of these activities on auditor independence, objectivity, and professionalism.*

The Release was intended to .sensitize the profession and its clients to the potential effects on the independence of accountants of performance of non-audit services for audit clients.. Mark Stevens, a close student of the profession, wrote that it .also cautioned the CPAs to avoid supplanting client management's role, to be cautious of accepting engagements that involve an audit of their own work (such as a review of internal controls installed by the auditor's MAS arm), and that client audit committees should gauge the relative merits of the firm's auditor providing non-audit services (Stevens 1981, 210.211). The Release had a chilling effect on the profession, as the firms expected companies to pull back from drawing on such services from their audit firm. The Release was couched in such categorical language that Chairman Williams felt it necessary to assure the profession in a speech that the Commission did not intend to prohibit any particular kind of MAS engagement (Williams 1980, 422).

Reacting to Release Nos. 250 and 264, Harvey E. Kapnick, the chairman and chief executive of Arthur Andersen, proposed to his partners in 1979 that the firm be split into two related firms: auditing and consulting. He reported on his private discussions with SEC Chairman Williams, who, he said, would soon require all of the big firms to make such a split. Kapnick.s proposal shocked his partners, and it met with stiff resistance. Although Kapnick did not accept the views of the SEC, he believed that this was the principled action to take before the SEC acted unilaterally. The heated controversy generated by his proposal led him to take premature retirement from the firm several weeks later (*A Vision of Grandeur* 1988, 150.151).

In the end, however, both SEC Release Nos. 250 and 264 were rescinded by the Commission in 1981/82, reflecting the new federal policy of deregulation under President Ronald Reagan. Nonetheless, the Commission averred in ASR No. 296 (1981) that .its views [expressed in ASR No. 264] are unchanged.. Because the Institute opposed both Releases, one supposes that it welcomed President Reagan.s selection as SEC Chairman, John S. R. Shad, in May 1981. The profession went on the offense by arguing that auditors rendering management advisory services to an audit client actually had a deeper knowledge of the client from an audit standpoint. John C. (Sandy) Burton, the immediate past SEC Chief Accountant, adopted this view and believed that the .scope of services. issue was mainly one of perception by those who do not possess an understanding of the audit process (Burton 1980, 51).

Yet, in 1979 the Public Oversight Board released a major study on *Scope of Services by CPA Firms*, in which it said:

> *there is enough concern about the scope of services in responsible quarters so that the question cannot be dismissed as a non-problem. The Board believes that there is potential danger to the public interest and to the profession in the unlimited expansion of MAS to audit clients, and some moderating principles and procedures are needed (Public Oversight Board 1979, 56).*

The board concluded, however, that at this time no rules should be imposed to prohibit specific services on the grounds that they are or may be incompatible with the profession of public accounting, might impair the image of the profession, or do not involve accounting or auditing related skills (Public Oversight Board 1979, 5). In its second year of operation, the POB was not prepared to take on the profession.

Section III: Institutionalization of Oversight on Public Accountancy Profession

In 2001 the world was chocked as it was revealed that some senior managers at Enron, an energy trading company, had embezzled a large sum of money. The Chief Financial Officer (CFO) had been using off-balance sheet accounts to shuffle around large amounts of money which eventually ended up in his own pocket (Brewster, 2003). Since off-balance sheet accounts were used these transactions did not appear on the financial statements and therefore investors had no reason to mistrust the financial health of the company. Though, the truth was that Enron had been completely depleted of its funds and was forced to declare bankruptcy in 2002 (Reinstein & McMillan, 2004). At about the same time WorldCom, a telecommunication company, declared bankruptcy after having revealed that profits had been blown up in the financial reports in previous years (Moeller, 2004; Lander, 2004; Braun, 2005). The years of 2001-2002 came to be known as the dark years in American industry with Enron and WorldCom as the most prominent examples of large frauds.

The scandal that received the most attention was Enron due to that the senior management had been helped somewhat by one of the "big five" auditing firms, Arthur Andersen, which led to that the Securities and Exchange Commission (SEC) started an investigation of the firm. However when SEC arrived at Andersen headquarters all documents had been destroyed which led to that the company was indicted for obstructing justice and all creditability was lost. Andersen was convicted and sentenced to pay a fine of $500,000 and five years probation (Moeller, 2004; Brewster, 2003). Andersen's clients fled and the company seized to exist in 2002 ending a 90-year long auditing career and "the big five" was reduced to four.

Prentice (2006) claims that Arthur Andersen rather assisted than prevented that these scandals occurred. This behavior from a well known public auditing firm as Arthur Andersen has resulted in uncertainties regarding the role of auditor (Prentice, 2006; Öhman, Häckner, Jansson & Tschudi, 2006). The purpose of auditing is to control that financial statements are in line with accepted accounting principals and thereby serve in the interest of shareholders and the public. Prentice (2006) argues about the importance of accurate audit reports and claims that accurateness is required to maintain the reliability of financial reports. The auditor thereby has a huge responsibility that comes with his/her profession to maintain that correct information is given to shareholders and others.

These circumstances pushed the U.S. market into uncertainty and the creditability of auditing firms plummeted. The American Institute of Certified Public Accountants (AICPA) received most of the criticism since they were responsible for establishing auditing standards and controlling that the auditing firms followed these standards (Moeller, 2004). However, Andersen had clearly violated almost all of these standards and AICPA had not been able to notice this and therefore could not act accordingly. *The U.S. Congress felt that AICPA clearly had failed in their role and argued that a radical change was needed to cool off the current climate and to satisfy investors.* The solution was a new Introduction legislation that would be the most radical change in auditing since the 1930s. The law was called Sarbanes Oxley Act (SOX) and was authorized by the American President George W. Bush on the 30th of July, 2002 (Lander, 2004). SOX is a law regarding internal and external accounting and corporate governance. The main purpose of SOX is to rebuild the public trust of companies and to prevent failure of inaccurate reports and frauds (Cenker & Nagy, 2004). With the implementation of SOX came much more strict rules about the general auditing role. Auditors are now given more direct responsibility for errors and are also subject to much more controls. A new controlling organ has been formed, Public Accounting Oversight Board (PCAOB), which major task is to act as an controller over auditors and to make sure that the new legislation is followed (Moeller, 2004). Not only American auditing firms are affected by PCAOB. All firms, disregarding geographical location that performs audit on a company that must follow SOX, is submit to follow and obey PCAOB (Sarbanes-Oxley Act of 2002). This means that Swedish auditing firms who perform audits on SOX-clients must comply with PCAOB.

Before the implementation of SOX, the earlier mentioned scandals brought on some self-regulated changes. These changes were seen, by a few, as essential but most auditors were offended. The big firms thought that they already had good standards and the small firms believed these changes to be just and extra expense since these standards were not applicable to their work (Matthews & Pirie, 2001). Some auditors even said that the gap between small and big firms widened due to these standards and that they threaten the very existence of the profession (Mattews & Pirie, 2001). Such drastic conclusions might be exaggerated but an interesting fact is that Matthews and Pirie (2001) performed these studies before the implementation of SOX. The Act is drastically more regulated than the self-regulative measured that are referred to in the beginning of this century and should therefore, if Matthews and Pirie is correct, face massive resistance.

3.1 An overview of Sarbanes Oxley Act

To easier understand and interpret SOX, the Act is divided into eleven sections covering different issues regarding corporate accountability. The sections are given below with a short explanation. *Public Company Accounting Oversight Board:* consist of nine different sub-sections (101-109) which consider areas as registration of auditing firms, independence and accounting standards, and disciplinary actions. The overall task of the board is to review external auditors who perform audits for companies who comply with SOX. *Auditor Independence:* contains of nine sub-sections (201-209) regulating various areas regarding the independence of the auditor as for example, audit partner rotation and that auditing firms are prohibit to offer both audits and non-audit services to a client. *Corporate Responsibility:* is divided into eight sub-sections (301-308) emphasizing on the importance of corporate responsibility when conducting audits. For example, an audit committee should be independent and the responsibility of management has been extended.
Enhanced Financial Disclosures: consist of nine sub-sections (401- 409). This part is considered to be the most extensive, which deal with internal control and documentation. Further, it contains a code of ethic and comprehensive demands of accounting and financial reports. *Analysts Conflicts of Interest:* sub-section 501, restrains securities analysts and their independence towards companies aiming to provide investors with more accurate information. *Commission Resources and Authority and Studies and Reports:* contains the sub-sections (601-604 and 701-705) which traverse rules related to the violation of professional or ethical public accounting standards and the involvement of SEC in future studies.

Corporate and Criminal Fraud Accountability: and White-Collar Crime Penalty Enhancement and Corporate Tax Returns: consists of sub-sections (801-807, 901-906 and 1001) which mainly brings up rules regarding forgery and destruction of documents but it also includes protection for employees that disclose corporate fraud. Finally, the last title, deals with the particular obligation of the CEO to confirm the corporate income tax return. *Corporate Fraud and Accountability:* contains sub-sections 1101- 1107 which describe overall corporate responsibility for irregularities in financial reports. This part differs from the others since it is the company as an entity, not the individual that is punished when violating the rules (Sarbanes-Oxley Act, 2002; Moeller, 2004).

3.2 Public Company Accounting Oversight Board (PCAOB)

Due to the discussion, that self-regulation of the auditing profession had not resulted in a satisfying protection for investors, a new regulatory board was founded. It was founded through SOX by the U.S. congress and SEC and is called Public Company Accounting Oversight Board (PCAOB) (Hilary & Lennox, 2005). PCAOB has major influence in rule making and regulatory power (Tackett, et. al, 2004; Grundfeld, 2004). Furthermore, PCAOB is a new non-profit board which is led by five members who are appointed by SEC. Three out of the five must not be auditors (Sarbanes-Oxley Act, 2002). This standard is stressed in SOX since one of PCAOB's roles is to be an unbiased controller (Moeller, 2004). The board members are instead dominated by lawyers and public interest activists. The first CEO of PCAOB was William McDonough, a man with no former work experiences from auditing but still with quite an impressing résumé. For example, before his assignment at PCAOB he was the president of the Federal Reserve Bank of New York (Moeller, 2004). McDonough's view of the role of PCAOB is clear: "The function of PCAOB is to restore the public's confidence in the accounting profession" (Osterland, 2004, p. 1).

Besides the role of controller, the board will issue ethics and conflict-of-interest standards and be responsible for disciplining auditors who do not comply with the standards. PCAOB will also conduct annual reviews of the auditing firms (Green, 2004). In short PCAOB is a regulative board who will control external, not internal auditors (Moeller, 2004). On the 25th of April 2003, it was determined by SEC that PCAOB was sufficiently organized and had enough resources to carry out its tasks, and by that PCAOB was launched (Lander, 2004). Since then, PCAOB has been constantly growing and in December 2004 PCAOB employed 260 persons besides its five board members (PCAOB, 2006a). PCAOB is an American institution but its powers stretch far beyond the US boarder. In Sarbanes-Oxley Act, section 106, it is clearly stated that any auditing firm, disregarding geographical location, that conducts an audit on a company which must comply with SOX is subject to PCAOB with its rules and standards (Sarbanes-Oxley Act, 2002). This basically means that auditing firms around the world that has an interest in conducting audits on companies registered on SEC or are partially owned by such a company must comply with PCAOB.

3.3 The tasks of PCAOB

As mentioned above, the overall role of PCAOB is to control auditing firms. Indirectly, this means that all auditors are under control of PCAOB. To do this, more specific responsibilities have been given to the board. These responsibilities are stated in the nine sub-sections in SOX's first section. They are mentioned below.

3.4 Registration of the public accounting firms

PCAOB was to make sure that all public auditing firms register at PCAOB no later than 180 days after PCAOB was launched (Sarbanes-Oxley Act, 2002). In reality this means that in the end of 2003 all public accounting firms in America had to be registered at PCAOB. Non-American auditing firms had an extra six months to register and only the firms that deals with companies who has to comply with SOX must register (Lander, 2004). The registration is quite complicated since PCAOB requires a lot of information. For example, full disclosure about fees charged to clients must be given (Moeller, 2004). All documents about quality standard and detailed information about the auditors employed must also be given. Further, information about any pending law suits against any of the firm's employees must be provided (Moeller, 2004). The PCAOB has the right do deny any firm registration due to incomplete disclosure (Lander, 2004). The application is quite expensive all though it is done electronically. As of today there are 1646 registered auditing firms and the Swedish firms are: KPMG Bohlins AB, Ernst & Young AB, BDO Feinstein International AB, Deloitte & Touche AB and Öhrlings PricewaterhouseCoopers AB (PCAOB, 2006b).

3.5 Establishing auditing standards

PCAOB is responsible for setting and administrating news standards about quality controls, ethics, independence and general auditing (Moeller, 2004).In the beginning these standards will look much like the old already existing ones but then continuously they will be replaced and developed to be more complex and detailed (Moeller, 2004). One example of a completely new standard from PCAOB is that all documents concerning an audit must be archived for seven years (PCAOB, 2006c). This standard is a direct response to the disaster with Arthur Andersen and the shredding campaign that they practiced which was mentioned in the introduction chapter. Conduct inspections of registered auditing firms. PCAOB will conduct reviews of registered firms in a quality-related matter. With these inspections the board shall assess if the firm follows the standards and SOX in general (Sarbanes-Oxley Act, 2002). These reviews are one of the key tasks of the board and it is expected that the American firms should be checked annually and non-American every three years (Lander, 2004). The model for the review is based on the old peer-review program but with, hopefully, some enhancements. This will lead to more detailed and tougher reviews for the auditing firms (Moeller, 2004). For example, PCAOB did a review in 2003 of one of the major firms which was planned to 15,000 hours on 70 different offices (Moeller, 2004).

3.6 Conduct investigations and disciplinary measures

PCAOB must establish rules and manuals for how to deal with auditing firms that fails to comply with SOX. These disciplinary actions must be fair and are not just applicable towards entire firms but also towards individuals (Sarbanes-Oxley Act, 2002) An example of such a disciplinary procedure would be to prohibit an auditing firm to perform audits on companies that must follow SOX (Moeller, 2004). Such a disciplinary reprimand would be a hard blow against the firm and probably lead to its bankruptcy (Moeller, 2004).

3.7 Perform measures to enhance and inspire higher quality

This task is not directly legislated in SOX but indirectly PCAOB should lobby strongly for that auditors and auditing firms achieve higher quality and become more trustworthy (Svernlöv & B:son Blomberg, 2003). PCAOB are allowed to get involved in other areas that does not deal directly with auditing if that leads to better protection of investors and if it is in line with the public interest (Moeller, 2004).

3.8 What changed for auditors with the formation of PCAOB

The most significant change for the auditor is the establishment of an independent controller, PCAOB. Before this board, auditors had been self-controlling for 110 years (Hill et al., 2005). The auditing profession set rules and standards through their professional organizations which are represented in America by the American Institute of Certified Accountants (AICPA) and in Sweden by FAR (Moeller, 2004). These organizations, which still exist today, consist of mostly auditors. This means that even though the auditors themselves, on an individual level, did not determine the rules for an audit, the organization that did still consisted of auditors with basically the same knowledge and preferences. Furthermore, auditors were also controlled by other auditors before PCAOB (Hill et al., 2005). The system for controlling auditors was based on peer-reviews performed by AICPA. In Sweden the control of auditors were done by the Supervisory Board of Public Accountants (Revisorsnämnden) (A. Tagde, personal communication, 2006-04-27). PCAOB has now taken over all these functions mentioned above. It is though important to clarify that both AICPA and FAR still exists. In Sweden only auditors performing audits on companies affected by SOX is subject to PCAOB's control. All other auditors still relies on FAR to help and develop good auditing standards in Sweden (A. Tagde, personal communication, 2006-04-27). In America AICPA has the same role but AICPA is also involved somewhat in PCAOB's standards setting. AICPA still has the possibility to suggest rules and standards to the PCAOB but they have no authority to enforce them. Ultimately it is the PCAOB that decides if or if not the auditing standard should be implemented (Moeller, 2004). To summarize, the PCAOB today controls functions that earlier were self-regulated.

3.9 The current academic debate about PCAOB

Tackett, Wolf and Claypool (2004) are critical towards the likelihood of PCAOB's ability to reduce audit failures. According to a study that examined audit failures that have occurred for over 30 years in US, the conclusion was that the reason for audit failure was not dependent on the absence of a needed auditing rule or technique (Tackett et al., 2004). Instead, the major root of audit failure origin in that auditor ignored applying existing auditing rules and techniques. However, they further argue that the PCAOB's ability to do reviews of auditing firms to secure quality control may reduce the possibilities of audit failures. The former procedure with peer review was very biased due to that other auditors in the same field performed the review (Tackett et al., 2004). A controller that has the same manuals and procedures that the person he/she is reviewing will probably find it very hard to detect any faults. Bazerman, Loewenstein and Moore (2002) called this *problem the unconscious bias theory*. With the implementation of PCAOB this problem will most likely disappear since the members of the board is independent and therefore should not be biased. This puts pressure on the auditing firms to enhance their own quality controls and hopefully therefore reduces audit failure (Tackett et al., 2004). Brewster (2003) concurs with this and further argues that PCAOB is needed to readjust the auditing procedure to more thorough testing in the field. The reason for this is that the global auditing firms have for a long time accentuated risk-based techniques of auditing in order to prompt consulting services (Brewster, 2003). Now, the need of more detailed auditing is being raised so that quality will be enhanced. Brewster further argues that the formation of PCAOB therefore might be able to increase the quality in auditing (Brewster, 2003).

This optimistic view of PCAOB's ability to enhance quality is not shared by everyone. Alles, Kogan, Vasarhelyi and Warren (2006) believes that PCAOB will have the same trouble as the old peer review groups since many of the board members are trained in the same way as auditors. PCAOB is independent but it is highly unlikely that they have developed a new inspection technique that would detect all errors (Alles et al., 2006). Bazerman et al. (2002) concur with this statement as they believe that PCAOB will not be able to change the true problem. The problem origins in that the mistakes from auditors are not deliberate and instead are caused by negligence and missed information. Since PCAOB reviewers will look at the same information the possibility for them to find and correct such a mistake is therefore minuscule (Bazerman et al., 2002). However, Bazerman et al. (2002) also argue that a purposely wrongful audits that have a part in a fraud will PCAOB probably be able to detect which might be a good enough reason to establish PCAOB. Alles et al. (2006) further argue that a more appropriate approach for the PCAOB would be to develop and enhance the auditing process rather than detecting faults that has already happened. The PCAOB's current approach presents an interesting dilemma. The key role of PCAOB is to restore the faith in auditing for investors and the public. By detecting the faults after they have happened and then publish this information will generate exactly the opposite. How could this happen? What did the auditors do? Such questions will then be the response from the public and faith towards auditor will only diminish further. Therefore PCAOB should try to detect faults before they happen and avoid this publicity (Alles et al., 2006).

3.10 Threats to the auditing profession

One of Montagna's ten attributes, a common body of knowledge, functions as a foundation for the auditing profession. Due to this, some problems have arise which can be considered as a threat to the legitimacy of the auditing profession (Hines, 1989). One of these is the expansion and diversification of auditing work which can have a negative effect on the profession (Hines, 1989, Artsberg, 2005). Furthermore, Zeff (1987) argues that the auditing profession has evolved towards an industry which he considers to be a sign of de-professionalizing. This is supported by Artsberg (2005) who discusses the fact that auditing firms nowadays offer non-auditing services3 which has made the auditing profession developed more to an industry. Furthermore has this phenomenon, now, occurred for such a long time that it is thought of as ordinary.

A prevention of auditing firms to offer non-auditing services to clients is therefore something that Swedish auditors strongly disagree with (Öhman et al., 2006). One explanation of this might be that the auditing firms are dependent on the huge revenues that stems from the possibility to offer non-auditing services. A restriction on that possibility would certainly strike the profession hard (Öhman et al., 2006). When such a variety of services are performed it is hard to distinguish a formal "body of knowledge" of auditors according to Hines (1989). This has required the auditing profession to absorb knowledge from other professions which results in that the knowledge base of the auditor profession does not solely consist of accounting knowledge anymore. Hence, due to the diversified tasks offered by auditors the coherent "body of knowledge" to sustain the profession is questioned (Hines, 1989). Öhman et al. (2006) points towards another threat of the auditing profession, namely, the standardization of work procedures. According to their study auditors are today focusing their attention on matters that they have standards and given procedures on in order to quickly make a satisfactory audit. This is done in the expense of matters that investors and stakeholder perceive as important. The increased amounts of standards and procedures that must be followed have made auditors more worried with their own situation than that of their clients. "Doing things right seems to be more important than doing the right things" (Öhman et al., 2006, p. 1). Hence, the unwillingness to change current practice and the presence of too many standards threatens the profession (Öhman et al., 2006).

3.11 Profession and change

With the establishment of PCAOB the auditing profession faced some changes, as discussed earlier. A profession can be characterized by change but the auditing profession is rather characterized by stability and similar work procedures (Matthews & Pirie, 2001). However a profession must react and adapt when the surrounding conditions are changing and according to Artsberg (2005) scandals involving auditors tend to strengthen the auditing profession and the requirement of extended auditing increases which has been notices during the 20th century. However, according to Hytti (2003) a strong profession tends to be less willing to accept changes and the auditing profession is considered to be a strong profession with a high level of professionalism according to Matthews and Pirie (2001). They further found that auditors see themselves as experts in their field of work and therefore do not appreciate when others try to force changes or rules upon them. This depends on the long period of time that auditors have worked in similar ways and therefore built up controls and manuals that they believe are completely satisfactory in terms of control (Matthews & Pirie, 2001). This is also confirmed by Hill et al. (2005) in their study. However, even though auditing is a strong profession, change is not considered bad by everyone. Zeff (2003) argues that the auditing profession is in some cases positive to change and that it even changes too quickly. He exemplifies this by pointing at the 1990s during which a large portion of the auditing profession changed their beliefs and became more concerned in making money then in doing good audits. He argues that this is a case of a major change in the profession that should have been taken a bit slower since much of the fundamental issues were lost (Zeff, 2003). The auditing profession were said to "gain the whole world, and lose its own soul" (Levitt, 2002 cited in Zeff, 2003, p. 278).

However, this fundamental change in the 1990s to the auditing profession was generated from within the profession by auditors which could be one explanation to why auditors adopted easily to this change (Zeff, 2003). A more reasonable explanation is though that auditors were exposed to large corporate pressure but was also rewarded extensively if they complied argues Zeff (2003). However, PCAOB is not a change that comes from within the profession but instead from the government and therefore constitutes a regulatory change (Moeller, 2004). Such a change is there still a great unwillingness to conform to in Sweden according to Öhman et al. (2006). They further argue that there is currently a great unwillingness to change current practice among auditors in Sweden. The reason for this is that Swedish auditors are generally traditionalist and only twice in the last 25 years have external pressure succeeded in changing the profession and its practices. Further, it is assumed to be a very high degree of homogeneity in the Swedish auditing profession which means that auditors basically think alike (Eklöv, 2001, in Öhman et al., 2006). Such a strong tradition and high level of homogeneity are signs of a strong profession according to Artsberg (2005) and Öhman et al., (2006). However, PCAOB constitute a major change for the profession which means that according to theory the implementation of PCAOB will be problematic. The establishment of PCAOB affects the whole profession which the theoretical discussion has focused on. However, the auditing profession consists of individuals which together creates and affects the professionalism of the profession. Therefore, it is also important to study and understand how individuals perceive changes in their profession.

3.12 Identity

In an environment with fast social and regulatory changes, individuals are forced to redefine themselves and thus change their perceptions of themselves (Lange & Edberg, 1992). This is especially true for people who are part of a strong profession or social class which means that they have a strong identity (Olesen, 2001). However, to further understand what constitutes a strong identity the term identity must be defined. Many researchers argue that the term identity is very multifaceted and it therefore becomes hard to explain this concept in a single line. Lange and Edberg (1992) instead try to explain the identity concept in a set of questions: Who am I? Who do I think myself be? Who do others think I am? In other words, identity is how you perceive yourself in a social context (Hytti, 2003), or as Weick (1995, cited in Åkerberg, 1999, p. 4) defines it *"something that is created by individuals interacting with their environment"*. To further simplify identity it can be divided into two classes, objective and subjective approach. The objective approach deals with how others perceive the individual (Lange & Edberg, 1992). For example how auditors are thought of by students. The subjective approach instead deals with how the individuals perceive themselves (Lange & Edberg, 1992). For example how auditors look upon themselves as a profession. If these two approaches are combined a good measure of identity should be retained (Lange & Edberg, 1992). Important to clarify is also that work identity or profession identity is almost synonymous to identity, the difference is that work identity is the individual's perceptions of his work and how he thinks of himself in that context (Olesen, 2001).
The identity that individuals have about themselves is created in a social and regulatory context (Lange & Edberg, 1992). The importance of the identity to the individual is depending on how long and in which context an individual have worked or existed (Olesen, 2001). Professions that have a long history are often characterized by individuals with a high work identity. Also professions who are more complex and characterized by high individual responsibility tend to have a higher work identity than other professions (Olesen, 2001). These professions are therefore more sensitive to change since a strong belief of how things should be and should be done exists (Hytti, 2003).

3.13 US Supreme Court Upholds Constitutionality of the Public Company Accounting Oversight Board

Peter et al (2010) reports US *Supreme Court Upholds Constitutionality of the Public Company Accounting Oversight Board, Requires Changes to its Oversight Structure But Declines to Invalidate Sox.* On June 28, 2010, the Supreme Court announced its ruling in *Free Enterprise Fund, et al. v. Public Company Accounting Oversight Board, et al.*, 561 U.S. ___ (2010) requiring changes to the oversight structure by the Securities and Exchange Commission (SEC) of the Public Company Accounting Oversight Board (the PCAOB) but declining to invalidate the entirety of the Sarbanes-Oxley Act of 2002 (SOX). The Court found that the "for cause" removal oversight structure by the SEC of the PCAOB in SOX was an unconstitutional encroachment upon executive branch power; however, it held that such oversight structure was severable from the rest of SOX. Thus, what could have been a case with major ramifications for SOX compliance and securities litigation if decided differently will instead entail little, if any, practical change in those legal areas. The case is, however, a significant Constitutional separation of powers ruling.

The Free Enterprise Fund on May 18, 2009, the United States Supreme Court granted certiorari in *Free Enterprise Fund, et al. v. Public Company Accounting Oversight Board, et al.*, 537 F.3d 667 (D.C. Cir. 2008). The case sought to resolve the constitutionality of the PCAOB, created as part of SOX in 2002. In June 2009, Paul Hastings issued a client alert examining the case and its potential impact on securities litigation. The case had the potential to invalidate the PCAOB, and perhaps even strike down SOX in its entirety. The PCAOB is a private nonprofit corporation created to oversee the auditors of publicly traded companies. Congress created the PCAOB in the wake of accounting scandals at Enron, WorldCom, and other companies, as part of the SOX legislation. The PCAOB has regulatory and enforcement authority over all accounting firms that audit publicly traded companies. The five members of the PCAOB are appointed by a majority of the five Commissioners of the SEC. But SOX specified that the PCAOB members may only be removed "for good cause" defined by the Act. 15 U.S.C. § 7211(e)(6). And, the Commissioners themselves can only be removed by the President "for cause."

In *Free Enterprise Fund*, a nonprofit public interest organization (Free Enterprise Fund) and a Nevada accounting firm (Beckstead and Watts, LLP) brought suit against the PCAOB seeking declaratory and injunctive relief. Those plaintiffs made two arguments about SOX: (1) the PCAOB violated separation of powers by conferring executive power on Board members not subject to presidential control because they were not freely removable; and (2) Congress violated the Appointments Clause of the Constitution by giving the SEC the power to appoint members of the PCAOB. The trial court granted the United States' and PCAOB's motions for summary judgment and found that PCAOB was constitutional, and the D.C. Circuit affirmed. The plaintiffs then sought and were granted certiorari.

The Supreme Court's Decision: The Supreme Court unanimously rejected the overall challenge to the PCAOB. But in a 5-4 opinion authored by Chief Justice Roberts, the Court ruled that the mechanism for removing PCAOB members was defective as it violated the Constitutional separation of powers.1 Under SOX as written, PCAOB members were appointed by the SEC Commissioners, and could only be removed "for good cause." Likewise, SEC commissioners can only be removed by the President for good cause. Thus, the majority reasoned that there were two layers of good-cause restrictions on the President's ability to control the actions of the PCAOB. The Court rejected such an arrangement, noting that "[t]he result is a Board that is not accountable to the President, and a President who is not responsible for the Board." *Free Enterprise Fund*, 561 U.S. (2010). Because the removal of executive officers is a key element of the President exercising his executive powers, the arrangement SOX created for the PCAOB "stripped" the President "of the power our precedents have preserved, and his ability to execute the laws – by holding his subordinates accountable for their conduct – is impaired."

Although the case had the potential to invalidate the entire SOX law, the Court rejected the plaintiffs' argument on that point. The Court explicitly rejected the notion that the existence of the PCAOB violates separation of powers, and instead ruled only that its removal process was defective. The Court proceeded to analyze the severability of the PCAOB's removal process from the rest of the law, and found it severable. The Court noted that unconstitutional provisions from otherwise constitutional laws were to be severed when possible, so long as the "remaining provisions are not incapable of functioning independently." Finding that the rest of SOX was permissible and capable of functioning apart from the removal mechanisms originally established for the PCAOB, the Court ruled that SOX "remains fully operative as a law with these tenure restrictions excised." But PCAOB members must now be removable by the SEC "at will." *Id.* Finally, the Court found no fault with PCAOB and the Appointments Clause, finding it permissible for the SEC to appoint PCAOB members. Thus, the PCAOB will continue to function largely as it did prior to this litigation, albeit with more potential for SEC oversight.

Conclusion: PCAOB and SOX escaped *Free Enterprise Fund* relatively unscathed, with the Supreme Court requiring only greater executive ability to remove Board members. A case that could have had dramatic implications on SOX, PCAOB, and securities litigation ended with a whimper, not a roar. The practical effects of *Free Enterprise Fund* are likely to be minimal if any. The decision, however, is an important one for the Constitutional separation of powers.

Section IV: Development of Oversight in Post PCAOB

4.1 Report Concerning Annually Inspected Firms

Danish Securities Council (2012) Report on financial reporting enforcement activities: In 2012, the Danish Securities Council continued its financial reporting enforcement activities regarding the annual reports and interim financial reports of listed undertakings. This report deals with financial reporting enforcement activities in 2012 by the Danish Securities Council, including the result of financial reporting enforcement activities on 2011 annual reports, 2012 interim financial reports, as well as decisions from previous years completed during the year. In addition, this report shows the overall status of financial reporting enforcement activities over a number of years. The final notes of the report describe misstatements and infringements ascertained in connection with financial reporting enforcement activities in 2012. As of 1 January 2013, the Danish Securities Council and the Financial Business Council merged, and tasks relating to financial reporting enforcement activities are now being continued by the Financial Council. The Financial Council is not an independent authority, but acts as part of the Danish Financial Supervisory Authority (Danish FSA). The Danish FSA will thus take over financial reporting enforcement activities, whilst the Danish Business Authority will take over from the Danish FSA financial reporting enforcement activities for non-financial listed undertakings.

Consequently, the Danish FSA and the Danish Business Authority will be making decisions in cases commenced in 2012 but which were not concluded as of 1 January 2013. Decisions of material and/or principle importance will be presented to the Financial Council.

4.2 Misstatements and infringements ascertained

Out of the cases concluded in 2012, five cases were decided by the Danish Securities Council, and have therefore been published on the Council's website. In these cases, the following misstatements were ascertained: Failure to disclose information that the undertaking reviewed is not in compliance with the minimum capital requirement (link). Failure to present documentation that the undertaking has had a correct calculation made of fair value of investment properties. Incorrect recognition of a deferred tax asset, as no convincing evidence had been presented that the deferred tax asset could be utilised in future taxable profits. Recognition of acquired deposits surplus and the advantage of utilising these as goodwill, even though the conditions for recognition as a separate intangible asset were met. Failure to ascertain objective evidence of impairment losses on loans and receivables, and failure to register sufficient impairment losses on loans and receivables, given that the impairment calculations did not represent a reasonable estimate of payments expected from the borrower and from any collateral. Failure to adjust the value of properties downwards to fair value. Incorrect recognition of land as investment property under construction.

The Sarbanes-Oxley Act of 2002 requires the Public Company Accounting Oversight Board ("PCAOB" or "the Board") to conduct an annual inspection of each registered public accounting firm that regularly provides audit reports for more than 100 issuers. The Board's report on any such inspection includes this preface to provide context for information in the public portion of the report.

A Board inspection includes, among other things, a review of selected audits of financial statements and of internal control over financial reporting. If the Board inspection team identifies deficiencies in those audits, it alerts the firm to the deficiencies during the inspection process. Deficiencies that exceed a certain significance threshold are also summarized in the public portion of the Board's inspection report. The Board encourages readers to bear in mind two points concerning those reported deficiencies.

First, inclusion in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. Under PCAOB standards, a firm must take appropriate action to assess the importance of the deficiency to the firm's present ability to support its previously expressed audit opinions. Depending upon the circumstances, compliance with these standards may require the firm to perform additional audit procedures, or to inform a client of the need for changes to its financial statements or reporting on internal control, or to take steps to prevent reliance on previously expressed audit opinions. A Board inspection does not typically include review of a firm's actions to address deficiencies identified in that inspection, but the Board expects that firms are attempting to take appropriate action, and firms frequently represent that they have taken, are taking, or will take, action. If, through subsequent inspections or other processes, the Board determines that the firm failed to take appropriate action, that failure may be grounds for a Board disciplinary sanction.

Second, the Board cautions against drawing conclusions about the comparative merits of the annually inspected firms based on the number of reported deficiencies in any given year. The total number of audits reviewed is a small portion of the total audits performed by these firms, and the frequency of deficiencies identified does not necessarily represent the frequency of deficiencies throughout the firm's practice. Moreover, if the Board discovers a potential weakness during an inspection, the Board may revise its inspection plan to target additional audits that may be affected by that weakness, and this may increase the number of deficiencies reported for that firm in that year. Such weaknesses may emerge in varying degrees at different firms in different years.

4.3 Notes Concerning the Report:

Portions of this report may describe deficiencies or potential deficiencies in the systems, policies, procedures, practices, or conduct of the firm that is the subject of this report. The express inclusion of certain deficiencies and potential deficiencies, however, should not be construed to support any negative inference that any other aspect of the firm's systems, policies, procedures, practices, or conduct is approved or condoned by the Board or judged by the Board to comply with laws, rules, and professional standards.

Any references in this report to violations or potential violations of law, rules, or professional standards should be understood in the supervisory context in which this report was prepared. Any such references are not a result of an adversarial adjudicative process and do not constitute conclusive findings of fact or of violations for purposes of imposing legal liability. Similarly, any description herein of a firm’s cooperation in addressing issues constructively should not be construed, and is not construed by the Board, as an admission, for purposes of potential legal liability, of any violation.

Board inspections encompass, among other things, whether the firm has failed to identify departures from U.S. Generally Accepted Accounting Principles ("GAAP") or Securities and Exchange Commission ("SEC" or "Commission") disclosure requirements in its audits of financial statements. This report's descriptions of any such auditing failures necessarily involve descriptions of the related GAAP or disclosure departures. The Board, however, has no authority to prescribe the form or content of an issuer's financial statements. That authority, and the authority to make binding determinations concerning an issuer's compliance with GAAP or Commission disclosure requirements, rests with the Commission. Any description, in this report, of perceived departures from GAAP or Commission disclosure requirements should not be understood as an indication that the Commission has considered or made any determination regarding these issues unless otherwise expressly stated.

4.4 2008 Inspection of KPMG LLP in the United States

In 2008, the Board conducted an inspection of KPMG LLP ("KPMG" or "the Firm"). The Board is today issuing this report of that inspection in accordance with the requirements of the Sarbanes-Oxley Act of 2002 ("the Act"). The Board is making portions of the report publicly available. Specifically, the Board is releasing to the public Part I of the report, Appendix A, and portions of Appendix B. Appendix A provides an overview of the inspection process. Appendix B includes the Firm's comments, if any, on a draft of the report.

The Board has elsewhere described in detail its approach to making inspection- related information publicly available consistent with legal restrictions. A substantial portion of the Board's criticisms of a firm (specifically criticisms of the firm's quality control system), and the Board's dialogue with the firm about those criticisms, occurs out of public view, unless the firm fails to make progress to the Board's satisfaction in addressing those criticisms. In addition, the Board generally does not disclose otherwise nonpublic information, learned through inspections, about the firm or its clients. Accordingly, information in those categories generally does not appear in the publicly available portion of an inspection report.

4.5 Inspection Procedures and Certain Observations

Members of the Board's inspection staff ("the inspection team") performed an inspection of the Firm from April 2008 through October 2008. The inspection team performed field work at the Firm's National Office and at 29 of its approximately 90 U.S. practice offices. Board inspections are designed to identify and address weaknesses and deficiencies related to how a firm conducts audits. To achieve that goal, Board inspections include reviews of certain aspects of selected audits performed by the firm and reviews of other matters related to the firm's quality control system. Appendix A to this report provides a description of the steps the inspection team took with respect to the review of audits and the review of certain firm-wide quality control processes.

In the course of reviewing aspects of selected audits, an inspection may identify ways in which a particular audit is deficient, including failures by the firm to identify, or to address appropriately, respects in which an issuer's financial statements do not present fairly the financial position, results of operations, or cash flows of the issuer in conformity with GAAP. It is not the purpose of an inspection, however, to review all of a firm's audits or to identify every respect in which a reviewed audit is deficient. Accordingly, a Board inspection report should not be understood to provide any assurance that the firm's audits, or its issuer clients' financial statements or reporting on internal control, are free of any deficiencies not specifically described in an inspection report.

4.6 A. Review of Audit Engagements

The scope of the inspection procedures performed included reviews of aspects of selected audits performed by the Firm. Those audits and aspects were selected according to the Board's criteria, and the Firm was not allowed an opportunity to limit or influence the selection process. In reviewing the audits, the inspection team identified matters that it considered to be audit deficiencies. These deficiencies included a failure by the Firm to identify or appropriately address an error in the issuer's application of GAAP. In addition, the deficiencies included failures by the Firm to perform, or to perform sufficiently, certain necessary audit procedures.

In some cases, the conclusion that the Firm failed to perform a procedure may be based on the absence of documentation and the absence of persuasive other evidence, even if the Firm claims to have performed the procedure. PCAOB Auditing Standard No. 3, *Audit Documentation* ("AS No. 3") provides that, in various circumstances including PCAOB inspections, a firm that has not adequately documented that it performed a procedure, obtained evidence, or reached an appropriate conclusion must demonstrate with persuasive other evidence that it did so, and that oral assertions and explanations alone do not constitute persuasive other evidence. For purposes of the inspection, an observation that the Firm did not perform a procedure, obtain evidence, or reach an appropriate conclusion may be based on the absence of such documentation and the absence of persuasive other evidence.

When audit deficiencies are identified after the date of the audit report, PCAOB standards require a firm to take appropriate actions to assess the importance of the deficiencies to the firm's present ability to support its previously expressed opinions, and failure to take such actions could be a basis for Board disciplinary sanctions. In response to the inspection team's identification of deficiencies, the Firm, in some cases, performed additional procedures or supplemented its work papers.

In some cases, the deficiencies identified were of such significance that it appeared to the inspection team that the Firm, at the time it issued its audit report, had not obtained sufficient competent evidential matter to support its opinion on the issuer's financial statements. The deficiencies that reached this degree of significance are described below, on an audit-by-audit basis, with the exception of deficiencies that were observed in multiple audits and are therefore grouped together.

4.7 Deficiencies in testing pension plan assets (three audits)

In three audits, due to deficiencies in testing assets held by the issuers' pension plans, the Firm failed to obtain sufficient competent evidential matter to support its audit opinions. The deficiencies are as follows:

In one audit, the Firm failed to test sufficiently the existence and valuation of the issuer's pension plan assets. Specifically, the Firm failed either to obtain a service auditor's report for the trustee of the plan assets or to identify and test controls over the existence and valuation of the pension plan assets held by the trustee. The Firm also failed to obtain a confirmation from the trustee of the individual assets that the trustee held and the fair value of the individual assets. In addition, the Firm relied on uncorroborated representations from the issuer's management that none of the plan assets related to subprime assets or alternative investments, such as hedge funds. Further, the Firm failed to obtain an understanding of the issuer's methods for determining fair value, and it failed to test the fair values of any of the plan assets.

Issuer A: In another audit, the Firm failed to sufficiently test the valuation of the issuer's pension plan assets, the majority of which did not have quoted market prices in active markets. The Firm selected a sample of securities for testing. For the majority of the items selected, however, the Firm only compared the securities' recorded values to amounts determined by the issuer's investment manager or the issuer's plans' trustees. The Firm failed to obtain an understanding of the methodologies, and to evaluate the reasonableness of the assumptions, that the investment manager or the trustees had used to estimate the fair values of the securities.

Issuer B: In the third audit, the Firm failed to sufficiently test the existence and valuation of the issuer's pension plan assets, the majority of which did not have quoted market prices in active markets. The issuer obtained fair value estimates for securities held by the pension plan from the plan's trustee, and the Firm selected a sample of 25 securities to evaluate the fair value estimates. The Firm failed to obtain an understanding of how the trustee determined the fair values of any of the sample selections for which no quoted market prices existed, and to evaluate the reasonableness of the assumptions the trustee had used to determine fair value. Furthermore, the Firm failed to obtain a confirmation from the trustee of the individual assets held and the fair value of the individual assets.

Issuer C: Review of Client Acceptance and Retention, Including the Firm's Risk-Rating System
The objectives of the inspection procedures in this area were to continue to assess whether the Firm appropriately considers and addresses the risks involved in accepting and retaining clients in the particular circumstances and to assess the Firm's responses to the risks identified, including the extent to which an observable link exists between those risks and the audit procedures performed. Toward those objectives, the inspection team obtained an understanding of any changes in the acceptance and retention processes and evaluated the Firm's policies and procedures relating to the Firm's risk-rating systems. The inspection team interviewed members of the Firm's management and selected a sample of issuer audits to (a) evaluate compliance with the Firm's policies and procedures for identifying and assessing the risks involved in accepting or continuing the client and (b) observe whether the audit procedures were responsive to the risks identified during the process.

Issuer D: In this audit, the Firm failed in the following respects to obtain sufficient competent evidential matter to support its audit opinion . The issuer provides financing through multiple business units. The issuer used different methodologies and assumptions to estimate the allowance for loan losses (ALL) at its business units based on the characteristics of the loans at each business unit. The Firm tested the consolidated ALL by testing the issuer's estimate of the ALL at specific business units that the Firm had selected. Deficiencies in the Firm's audit procedures regarding the ALL at selected business units included:

The degree of reliance the Firm placed on controls at certain of the business units was inappropriate in light of the control testing performed. For example, in one instance the Firm relied on a control that did not achieve the specified control objective. In another instance, the Firm's sample of one used to test certain manual controls was insufficient to support the reliance that the Firm placed on those controls.

At certain of the business units selected for testing, the Firm failed to test certain of the issuer's assumptions, including those developed by the issuer's specialist, and/or data used in estimating the ALL, including loan loss rates, environmental factors, enterprise valuations, liquidation analyses, debt service coverage and loan-to-value ratios, weighting factors, and the homogeneity of loan pools. The Firm failed to expand testing as a result of exceptions that the issuer's internal audit department had identified in its tests of the data that the issuer had used to estimate the ALL at a business unit.

To test the valuation of the issuer's securities, the Firm obtained valuations for the securities from outside pricing services. The Firm failed, however, to determine which of those valuations were based on financial models and failed to obtain an understanding of the assumptions and methods used in any such models. In addition, with respect to some of the issuer's securities, the Firm was unable to obtain values from outside pricing services and failed to perform procedures to test the issuer's valuation of those securities.

The Firm failed to perform sufficient audit procedures with respect to certain financing receivables. The Firm did not send confirmation requests for two of the 14 sample items selected for confirmation, one of which represented the largest item in the sample. For this receivable, the Firm relied on documents supplied by the issuer but failed to perform procedures to obtain the necessary corroboration of those documents. In addition, the Firm selected the sample to confirm from a population that excluded certain financing receivables. Also, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had reconciled the differences between the amounts on the individual confirmation requests and the recorded amounts of the receivables.

Issuer E: In this audit, the Firm failed in the following respects to obtain sufficient competent evidential matter to support its audit opinion . The Firm failed to perform sufficient audit procedures with respect to the valuation of certain hard-to-price financial instruments. First, the degree of reliance the Firm placed on the issuer's controls exceeded what was appropriate in light of the Firm's assessment of the overall risk of material misstatement as high, the existence of fraud risk factors related to the valuation of financial instruments, and deficiencies in the nature and extent of the tests of controls the Firm performed. For example, in one instance in an area of higher risk, the Firm limited its tests of a price verification control it relied on to inquiry and observation without obtaining corroboration, and in another instance, the Firm's sample of one used to test certain manual controls was insufficient. Second, the substantive procedures the Firm performed to test the valuation of the financial instruments did not provide the Firm with the necessary level of assurance. For example, the Firm selected sample sizes based on its preliminary view of the acceptable threshold for errors, which was nearly three times as large as its revised acceptable threshold for errors, and the Firm failed to obtain, from an independent source, information corroborating key data and assumptions underlying the fair values the issuer had used for approximately 30 percent of the financial instruments the Firm tested.

In addition, the Firm's tests of controls that it performed to evaluate the issuer's classification of financial instruments were not sufficient because the controls identified and tested were not relevant to the assertion being tested. With respect to the valuation of certain other hard-to-price financial instruments, the Firm failed to identify and test controls over the issuer's process for valuing these instruments, and the Firm failed to perform substantive procedures to test the values the issuer had assigned to these instruments.

During the fourth quarter of the year, the Firm lowered its assessment of the acceptable threshold for errors in certain accounts by two-thirds due to the market disruption that had occurred during the second half of the year. Other than inquiry of management, the Firm did not test certain significant information and assumptions the issuer had used in assessing whether the impairment in a portion of its portfolio of available-for-sale mortgage-backed securities was other than temporary, even though securities representing approximately 90 percent of this portion of the portfolio had been in an unrealized loss position for more than 12 months, and the unrealized losses were nearly twice the Firm's revised acceptable threshold for errors. In addition, the Firm did not evaluate whether the issuer's analysis considered the negative developments affecting the mortgage market and mortgage backed securities. The Firm also failed to consider certain of the audit implications of the other-than-temporary impairment charges that the issuer had recorded for this portion of the portfolio in the first month after year end, such as whether it needed to determine whether the conditions that resulted in such charges were present in the issuer's securities included in its portfolio in the year under audit.

Issuer F: The issuer had experienced significant deterioration in its loan portfolio during the year under audit. For example, the issuer had an increase of over 80 percent in non- performing mortgage loans. The issuer's allowance for losses on mortgage loans ("ALL") included a "non-current component" related to loans more than 90 days past due. The issuer calculated the non-current component of its ALL by applying certain percentages to different aging categories of loans in that component.

As part of its procedures to audit the ALL, the engagement team used a Firm Credit Risk Specialist ("FCRS") to review the issuer's ALL methodology, and the FCRS observed that the issuer needed to develop additional quantitative support for its ALL methodology, including for loss experiences on delinquent mortgage loans, and to further analyze the validity of historical percentages in light of new economic circumstances. Despite these concerns, the Firm accepted the percentages the issuer had used to calculate the non-current component of the ALL without determining whether they were supportable and appropriate.

Issuer G: In this audit, the Firm failed in the following respects to obtain sufficient competent evidential matter to support its audit opinion. In the year under audit, the issuer changed its accounting for an agreement it had entered into in the prior year to outsource its information technology function. Under the revised accounting, the issuer deferred certain transition costs that had been, or would have been, expensed as incurred under the original accounting. The Firm failed to identify that the issuer's revised accounting was not in compliance with GAAP because certain of the deferred costs did not meet the definition of an asset, as the costs did not represent a probable future economic benefit for the issuer.

The Firm noted that the revenue growth rates that management had used in its cash flow projections to evaluate whether a reporting unit's goodwill was impaired appeared aggressive. The Firm performed a sensitivity analysis using lower revenue growth rates, which resulted in an estimated fair value of the reporting unit that was lower than its carrying value. Also, the issuer had received an offer to purchase the reporting unit for less than its year-end carrying value. Despite these indicators of potential impairment, the Firm relied on management's representations that it would not sell the unit for less than its carrying value, and accordingly accepted management's assertion that goodwill for this reporting unit was not impaired.

Issuer H: The issuer determined that operating losses for an asset group, combined with delays in product release and increased competition, constituted a triggering event, which required that the asset group be evaluated for impairment. The issuer's memorandum assessing possible impairment that was included in the Firm's work papers stated that the issuer had determined that the group's primary assets had a longer life than had previously been estimated, so that an additional year of cash flows should be included in the impairment analysis. The memorandum concluded that the asset group's estimated future cash flows exceeded its carrying value, although the projected cash flow schedules attached to the memorandum in the Firm's work papers indicated the opposite.

The Firm failed to perform sufficient procedures to audit the issuer's impairment analysis. For example, the Firm compared the projected revenue growth to the most recent period and to other internal projections, but did not evaluate the appropriateness of the significant increase in the revenue projections from those used to value the assets when the issuer acquired them in the prior year, nor did it assess certain significant assumptions, such as the price and volume information, that drove the revenue increases. Also, the Firm failed to substantiate, beyond inquiry of issuer personnel, a substantial projected decrease in research and development costs in light of the issuer's position that it intended to continue to develop the group's products. The Firm concluded, based on these adjusted projections, that the projected cash flows exceeded the carrying value of the asset group, and that the asset group was not impaired. In addition, the Firm's analysis of possible impairment excluded from the group certain tangible assets that should have been included and that the issuer had included in its analysis. Had the Firm's analysis included the carrying value of these tangible assets in the asset group, the projected cash flows would have been less than the carrying value of the asset group.

Issuer I: In this audit, the Firm failed to sufficiently test the existence and accuracy of a substantial portion of the issuer's payroll costs, which formed the basis for the recognition of much of the issuer's revenue. Specifically, the Firm planned to select a single sample for two purposes: to test the issuer's controls over payroll and to substantively test the existence and accuracy of payroll costs. The Firm, however, failed to calculate the sample size it would need to achieve both purposes. As a result, the sample tested by the Firm was not sufficient for substantive testing of the existence and accuracy of the payroll costs.

4.8 B. Review of Quality Control System

In addition to evaluating the quality of the audit work performed on specific audits, the inspection included review of certain of the Firm's practices, policies, and processes related to audit quality. This review addressed practices, policies, and procedures concerning audit performance and the following five areas (1) management structure and processes, including the tone at the top; (2) practices for partner management, including allocation of partner resources and partner evaluation, compensation, admission, and disciplinary actions; (3) policies and procedures for considering and addressing the risks involved in accepting and retaining clients, including the application of the Firm's risk-rating system; (4) processes related to the Firm's use of audit work that the Firm's foreign affiliates perform on the foreign operations of the Firm's U.S. issuer audit clients; and (5) the Firm's processes for monitoring audit performance, including processes for identifying and assessing indicators of deficiencies in audit performance and processes for responding to weaknesses in quality control. Any defects in, or criticisms of, the Firm's quality control system are discussed in the nonpublic portion of this report and will remain nonpublic unless the Firm fails to address them to the Board's satisfaction within 12 months of the date of this report.

4.9 The Inspection Process

The inspection process was designed and performed to provide a basis for assessing the degree of compliance by the Firm with applicable requirements related to auditing issuers. This process included reviews of components of selected issuer audits completed by the Firm. These reviews were intended both to identify deficiencies, if any, in those components of the audits and to determine whether the results of those reviews indicated deficiencies in the design or operation of the Firm's system of quality control over audits. In addition, the inspection included reviews of policies and procedures related to certain quality control processes of the Firm that could be expected to affect audit quality.

1. Review of Selected Audits

The inspection team reviewed aspects of selected audits, which it chose according to the Board's criteria. The Firm was not allowed an opportunity to limit or influence the engagement selection process or any other aspect of the review. For each audit engagement selected, the inspection team reviewed the issuer's financial statements and certain SEC filings. The inspection team selected certain higher-risk areas for review and inspected the engagement team's work papers and interviewed engagement personnel regarding those areas. The areas subject to review included, but were not limited to, revenues, fair value, financial instruments, income taxes, reserves or estimated liabilities, inventories, consideration of fraud, related party transactions, supervision of work performed by foreign affiliates, and assessment of risk by the engagement team. The inspection team also analyzed potential adjustments to the issuer's financial statements that were identified during the audit but not corrected. For certain selected engagements, the inspection team reviewed written communications between the Firm and the issuer's audit committee. With respect to certain engagements, the inspection team also interviewed the chairperson of the issuer's audit committee.

When the inspection team identified a potential issue, it discussed the issue with members of the engagement team. If the inspection team was unable to resolve the issue through this discussion and any review of additional work papers or other documentation, the inspection team issued a comment form on the matter and the Firm provided a written response to the comment form.

2. Implementation of AS No. 5: Shortly after the approval of AS No. 5, members of the Board's Office of the Chief Auditor and of the Division of Registration and Inspections reviewed documentation of the Firm's initial approach to the implementation of AS No. 5 and provided feedback to the Firm's National Office. Field inspection procedures in this area began with discussions with members of the Firm's leadership to address specific areas of inspection emphasis and the appropriate use of auditor judgment, and to outline planned communications with the Firm. The reviews of certain audits included discussions with engagement teams and the review of documentation regarding the following aspects of the Firm's audit of internal control over financial reporting: (1) risk assessment; (2) risk of fraud; (3) entity-level controls; (4) the nature, timing, and extent of tests of controls; and (5) evaluating and reporting deficiencies. The inspection team discussed its observations about the effectiveness of the implementation of AS No. 5 with the engagement teams, with emphasis on areas where implementation could be improved in subsequent audits. Periodically the observations were summarized and discussed with the Firm's National Office.

3. Review of Firm Management and Monitoring Processes Related to Audit Quality Control: The inspection team's approach to its review of the Firm's system of quality control was intended to further its understanding of how the Firm manages audit quality, so as to enhance its basis for assessing, in this year and in future years, whether that system is appropriately designed and implemented to achieve the goal of conducting audits that are in compliance with applicable standards. The inspection team also continued its assessment of the Firm's processes and controls that relate to certain specific functional areas that relate to audit performance. The overall approach was designed to identify possible defects in the design or operation of the Firm's system of quality control, while also continuing and enhancing the evaluation of the Firm's ability to respond effectively to indications of possible defects in its system of quality control.

a. ***Review of Business Management:*** The objectives of the inspection procedures in this area were (a) to obtain an enhanced understanding of how the Firm's management is structured and operates the Firm's business, and the implications that the management structure and processes have on audit performance and (b) to continue assessing whether actions and communications by the Firm's leadership – the Firm's "tone at the top" – demonstrate a commitment to audit quality. Toward that end, the inspection team interviewed members of the Firm's national, regional, and local leadership to obtain an understanding of the Firm's approach to, and processes for, its management, including the various management committees or other mechanisms, formal or informal, that relate to assessing and monitoring audit performance, or that otherwise affect audit performance. The inspection team also obtained and reviewed significant management reports and documents, as well as information regarding financial metrics and the budget and goal setting processes that the Firm uses to plan for, and evaluate the success of, its business.

b. ***Review of Partner Management:*** The objectives of the inspection procedures in this area were (a) to continue to assess whether the design and application of the Firm's processes related to partner evaluation, compensation, admission, termination, and disciplinary actions could be expected to encourage an appropriate emphasis on audit quality and technical competence, as compared to marketing or other activities of the Firm; (b) to assess the Firm's quality controls over the allocation of its partner resources; and (c) to identify and assess the accountability and responsibilities of the different levels of Firm management with respect to partner management. The inspection team interviewed members of the Firm's management, as well as audit partners in practice offices, regarding these topics. The inspection team's interviews of audit partners included their time and responsibilities and the interviews of practice office management included the performance of the partners being inspected, the evaluation and compensation process, any disciplinary actions, and any situations where client management requested a change in the lead audit partner. In addition, the inspection team reviewed a sample of partners' personnel files, including files of partners who resigned or took early retirement and partners who had significant negative inspection results from recent internal and PCAOB inspections.

c. ***Review of Client Acceptance and Retention, Including the Firm's Risk-Rating System:*** The objectives of the inspection procedures in this area were to continue to assess whether the Firm appropriately considers and addresses the risks involved in accepting and retaining clients in the particular circumstances and to assess the Firm's responses to the risks identified, including the extent to which an observable link exists between those risks and the audit procedures performed. Toward those objectives, the inspection team obtained an understanding of any changes in the acceptance and retention processes and evaluated the Firm's policies and procedures relating to the Firm's risk-rating systems. The inspection team interviewed members of the Firm's management and selected a sample of issuer audits to (a) evaluate compliance with the Firm's policies and procedures for identifying and assessing the risks involved in accepting or continuing the client and (b) observe whether the audit procedures were responsive to the risks identified during the process.

d. *Review of Policies Related to Foreign Affiliates:* The objective of the inspection procedures in this area was to evaluate the processes the Firm uses to ensure that the audit work that its foreign affiliates perform on the foreign operations of U.S. issuers is effective and in accordance with applicable standards. To accomplish its objective, the inspection team reviewed the Firm's policies and procedures related to its supervision and control of work performed by foreign affiliates on the operations of U.S. issuer clients, reviewed available information relating to the most recent foreign affiliated firms' internal inspections, interviewed members of the Firm's leadership, and reviewed the U.S. engagement teams' supervision and control procedures concerning the audit work that the Firm's foreign affiliates performed on a sample of audits. The inspection team also reviewed, on a limited basis, certain of the audit work performed by the Firm's foreign affiliates on the foreign operations of U.S. issuer clients.

e. *Review of Firm's Processes for Monitoring Audit Quality*

(i) *Review of Processes for Identifying and Assessing Indicators of Deficiencies in Audit Performance:* The objective of the inspection procedures in this area was to identify and assess the monitoring processes that the Firm considers to be significant to its ability to monitor audit quality for individual engagements and for the Firm as a whole. Toward that objective, the inspection team interviewed members of the Firm's management to build on its understanding of how the Firm identifies, evaluates, and responds to possible indicators of deficiencies in audit performance, including internal inspection findings, PCAOB inspection observations, restatements, and litigation. In addition, the inspection team reviewed documents related to the design, operation, and findings of the Firm's internal inspection program, and reviewed certain audits that the Firm had inspected and compared the results to those of the Firm.

(ii) *Review of Response to Weaknesses in Quality Control:* The objectives of the inspection procedures in this area were to assess the design and test the effectiveness of the Firm's processes for addressing possible deficiencies in the Firm's system of quality control, including any deficiencies in the Firm's system of quality control that were noted in prior PCAOB inspection reports. Toward those objectives, the inspection team reviewed steps the Firm has taken in the past several years to address possible quality control deficiencies. The inspection team then assessed the design and evaluated the effectiveness of the processes identified. In addition, the inspection team conducted focused inspections of audits of certain issuers whose audits had been reviewed during previous PCAOB inspections of the Firm to ascertain whether the audit procedures in areas with previous deficiencies had been improved.

(iii) *Review of Certain Other Policies and Procedures Related to Monitoring Audit Quality:* The procedures in this area included obtaining an update of the inspection team's understanding of policies, procedures, and guidance related to the Firm's independence requirements and its consultation processes and the Firm's compliance with them. In addition, the inspection team reviewed documents, including certain newly issued policies and procedures, and interviewed Firm management to update its understanding of the Firm's methods for developing audit policies, procedures, and methodologies, including internal guidance and training materials.

4.10 KPMG LLP Response to the Draft Inspection Report

Pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(a), the Firm provided a written response to a draft of this report. Pursuant to section 104(f) of the Act and PCAOB Rule 4007(b), the Firm's response, minus any portion granted confidential treatment, is attached hereto and made part of this final inspection report.

We appreciate the opportunity to read and comment upon the PCAOB's Draft Report on the 2008 Inspection of KPMG LLP dated April 24, 2009 ("Draft Report"). We share a common objective - serving our capital markets by performing high quality audits - and we value the input and information provided by the PCAOB in connection with its inspection process.

We acknowledge the professionalism and commitment of the PCAOB inspection staff and the important role the PCAOB plays in improving audit quality. We would also like to recognize the people of KPMG and the effort they expend to perform high quality audits in an increasingly challenging environment.

We recognize that professional judgments are involved in both the performance of an audit and the PCAOB's inspection process. In specific circumstances, we may have differing views on the assessment of audit risk, the materiality of particular issues in the context of the financial statements taken as a whole and the related nature and extent of necessary auditing procedures, resulting conclusions, and/or required documentation. We also understand that the comments made on individual Issuers cannot by their nature include a description and analysis of all procedures performed in a particular audit area.

As we previously communicated to the PCAOB, we conducted a thorough review of the matters identified in the Draft Report and addressed the engagement-specific findings in a manner consistent with PCAOB auditing standards and KPMG policies and procedures. Based on this review, in some cases, we performed additional audit procedures and/or supplemented our audit documentation; in other cases, we determined that no remediation was necessary.

None of the matters identified by the PCAOB required the reissuance of any of our previously issued reports.

In the past several years, we have further strengthened our commitment to quality. We remain dedicated to evaluating our systems of quality control, monitoring audit quality and implementing changes to our policies and practices in order to enhance audit quality. We have taken these actions mindful of our responsibility to the capital markets. We are committed to continually improving our firm and the profession and working constructively with the PCAOB to improve audit quality.

4.11 US Senate Members Proposal to PCAOB Rulemaking on Disclosing Audit Engagement Partners

The purpose of this letter is to express support for amendments proposed by the Public Company Accounting Oversight Board (PCAOB) to improve audit quality, transparency, and accountability by requiring registered public accounting firms to disclose the name of the lead engagement partner in each audit report and in the firm's Annual Report Form as well as the name of any other independent public accounting firm or other person who took part in the audit.

Strengthening Public Company Audits. The U.S. Senate Permanent Subcommittee on Investigations, which I chair, has long had an interest in strengthening audits of publicly traded corporations to protect investors, prevent fraud, and provide a strong foundation (or the American economy. Its investigations have included exposing the poor quality audits that contributed to the collapse of the Enron Corporation, [1] the development and sale of financial products designed to help corporations hide debt on their financial statements, and the development and sale of abusive tax shelter and other schemes by accounting firms and other professionals to minimize corporate taxes and innate corporate earnings.[3] The Subcommittee's work has contributed to legislative efforts to strengthen the auditing process, including the Sarbanes-Oxley reforms that created the PCAOB, imposed new requirements to ensure auditor independence, and strengthened corporate board oversight of auditing procedures.

Poor quality audits of publicly traded corporations continue to plague the U.S. investment community, allowing misleading accounting, outright frauds, and substantial losses to occur. Egregious recent examples include Olympus Corp., where Japanese affiliates of KPMG and Ernst & Young approved financial statements in which the corporation shifted billions or dollars in investment losses off its balance sheet while including other assets at inflated values; Sat yam Computer Services Ltd., where an Indian affiliate of PricewaterhouseCoopers approved financial statements in which the company reported years of inflated assets and cash balances; [6] and Parmalat, where Italian affiliates of Grant Thorton and Deloitte Touche approved financial statements in which the company reported over $5 billion in phantom assets and falsified earnings,[7] Those are on top of older accounting scandals involving prominent public corporations like Enron, WorldCom, Xerox, and Adelphia. These prominent audit failures indicate that more needs to be done to encourage accurate and effective audits of public corporations and increase accountability for poor auditing practices.

Proposed Amendments. In 2009, in a bid to strengthen audit quality, transparency, and accountability, the PCAOB issued a Concept Release seeking comment on whether auditors should require the engagement partner with final responsibility for a particular audit to sign the audit report. The engagement partner is the key person within a registered public accounting firm who is "responsible for the engagement and its performance," and who coordinates and oversees the audit work and issuance of the audit report.[9] After receiving multiple comments, in 2011, the PCAOB issued the revised proposal currently under consideration. This proposal would require public auditors to disclose the name of the engagement partner in each audit report, but would not require the partner to sign the report; it would require each audit report listed in a public accounting firm's Annual Report Form to identify the relevant engagement partner; and it would require each audit report to disclose the name of any independent public accounting firm or other person who took part in the audit. All three of these proposals are important reforms that would strengthen public company audits.

Increased Public Disclosure. The Board's proposal to increase public disclosures about who actually conducts and is responsible for a particular audit is a welcome departure from a history of excessive secrecy and weak accountability for public company audits. Most public company audits are now performed by a small number of large firms. The "Big Four" accounting firms, which reported $45 billion in revenue in 2011 alone, [10] employ thousands of auditors with differing experience, qualifications, expertise, and work performance. Currently, these firms provide no routine public information about the engagement partner who is responsible for the audit of a particular company nor do they provide information about any third party contributor to their audits. Investors, lenders, regulators, and others currently have no means for tracking audit partners responsible for accurate audits, audit failures, or audits later found to have varying strengths and weaknesses. Because auditing firms are paid by the companies whose financial statements they audit, inherent conflicts of interest make public accountability and transparency all the more important. An accounting firm that receives large auditing fees from a client becomes susceptible to pressures by that client to overlook problems or resolve auditing issues in ways that are overly favorable to the client, or risk losing fee revenue. Engagement partners that recommend advising a client to accept a disagreeable auditing result may receive little or no support from colleagues concerned about losing business. Public accountability, in which specific individuals are recognized for high quality audits, as well as audit failures, can be a powerful antidote to such internal pressures.

Disclosing the Engagement Partner. Multiple reasons support disclosing the name ofthe engagement partner responsible for a particular audit. First is the impact on audit quality. Publicly tying the lead auditor's professional reputation to the audits for which that partner is responsible would encourage the partner to require better audit procedures, exercise better supervision of the audit team, and perform a more careful review of the audit results. It may also deter poor oversight, sloppy procedures, and high risk audit practices leading to unreliable audit opinions. Audit quality would improve, not only because engagement partners would want to protect their professional reputations, but also because public disclosure would expand the audience to which each partner would be routinely answerable, from the partner's firm and the audit client, to the broader business community, including investors, lenders, regulators, policymakers, and fellow auditing professionals.

Second, disclosure of the engagement partner's name would strengthen audit transparency by shedding light on the audit process and facilitating communications. Identifying the engagement partner would alert the audited corporation's officers, directors, audit committee, and employees to the key person responsible for resolving audit issues and help corporate employees communicate any auditing concerns to the right person. It would also inform third parties, including investors, lenders, regulators, and others, of the right person to contact with financial reporting interests or concerns. In addition, knowing the key person responsible for an audit could facilitate investigations, simplify research, and aid in evaluations of audit reports. Investigations examining financial misconduct would also be more efficient and effective if they had ready access to the names of the engagement partners responsible for particular audit reports.

Public disclosure would also facilitate evaluation of senior auditors and the audit reports for which they are responsible. Disclosure would enable not only the audit client, but also investors, lenders, regulators, and other financial statement users, to identify and evaluate an engagement partner's experience, expertise, track record, and work for other clients that might present conflict of interest problems.

Third, disclosure of the engagement partner would strengthen both partner and firm accountability for audit failures. Right now, when a company is found to have engaged in misleading or fraudulent accounting, the identity of the engagement partner is not readily apparent; making that information publicly available would facilitate holding particular engagement partners accountable for the audits they oversee. Because both the engagement partner and the public accounting firm would be identified in the audit report, the current proposal intentionally and clearly signals that accountability is intended to attach to both. In addition, as engagement partners are often indemnified by their employers in the same manner as officers and directors of corporations, any lawsuit over inaccurate financial reporting would likely affect the firm as well as the partner, providing an added incentive for the firm to monitor the performance of its engagement partners.

A fourth reason to support the PCAOB proposal is that it would promote auditor independence by highlighting the occasions on which an engagement partner is replaced. The Permanent Subcommittee on Investigations conducted an examination into the collapse of Enron Corporation in 2002, and discovered that when an Arthur Anderson senior partner raised objections to certain Enron accounting practices, he was removed at Enron's request, with no public notice. The Enron investigation demonstrates that even senior auditors can be removed at the request of a client displeased with their accounting advice. Disclosure of an engagement partner's name and any replacement might discourage audit clients from inappropriately pressuring that partner or the audit firm to cooperate with its accounting requests, since any replacement would require public notice and, in turn, raise public questions about the reasons for the replacement. To further support auditor independence, the proposal could be strengthened by requiring registered public accounting firms to file a special report on Form 3 within a few days of replacing an engagement partner in charge of a public company audit.

Still another reason to support disclosure of the engagement partner is that it would bring U.S. audit professionals in line with other U.S. corporate professionals and their international counterparts. U.S. corporate officers already sign their names to a variety of opinions and reports filed with the SEC, including certifications regarding the accuracy of the corporation's financial statements, while a majority of corporate directors sign their corporation's Annual Form 10-K. Attorneys are required to sign a variety of documents filed with federal and state regulators and the courts. In addition, the Federal Reserve already requires bank holding companies to provide the names of audit engagement partners.[12] The European Union already requires its member states to compel audit reports to be "signed by at least the statutory auditor(s) carrying out the statutory audit on behalf of the audit firm." [13] The PCOAB would bring U.S. audit professionals into closer alignment with other public company professionals by requiring public auditors to identify their audit engagement partners in the documents which they make publicly available and which they intend to be relied upon by the investing public.

Requiring A Signature. The PCAOB proposal seeks comment on whether, in addition to disclosing the name, an engagement partner should be required to sign the audit report for which the partner is responsible. The proposal should require such signatures. Critics contend that requiring a signature would increase liability for individual audit partners, while decreasing the liability of the audit firm as a whole. Those criticisms fail to acknowledge, however, that through indemnification and insurance agreements, the liability of senior audit partners and their employers are already typically closely intertwined. In addition, professions such as public accounting have long nurtured trust and respect by placing the reputation of their senior professionals on the line in support of their work. An audit report that carries the personal signature of a financial professional would not only strengthen audit quality, transparency, and accountability, but also help restore the personal responsibility critical to a trustworthy and respected accounting profession.

Disclosing Engagement Partners in Annual Reports. Public accounting firms currently file with the PCAOB an Annual Report Form listing each of the audit reports they have issued during the covered year.14 The proposal would amend the Annual Report Form to also require public accounting firms to identify the engagement partner for each of their listed audits. This proposed disclosure offers an inexpensive, sensible, and effective means for further strengthening public audits.

The proposed disclosure would provide a convenient mechanism for financial statement users to retrieve information about the work assigned by a public accounting firm to its engagement partners over the course of a year. The information would appear in one location and would be easily accessible since the annual reports are posted by the PCAOB on its website. The proposal would facilitate auditor oversight by making it easy for audit clients, investors, lenders, regulators, and others to research the work of a particular engagement partner, including by identifying the other clients the partner serves, evaluating the partner's workload, and making it easier to identify any conflict of interest or disciplinary issues. It would also facilitate oversight of audit firms as a whole by making all of the work assignments made to individual engagement partners available in one location.

Naming engagement partners in the Annual Report Form would further strengthen audit quality, transparency, and accountability by enabling more efficient and effective research into the work of individual partners and of audit firms as a whole. These disclosures would encourage engagement partners to provide consistent, high quality work, because knowing that the public can obtain one's name only by inquiring about a particular audit is not the same as knowing that the public can easily associate one's name with every audit performed during the year. In addition, the disclosures would help ensure that public accounting firms assign audits to engagement partners with appropriate expertise and availability, and avoid conflicts of interest that might otherwise be hidden from public view. The disclosures could also promote auditor independence by highlighting any engagement partner replacements during the covered year.

Disclosing Third Party Audit Participants. In addition to disclosing engagement partner names, the PCAOB proposal contains an important provision that would require disclosure of third party participants in particular audits. This provision would shine needed sunlight on a little known and difficult to monitor area of auditing, while significantly strengthening audit quality, transparency, and accountability.

When investors see the name of a major auditing firm on an audit report, they may make certain assumptions about the quality of that audit based upon that company's reputation. It is often the case, however, that an accounting firm issuing an audit report has not performed 100% of the underlying audit work, but has instead delegated all or a portion of the work to one or more outside parties, including independent auditing firms or specialists in particular areas. In addition, the accounting firm may have supervised and taken responsibility for the work performed by the third party, or may have contracted to hold the outside party solely responsible for the work it performed. Audit clients, investors, lenders, regulators, and others may be unaware of the extent to which some or all of the work in a particular audit was outsourced to outside parties. They may also be unaware of the identity of the third parties that actually performed the audit work and the extent to which the firm issuing the audit report has relied upon and taken responsibility for that work. Since auditors vary significantly in their expertise, resources, and reputation, knowing which parts of an audit were outsourced and who performed what portions of the work may be critical to assessing audit quality.

The Permanent Subcommittee on Investigations has firsthand experience with the variability of audit work performed by different firms. For example, a year-long investigation conducted by the Subcommittee into illicit money flows involving banks in foreign jurisdictions uncovered a host of problems with foreign auditors, especially those operating in foreign jurisdictions with strong secrecy laws and weak anti-money laundering controls. A number of foreign accountants contacted during the investigation were uncooperative or even hostile when asked for information. A PricewaterhouseCoopers auditor in Antigua serving as a government- appointed liquidator for Caribbean American Bank (CAB), for example, refused to provide copies of its report on CAB's liquidation proceedings, even though the reports were filed in court, they were supposed to be publicly available, and the Antiguan government had asked the auditor to provide the information to the investigation. The investigation also came across evidence of conflicts of interest and incompetent or dishonest accounting practices. In one Naming engagement partners in the Annual Report Form would further strengthen audit quality, transparency, and accountability by enabling more efficient and effective research into the work of individual partners and of audit firms as a whole. These disclosures would encourage engagement partners to provide consistent, high quality work, because knowing that the public can obtain one's name only by inquiring about a particular audit is not the same as knowing that the public can easily associate one's name with every audit performed during the year. In addition, the disclosures would help ensure that public accounting firms assign audits to engagement partners with appropriate expertise and availability, and avoid conflicts of interest that might otherwise be hidden from public view. The disclosures could also promote auditor independence by highlighting any engagement partner replacements during the covered year.

Section V: Public Oversight System in Mediterranean Countries

This survey has been prepared by Federation Des Experts Compatables Mediterrneens the representative organization of the accountancy profession in the Mediterranean area, and the objective of this survey is to provide a brief overlook of public oversight arrangements across the area. 15 countries, of which 8 are EU member states, have contributed, plus Kosovo, a special status territory within Serbia.

5.1 Existing public oversight systems or the implementation in the near future

The Survey poses the question which Mediterranean Countries have an implemented public oversight system and which will see an implementation in the near future. The answer is that a public oversight system exists in 7 out of the 15 countries which contributed to the survey. A public oversight system exists also in the Kosovo region. Of these 7 countries, 5 are EU member states (France, Greece, Italy, Malta, and Spain) and 2 are non EU member states (Israel and Tunisia). Of the other 8 countries which do not have a public oversight system. Out of them 3 are EU member states (Cyprus, Bulgaria and Romania). To comply with the EC Directive on Statutory Audit, these countries would however have to implement a public oversight system. Among the remaining 5, only Serbia and Turkey envisage to implement a PO system in the near future, while Albania, Egypt and Morocco do not. Respondents from Albania and Egypt think that a public oversight system is needed in their countries, while respondents from Morocco indicated that the introduction of such a system would not be needed in the near future, because a "quality control system" has just recently been introduced and members need some time to be trained and used to quality control procedures.

5.2 Details of public oversight systems implemented

The public oversight systems differ significantly among the responding countries, also among those within the EU member states, depending on the regulatory framework for the statutory audit activity (the EU Directive allows for the implementation of a range of different public oversight systems in the European Union1).

5.3 Nomination procedure and Composition (practitioners/non-practitioners)

In 5 out of 8 countries the public oversight board is nominated by the local governments. In Spain, there is a national law stating the composition of the public oversight board and its members are appointed with consideration of their position in other regulatory bodies such as Stock Exchange, Central Bank, etc. In France, Greece, Italy, and Spain (within the EU) as well as in the Kosovo region, the public oversight board is composed by a majority of non-practitioners. In Malta, the public oversight board currently has a majority of practitioners but will change over the next two years to conform to the EU Statutory Audit Directive. In Tunisia, the public oversight board functions are carried out by two committees: the Discipline Committee with a majority of non practitioners, and the Quality Control Committee, composed equally of civil servants and practitioners. In Israel, the public oversight board (Steering Committee) is composed by all practitioners.

5.4 Scope of activities and responsibilities

Considering the scope of activities and responsibilities, all respondents stating that a public oversight system exists in their countries mentioned that its functions include monitoring and supervision of the auditing profession and the overall responsibility for the conduct of the profession. In all countries having a public oversight board in place, the board also has the responsibility to ensure the oversight of the profession through quality control. Within the EU, France, Italy and Malta's public oversight board approves and registers statutory auditors and audit firms. This is also a responsibility of the board in the Kosovo region. Standard setting is a public oversight system responsibility in France, Greece, Spain (within the EU) and in the Kosovo region. The investigative and disciplinary systems are a public oversight board's responsibility in France, Italy, Malta (within the EU) as well as in the Kosovo region.

5.5 Funding

The public oversight system is entirely publicly funded in France, Italy, and Spain (within the EU), as well as in the Kosovo region. It is entirely professionally funded in Greece (EU) and Tunisia (non EU) and co-funded in Malta (EU).

5.6 Transparency

Half of the countries which have a public oversight system implemented publish some information about sanctions. In France an annual report is issued, available to the public at large, where the results of the yearly reviews are published. In Malta the public oversight board, as a governmental organ, is subject to full accountability to the public. In Spain the ICAC does not publish any information either on its program nor the results. Only documents related to technical principles can be made public. In Tunisia a category of sanctions is published.

5.7 Nomination procedure to the Public Accounting Oversight

France: The Haut Conseil du Commissariat aux Comptes has been instituted by the Financial Security Law, which created a new article L 821-1 of the Code of Commerce. The Haut Conseil du Commissariat aux Comptes is a public authority external to the profession. It contributes to a better transparency of the statutory audit profession, and to the reinforcement of its oversight. Appointed by the Ministry of Justice, the Haut Conseil ensures the oversight of the profession, along with the contribution of the Compagnie Nationale des Commissaires aux Comptes. The Haut Conseil designates specialised consultative commissions. Whenever required, it appoints experts to help prepare its decisions.

Greece: The President and the two Vice Presidents are appointed by the Minister of Finance and Economy. The Bank of Greece (Central Bank), the Capital Market Committee, the Federations of Greek Industries and Industries of Northern Greece nominate one member each.

Israel: There is a Steering Committee that consists of 14 certified public accountants, who are also members of the Institute of Certified Public Accountants: the chairman of the Steering Committee, six members representing the five largest firms, one from each firm (these members will be chosen by the steering committee, preferably in co-operation with the firms), four members in public practice, three members, whose main pursuits are not in public practice (controllers, managing directors, lecturers from academia etc.). The chairman of the Steering Committee and its members are chosen by the central committee. The chairman and members of the Steering Committee are chosen for a period of three years and they may be chosen for additional terms (maximum of three executive terms).

Italy: The Commissione Centrale per i Revisori Contabili is composed of 12 members, three of them are practitioners. The practitioners are appointed by the Ministry of Justice; the other members are appointed by other Ministers and delegated by Consob, Banca D'Italia and Assonime. The Consob is composed by non practitioners and is appointed by the Government.

Kosovo region: The Special Representative of the UN Secretary-General shall appoint seven members to serve on the board. Of the seven members of the board, one member shall be nominated by the BPK and six members shall be nominated by the Central Fiscal Authority, of whom five shall be representatives from the Kosovo business community and the accounting and auditing professions. The members shall not hold elected public office. The board shall be multiethnic in composition. The members of the board shall be appointed for a term of three years and shall be eligible for reappointment, but shall serve no more than two consecutive terms. However, of the members first appointed following the entry into force of the present regulation, two members shall be appointed for a term of three years, three members for a term of two years and two members for a term of one year.

Malta: Nomination is done by the Ministry of Finance.

Spain: The members of the Advisory Audit Committee (the Spanish POB) are appointed by the Government (Ministry of Economy: by a special body called ICAC).

Tunisia: The OECT (Ordre des Experts Comptables de Tunisie, that is The Tunisian Institute of Chartered Accountants), founded in 1982 and instituted by law is under the guardianship/administrative supervision of the Ministry of Finance. A representative of the Ministry of Finance sits in all the meetings of the Board of the OECT and report to the Minister of Finance.

5.8 Composition (practitioners/non-practitioners) in Public Accounting Oversight Board

France: The Haut Conseil du Commissariat aux Comptes is composed of 12 members. Three judges from the Cour de Cassation, Cour des Comptes and the judicial order, the President being the judge from the Cour de Cassation. The President of the AMF (Autorité des Marchés Financiers, former COB) or his representative, one representative from the Ministry of Economy, a university professor specialised in legal, economic or financial matters. Three experts in financial and economic matters : two being competent in public issue matters, one being competent in small or medium sized companies or in matters involving associations. Three statutory auditors, two of which having knowledge in the statutory audit of companies issuing securities to the public or in donation. The members are nominated by decree for a period a six years. The H3C is renewable by half every three years.

Greece: The President and two Vice Presidents are appointed by the Minister of Finance. The Bank of Greece (Central Bank), the Capital Market Committee, the Federations of Greek Industries and Industries of Northern Greece nominate one member each. Total members number of members are hence seven.

Italy: The Commissione Centrale per i Revisori Contabili is composed of 12 members, three of them are practitioners.

Kosovo: Of the seven members of the board, five shall be representatives from the Kosovo business community and the
accounting and auditing professions.

Malta: The board currently has a majority of practitioners but will change over the next two years to conform to the Eight Directive of the EU where the number of practitioner has to be in minority.

Spain: The Advisory Auditing Committee of the Accounting and Auditing Institute is an advisory body chaired by the Chairman of the Institute and composed by the following 13 members appointed by the Ministry of Economy. One member proposed by the Tribunal de Cuentas (Public Account Court). One member from the "Intervención General del Estado". One member from the Ministry of Justice. One member from the National Bank. One representative from the CNMV (Stock Exchange Institution) and by an investor analyst. One member from the "Dirección General de Seguros" (Insurance Department). Four members by the Professional Auditing Bodies. A Professor at University and an expert on auditing and accountancy. Some other experts on the issue may be invited to participate if needed.

Tunisia: Two committees legally supervise the activities of the Tunisian practitioners. The "Chambre de Discipline" (Discipline Committee). Chaired by a Judge, designated by the Minister of Justice. Three civil servants, designated by the Minister of Finance. Three practitioners elected for 3 years at a time. It is referred to in case of violation of the Code of Conduct and the Internal Rules and Regulations of the profession. The "Commission de Contrôle" (Quality Control Committee). Three civil servants, designated by the Minister of Finance, one of them being the Chairman. Three practitioners elected for 3 years at a time. It is responsible for the quality control of the practitioners engaged in statutory audits.

5.9 Scope of activities (quality assurance, standard setting, approval of auditors, discipline, education and others for listed, public interest or other entities)

France: The legislator has charged the Haut Conseil du Commissariat aux Comptes with two main missions: to ensure the oversight of the profession; to check that ethics is duly followed and that the independence of the statutory auditors is duly maintained. To this end, the Haut Conseil should: organise the reviews of the professionals in practice, give its opinion to the Minister of Justice on the « Code de déontologie des commissaires aux comptes », gives its opinion to the Minister of Justice on professional standards, identify and promote the good professional practices, define and supervise the new professional trends and the framework of periodic reviews.

Greece: Activities include recommendations to the Ministry of Finance on accounting and auditing standards, professional ethics setting, quality control on auditor's work and oversight of the audit profession.

Israel: Peer review, administrated by the Steering Committee. Its responsibilities include selection and affirmation of certified public accountants who will undertake the review work; supervision over the review - timing and frequency of the review, branch offices that are reviewed, considering the need for repeat reviews, etc In deciding on the timing of the review, the steering committee will take into account, inter alia, the periods of work – related pressures at the firms under review. **R**eceiving the review reports and the preparation of findings. The Steering Committee will consider forwarding its broad findings to every firm and will consider the need to publish its guidelines/clarifications, and if necessary, will forward its recommendations to the Accounting Standards Committee for further attention. Co-ordination with other bodies, as follows:

Auditors' Council - the Steering Committee will update the Auditors' Council in circumstances where it has uncovered significant violations that were not corrected, and which constitute violations of the Auditors' Law and Regulations.

Securities Authority - the Steering Committee will advise the Securities Authority of every report to the Auditors' Council, as noted above. In addition, the Steering Committee will advise the Securities Authority of any violation (which is not technical in nature) even if it is not a violation that requires a report to the Auditors' Council. In addition, the Steering Committee will update the Securities Authority on a regular basis, at least once per year, on the broad findings that were uncovered during the reviews. This update will be undertaken without noting the identities of the firms involved. The Securities Authority, for its part, will advise the Steering Committee of any specific matters which, in its opinion, should be included in the review framework.

Italy: The Commissione Centrale per i Revisori Contabili keeps the statutory auditor's register (including the practical trainer register); it approves the auditors and supervises their activity. It carries out investigation and provides sanctions on the basis of external complain for inadequate execution of the statutory audit. Consob supervises the auditing firms and their activity, verifies their independence and technical adequacy and recommends the auditing standards. The quality assurance carried out by Consob regards the internal quality control system of the audit firm and its client dossier.

Kosovo region: The board shall be independent in the execution of its responsibilities and functions, subject to the overall authority of the Special Representative of the Secretary-General. It may issue administrative instructions on any matters pertaining to its functions. It shall have the authority to enter into contracts as required to carry out its functions, including employment contracts and contracts for rental accommodation and leasing of equipment. Such contracts shall be in compliance with procurement rules and procedures of the competent governmental authority. The Board shall issue accounting standards in conformity with IAS. The board shall determine which IAS standards apply, taking into consideration the business environment in Kosovo. It shall further issue auditing standards in conformity with ISA and provide technical guidance and information to business organizations concerning accounting and auditing standards issued by it. The board shall establish and issue standards for the technical training for certification of accountants and for the licensing of auditors, as well as having the responsibility for the licensing of auditors.

Malta: The Accountancy Board (the Regulator and Public Oversight Board) has a wide scope and is responsible for the conduct of the profession in Malta even though it appoints recognised professional bodies to assist it in the execution of its role. For example whilst it remains responsible for CPE, it delegates its administration to the Malta Institute of Accountants.

Spain: The Advisory Committee has an advisory role on audit issues (standard setting, quality assurance, control and discipline of auditors etc.) The final decision is taken by ICAC. The Professional bodies recognized by ICAC are responsible for: a) To draft, adapt and review audit and ethical standards, as well as the code of professional conduct of its members and to control the compliance with such standards and code, as provided for in the Audit Law and related legislative provisions. b) To collaborate with the Institute of Accounting and Auditing (Instituto de Contabilidady Auditoría de Cuentas, ICAC) in exercising the technical control assigned to the said Institute in the Audit Law. Due to an agreement with ICAC, the professional institute carries out quality control revisions on behalf of ICAC. c) To propose to the Institute of Accounting and Auditing (ICAC) that disciplinary procedures be taken against members, in accordance with applicable legislation. d) To carry out the corresponding disciplinary procedures against members. e) To provide CPE and Access Education, namely: - to provide, either directly or through delegation, theoretical training programmes to be approved by the Institute of Accounting and Auditing, and to be mastered by those wishing to become members of the Official Register of Auditors; - to establish the standards and procedures to be followed in the practical training of those wishing to become members of the Official Register of Auditors. f) To organize the access examination to enter into the Official Register of Auditors. The Examination Board is chaired by the ICAC who has the final decision on the admission of a candidate. g) To maintain the professional training of its non-practising members. h) To regulate the professional practice of its members, whether this be on an individual basis or through some form of association with auditors or other professionals.

Tunisia: The Quality Control Committee is responsible for the Peer review of the Tunisian auditors. But the financial auditor(s) also report to other public oversight bodies: The "Banque Centrale de Tunisie" (The Central Bank) BCT *:* Are forwarded to the BCT. The banks auditor(s) report(s) as well as the mid-term audit report and monthly and quarterly statistic data. The listed entities and issuers audit report(s). The audit reports of entities with over 5 million Tunisian dinars (about 3,5 Million USD) of financial debts**.** The audit report(s) of consolidated financial statements of entities with over 10 million Tunisian dinars of assets. The “Conseil du Marché Financier” (Listed Entities Oversight Board): It supervises the listed entities and is entitled to control the auditors work. Are forwarded to the CMF. The listed entities and investment funds audit report(s) : Financial audit reports and Internal Control reports. The mid-term financial reports of listed entities. Any "warning report' at any time. The quarterly statistic data on the activities of the listed entities. The "Comité Général des Assurances" (The supervising body of Insurance Companies) CGA. Are forwarded the CGA. The audit reports of insurance companies. A specific financial and statistics report prepared by the auditors. Mid term audit reviews Started from 2005,"Loi sur la Sécurité Financière" (The financial Security Act) introduced. The joint audit for banks, multi-branch insurances and consolidated financial statements for entities with other 50 million Tunisian dinars of assets. The obligation for listed entities to have an "Audit Committee". The requirement for auditors to give an opinion on the Internal Control Procedures of listed entities. The State Owned Entities are controlled by several public control structures (Cour des Comptes; CGF etc.) They also have to be audited by a member of the OECT.

5.10 Funding of Accounting Oversight Board

France: The Haut Conseil du Commissariat aux Comptes is a public body. It is funded by the Ministry of Justice, and the Minister in charge of the budget. The remuneration of the members of the Haut Conseil has been instituted by decree n° 2003-1121 of November 25, 2003 (published in the Official Journal of the French Republic).

Greece: The public oversight system in Greece is entirely funded by contributions by the audit firms. These are calculated as a percentage of audit fees.

Israel: The committee is funded by the audited firms. The rate is set according to the number and the size of the public companies.

Italy: Both the public oversight bodies are public, and funded by public resources .The statutory auditors enrolled in the register kept by the Commissione Centrale per i Revisori Contabili have to pay a contribution for the keeping of the register. Also the audit firms enrolled in the special register kept by Consob have to pay a contribution proportional to their revenue.

Kosovo: The board shall have an annual appropriation from the Kosovo Consolidated Budget that provides honoraria, reasonable expenses and adequate administrative and technical support that shall be no less than the amount appropriated from the previous year's budget.

Malta: It is funded by the Ministry of Finance. It also levies fees on practitioners.

Spain: The ICAC is a department of a Ministry and therefore funds come from the General Budget of the State. However, recently a special tax has been issued to finance the quality control of audits.

Tunisia: The OECT has its own budget levied through membership fees. From this budget, two sub-budgets are allocated to the "Discipline Committee" and the "Quality Control Committee". The other entities that have the possibility to control and supervise the work of the auditors (Banque Centrale; CMF; CGA etc.) have their own budgets.

5.11 Transparency of Accounting Oversight Board

France: The Haut Conseil issues an annual report where one can find the results of its reviews over the year. The report is sent to the Minister of Justice. It can be consulted by the public at large.

Greece: As a recently established body, no information has yet been published.

Israel: The committee publishes general information (results).

Italy: N/A

Kosovo region: N/A

Malta: As a governmental organ it is subject too full accountability to the public.

Spain: The ICAC does not publish any information either on its program nor the results. Only documents related to technical principles can be public.

Tunisia: The OECT publishes its annual report to its members

Section VI: Public Accounting Oversight in Asia

After global focus on the U.S. accounting scandals of the early 2000s, several Asian economies adopted measures to enhance the integrity of their local accounting professions and to promote the transparency of financial statements issued by local companies. As in the United States, these economies focused on two major types of provisions: the creation of an accounting oversight organization and the tightening of auditor rules. The roles of Asian accounting oversight bodies are similar to those of the PCAOB in the United States. All oversee the registration of public accounting firms and inspect the quality of audits performed by these firms. The quality of an audit is determined by a number of factors, including an auditor's independence from the firm it reviews and it's testing of internal controls. To support audit quality, independence, and accurate financial statements, accounting oversight bodies may mandate a number of requirements, including: (i) auditor rotation, (ii) restrictions on non-audit services, and (iii) attestations by external auditors on the quality of a firm's internal controls over financial reporting.

The regulatory bodies of seven Asian economies—Japan, Malaysia, Singapore, South Korea, Sri Lanka, Taiwan, and Thailand—have joined the International Forum of Independent Audit Regulators (IFIAR), an organization of independent audit regulators through which members share their experience and knowledge about regulatory practices and activities. As of early 2012, IFIAR had 39 member economies, including the United States. Although Hong Kong and China are not IFIAR members, they do have regulatory organizations that perform the audit oversight function of firms operating within their territories. Table I summarizes the structure of accounting oversight bodies in selected Asian economies and the United States.

6.1 Accounting Oversight Bodies in Asia and the United States

Economy	Accounting Oversight Body	Description
	IFIAR Member Economies	
Japan	Certified Public Accountants & Auditing Oversight Board (CPAAOB)	Under the Financial Services Agency (FSA).
Malaysia	Audit Oversight Board (AOB)	Under the Securities Commission (SC).
Singapore	Accounting and Corporate Regulatory Authority (ACRA)	Statutory board under the Ministry of Finance (MOF).
South Korea	Financial Supervisory Service (FSS)	Under the Financial Services Commission (FSC).
Sri Lanka	Sri Lanka Accounting and Auditing Standards Monitoring Board (SLAASMB)	Currently funded by the Parliament. Its governing board is heavily comprised of government officials, including the Director General of the Securities and Exchange Commission
Taiwan	Financial Supervisory Commission (FSC)	An independent authority under the Executive Yuan (the executive branch of the government). The Accounting and Auditing Supervision Division of the Securities and Futures Bureau under the FSC implements audit regulatory oversight.
Thailand	Securities and Exchange Commission (SEC)	An independent state agency whose board chairman is appointed by the Finance Minister
United States	Public Company Accounting Oversight Board (PCAOB)	A private-sector, nonprofit corporation under the oversight of the Securities and Exchange Commission (SEC).
	Non-IFIAR Economies	
China	Ministry of Finance (MOF)	Acts as the primary audit oversight body, but the Chinese Institute of Certified Public Accountants conducts quality reviews of public accounting firms.[5]
Hong Kong	Hong Kong Institute of Certified Public Accountants (HKICPA)	A professional accounting association responsible for both overseeing auditor registrations and audit quality.[6] The Chief Executive of the Hong Kong Special Administrative Region may appoint four lay persons to its Council.
Source: "Accounting Regulatory Architecture in Asia", **COUNTRY ANALYSIS UNIT FEDERAL RESERVE BANK OF SAN FRANCISCO APRIL 2012, Asia Focus-**		

6.2 Key Audit Roles and Requirements in Four IFIAR Member Economies

A detailed comparison of the key roles of accounting oversight bodies and related audit requirements is possible based on available information covering four IFIAR economies: Japan, Malaysia, Singapore, and Thailand. These roles and requirements are summarized below, while additional details are summarized in the reference table at the end of the report.

Registration of Auditors and Audit Firms: In audit oversight practices, a designated authority is responsible for registering the auditors and audit firms of relevant companies under their jurisdiction. Typically, this responsibility lies with the appropriate national accounting association or oversight body. The audit registration requirement implies that the designated authority has reviewed and played a role in vetting the quality of the auditor or audit firm in order to approve the registration. The requirement also ensures that auditors and audit firms fall under the oversight of the designated authority. All four Asian economies require all audit firms to register with their respective audit oversight body or national professional organization. In addition, some Asian economies require firms that audit financial institutions to register separately with the local bank regulator. For example, bank audit firms in Malaysia, Singapore and Thailand must receive approval from their regulatory agency, which is the central bank in these economies. This additional requirement ensures an adequate level of oversight for bank because of their economic importance.

Inspections of Audit Quality and Audit Firms: Audit inspections play a critical oversight role in ensuring audit quality. In audit inspections, the designated authority reviews the quality of audit firms' work and their internal controls and practices. Depending on the designated authority's scope, the inspection may review compliance with auditing and ethical standards, the quality of individual audit reports, and the potential impact of corporate culture on audit quality. Audit inspections are typically more rigorous for the Big Four7 and other major audit firms that employ a large number of auditors or audit a large number of listed clients. Both the United States and the four Asian economies subject these firms to a more frequent inspection cycle ranging from one to four years, as opposed to three to five years for smaller audit firms. Audit inspections target the Big Four because they tend to audit the majority of listed companies in a given economy, ranging from 61 to 88 percent in the selected Asian economies8 and 98 percent in the United States (Chasan,, 2012). As such, the quality of the Big Four's audit performance has a greater potential impact on the integrity and reliability of financial reporting in the market. Indeed, Japan's audit oversight agency (the Certified Public Accountants & Auditing Oversight Board) subjected these firms to a series of special investigations following a spate of accounting scandals in 2005. The investigations resulted in the agency's issuance of a number of recommendations to improve audit quality control at the four accounting firms (CPAAOB, 2005),

Requirements on Auditor Rotation: Audit rotation requirements mandate that companies periodically change auditors or audit firms to ensure auditor independence. The concern is that if an auditor works with the same client for an indefinite period of time, the auditor may develop too close a relationship with the client that might impair his/her objectivity and professional skepticism. The Enron scandal highlighted the importance of auditor independence, particularly given Arthur questionable role in shredding key documents. Audit rotation requirements may apply to auditors, audit firms, or both. They typically specify the length of the mandatory rotation period and the length of the subsequent "time-out period," during which the auditor or audit firm may not engage in an audit for a particular client. The requirements' strictness varies across Asian economies, with the audit rotation period for key auditors ranging from five to seven years, and the time-out period for key auditors ranging from two to five years, if any. Singapore is the only selected Asian economy that requires mandatory rotation of audit firms; however, this requirement applies only to firms that audit banks. These firms face a five-year rotation period and five-year time-out period.

The United States also does not require the mandatory rotation of audit firms, although PCAOB is seeking public comments on a proposal to do so (Public Company Accounting Oversight Board, 2011). During a public hearing in March 2012, the Big Four and many large U.S. corporations expressed opposition to the proposal (Reuters, March 22, 2012).They argued that new auditors would not have the institutional knowledge required for an in-depth audit, particularly for complex multinational corporations. They alleged that this lack of familiarity with the client operations would lead to more costly audits because of the time required to fully understand the company's business and accounting system. Opponents also opined that there could be a higher risk of missing potential problematic areas resulting in poor audit quality, and that the mandatory audit partner rotation is sufficient for a "fresh look" at the audit. The PCAOB reportedly expects the debate over mandatory audit firm rotation to extend into 2013.

Restrictions on Providing Non-Audit Services: Audit oversight agencies in both the United States and Asia restrict audit firms from providing non-audit services to promote independence. The importance of non-audit service restrictions is highlighted by Arthur Anderson's non-audit services to Enron in both the nature of the service provided and the magnitude of the fees. Arthur Anderson had provided extensive tax advisory services in structuring many of Enron's special purpose vehicles, which hid the company's off-balance sheet losses. In addition to services that directly affected Enron's financial statements, Arthur Anderson's non-audit fees exceeded its audit fees from Enron and generated a significant conflict of interest in providing an objective audit opinion. Restrictions on non-audit services vary based on how the audit regulatory body anticipates which activities will impair the auditor's independence. The restrictions may range from a prescriptive list of prohibited services to broad guidance. For example, similar to the United States, Japan explicitly prohibits the same audit firm from providing non-audit services related to the client's financial statements and investment advisory services. However, Singapore allows the same audit firm to provide non-audit services if the resulting threat to auditor independence is at an "acceptable" level. Malaysia is unique in that it provides a quantitative criterion based on audit fees. Specifically, the non-audit fees may not be more than 20 percent of audit fees.

Attestation of Internal Controls: Auditor attestation of internal controls over financial reporting is a relatively new development in Asia. Under this requirement, the external auditor must issue a statement that opines on the effectiveness of the internal controls over financial reporting. This statement effectively ensures that the auditor thoroughly assess internal controls as part of the external audit. Auditor attestation requirements have been partially driven by accounting scandals, which by nature imply a breakdown of internal control. This breakdown of internal control at management levels was exemplified in the Enron scandal in the United States and in Japan by the Livedoor and Nikko Cordial scandals in 2006 and 2007, respectively. In 2011 and 2012, Japan and China implemented auditor attestation requirements similar to those of the United States (Standard for Enterprise Internal Control, dated May 22, 2008)**.** These are the only two economies to have issued such requirements. Notably, both economies have experienced a number of accounting scandals in recent years. Indeed, the high-profile Kanebo scandal in 2005 was one of the catalysts that prompted audit oversight reforms in Japan. China goes beyond requiring the review of internal controls over financial reporting by including non-financial reporting objectives (PWC 2011).

Over the last decade, regulators in Asia have acknowledged the need for continual improvement in audit regulatory oversight. High-quality external audits are crucial to ensuring the integrity of financial statements and bolstering market confidence. During critical times, market stress may add pressure on corporate management to meet performance targets and expectations, and manage cash flow and ongoing operations. Indeed, recent accounting scandals in some Asian economies reinforce the importance of audit oversight. Given the increasing complexity of business transactions and the opportunity for "creative" accounting practices, the continual development of audit oversight by Asian economies is highly encouraging and should contribute to supporting market confidence and stability.

Table-1: Roles of Auditing Oversight Bodies

Oversight Body /Legislation	Roles of Auditing Oversight Bodies	
United States of America		
Public Company Accounting Oversight Board (PCAOB) **Sarbanes-Oxley Act, 2002, last amended 2010**	Audit firms of publicly listed companies must register with the PCAOB. The PCAOB is responsible for registering "issuers, brokers, and dealers" as defined under the PCAOB Rules and Securities Exchange Act of 1934.	PCAOB conducts annual inspections annually for firms that regularly provide audit reports for more than 100 audited companies. It conducts inspections, at least triennially, for firms that regularly provide audit reports for 100 or fewer companies.
Japan		
Certified Public Accountants & Auditing Oversight Board (CPAAOB) **CPA Law, 2004, last amended**	All CPAs must register with the Japanese Institute of Certified Public Accountants (JICPA). JIPCA's Center for Listed Company Audit	JICPA's Quality Control Review Team reviews auditors and CPAs every three years on the audit of financial statements, particularly the audit process, of listed companies, certain large companies and other entities that must have audited financial statements. Notably, JICPA tries to review the big audit firms every other year.

2007	Firms is responsible for registering audit firms engaged in the audit of listed companies to reduce the burden on the CPAAOB and place more emphasis on self-regulatory mechanisms.	CPAAOB's Office of Monitoring and Inspection oversees JICPA's quality control reviews, and will conduct on-site inspections of the audit firm, JICPA, and related sites, if necessary.
Malaysia		
Audit Oversight Board (AOB) **Part IIIA of the Securities Commission Act, 2010, last amended 2011**	ACRA's Public Accountants Oversight Committee (PAOC) is responsible for registering all public accountants and audit firms. For banks, the Monetary Authority of Singapore (MAS) must approve the bank's auditor. For listed companies, the Singapore Exchange Limited (SGX) requires that auditors are registered with ACRA, amongst other alternatives.	Singapore divides the responsibilities for audit quality inspections between its audit oversight body and professional accounting association based on the whether the company is a PIE. Under ACRA's Practice Monitoring Program (PMP), ACRA directly reviews audit firms that audit public interest entities (PIEs), and the Institute of Certified Public Accountants of Singapore (ICPAS) reviews firms that look at non-PIEs. The average inspection cycle is two years for the Big Four audit firms, three to four years for firms that audit PIEs, and four to five years for firms that do not audit PIEs.
Thailand		
Securities and Exchange Commission (SEC) **Securities and Exchange Act (1992), last amended 2008**	All accountants and auditors must be Federation of Accounting Professions (FAP) members and all audit firms must register with the FAP. The Securities and Exchange Commission (SEC) must approve the auditors of listed companies, securities issuers and other market intermediaries (SEC-regulated entities). The FAP's Quality Screening Committee reviews the auditors of SEC-regulated entities prior to SEC approval. The auditors of financial institutions must also receive BOT approval.	Thailand divides the responsibilities for audit quality inspections between its audit oversight body and professional accounting association, largely based on whether the company is listed. The FAP is responsible for reviewing auditors' work quality. The SEC inspects audit firms for reliable quality assurance systems, and approved auditors must be part of the approved audit firms. The inspection cycle is every year for the Big Four firms and at least every three years for small and medium audit firms. While these measures were issued in September 2010 and will take full effect as of January 2013, the SEC began the inspections as of October 2010.

Table 2: Audit Oversight Requirements

Audit Oversight Requirements		
Auditor Independence: Auditor Rotation	**Auditor Independence: Non-Audit Services**	**Auditor's Attestation on Internal Controls**
United States of America		
Every five years for lead and concurring partners and a five-year time-out period; for other significant audit partners a seven-year rotation period and a two-year time-out period. Seeking proposal on mandatory rotation of audit firms.	Section 201 prohibits audit firms from providing nine non-audit services, and allows the provision of other non-audit services, including tax services, with the approval of the company's audit committee.	Section 404 requires public companies to report on the responsibilities of management for establishing and maintaining adequate internal controls over the company's financial reporting process, as well as management's assessments of the effectiveness of those controls. The company's external auditor then opines on the effectiveness of the internal controls over financial reporting as part of the external audit.
Japan		
Under the Amended CPA Act, engagement audit partners must rotate every seven years with a two year time-out period. Large audit firms that audit 100 or more listed companies in Japan have a five-year rotation rule with a five-year time-out period for the lead engagement partners and engagement quality control review partners.	Article 34-11 of the Amended CPA Act prohibits audit firms, auditors, and spouses of auditors from providing non-audit services related to the company's financial documents. A supplemental Cabinet Ordinance lists eight prohibited non-audit services, which also includes investment advisory services.	On March 30, 2011, the FSA's Business Accounting Council released standards on the "Management Assessment and Audit concerning Internal Control over Financial Reporting," which requires external auditors to release an "Audit Report on Internal Control Assessment." These standards are effective as of April 1, 2011.
Malaysia		
Under MIA By-Laws on Professional Ethics, Conduct and Practice (MIA By-Laws), the key audit partner must rotate every seven years. For public interest entities, the rotation period is five years and the time-out period is two years. For banks, Bank Negara requires a five-year rotation period and a five-year time-out period for the engagement partner.	Article B-1.4 of the MIA By-Laws prohibits audit firms and auditors from providing certain non-audit services that would be a significant threat to auditor independence, integrity or objectiveness. The article lists seven categories of prohibited non-audit service. Notably, the last category is a quantitative criterion under which the nonaudit fees may not be 20 percent or more of the audit firm's total annual fees for two or more consecutive periods or an individual auditor's revenue.	Auditor's opinion refers to but does not attest for the company's internal control.
Singapore		
For listed companies, SGX requires a five-year rotation period and two-year time-out period for the audit engagement partner. Singapore's *Statement of Auditing Practice 25 on the Audit of Listed Companies* also reiterates the five-year rotation period for the auditor-in-charge, but does not mention the time-out period. Furthermore, the ACRA *Code of Professional Conduct and Ethics* (ACRA Code of Ethics) provides for a rotation period of "normally no more than seven years" and a subsequent two-year timeout period for listed companies. For banks, MAS requires a five-year rotation period and a five-year time-out period of the audit firm.	Section 290 of ACRA's Code of Ethics allows for the provision of non-audit services if its threat to auditor independence is at an "acceptable" level. It describes potential threats to and safeguards for independence.	Auditor's opinion refers to but does not attest for the company's internal control
Thailand		
The SEC and BOT require the auditor who signs the audit opinion to rotate every five years for listed companies and banks, respectively.	Thai SEC *Notification Kor Jor 16/2548* requires companies to disclose the audit fees and nonaudit services fees paid to auditors.	None

6.3 Oversight of Accountancy Profession in Bangladesh

Soon after the impendence country in 1971 from the Pakistani rulers accountancy profession started its journey with the former 77 members of Pakistan Institute Chartered Accountants located in the newly created Bangladesh through passing an ordinance. Accountancy profession worked under an environment where 92% of industrial assets were nationalized. The professional accountants took lead in taking over of industrial and financial service conglomerates abandoned by the Pakistani owners. The Government of Bangladesh was the main service receiver from the professional accountants when country was running to implement the socialist economic agenda. Stock Exchange located in Dhaka was not in operation up to 1976 until starting of financial deregulation and denationalization. Changing economic philosophy from command to market started grounding in Bangladesh. Liberalization of import and export, foreign exchange, and right of ownership took place and the country exposed to international market when Dhaka Stock Exchange started operation, restriction on foreign investment in stock market was withdrawn and the accountancy profession exposed to international and national investors including the government. As a critical component of market economy accountancy profession started playing role. Professional Accounting bodies became member of IFAC,IASB and Regional bodies and adopted International Accounting Standards (IAS/IFRS) and International Standards on Auditing (ISA).

Soon after the independence Bangladesh became a hot destination for the international donors and funding agencies and subsequently the UNDP, World Bank, Asian Development Bank and International Monetary Fund took interest in accountancy profession. Several studies taken place on the structure and functioning and development of the profession by the development partners. Bangladeshi researchers undertaken PhD research on the Accounting and Financial Reporting in the in foreign universities of UK, USA, Australia, Canada, NewZealand, India and in many other countries. All these research studies and reports identified problems of accountancy profession. In particular, structural problems relating the Institute of Chartered Accountants of Bangladesh (ICAB), practicing CA firms with regards to corporate governance, code of ethics, Independence, disciplinary process and the quality of financial reporting including corporate financial disclosures are widely criticized by the stakeholders and regulators. All these reports suggested for oversight on the accountancy profession since the country is fast moving towards marker economy considering private sector as the engine for growth. The latest one was produced by the World Bank through ROSC. This report came with specific suggestion in the post Enron Era similar line following creation of Public Company Accounting Oversight Board of USA under the Sarbese-Ouxly Act. In Bangladesh, the name of the Act is proposed as Financial Reporting Act (FRA) under which Financial Reporting Council (FRC) would be enacted and established to oversight the Accountancy Profession of Bangladesh. Regulators like central bank, Securities and Exchange Commission, stock exchanges, bankers association, FBCCI, MCCI, DCCI and other trade bodies like Association Listed Companies are supporting the oversight of accountancy profession in line with the developments taken place internationally.

Arguments put forward in favor of Financial Reporting Act and the proposed Financial Reporting Council under the proposed act is that the ICAB and ICMAB are operated through elected body voted by the members. This is a conflicting situation as compared to the separation of management from the owners in public companies. In the corporate World there is a line of separation from management and the Board, however, the accountancy profession of Bangladesh is operated by the elected body and management is not separated. The council members seek votes from the members and after election they rule them. Those who voted against the elected members they suffer by the winning council members. Like the members of stock exchange in pre-demutualization era. In the Stock Exchanges, elected members used to sit at committees like, listing, surveillance, Board, and doing brokerage and working as IPO managers including consulting on valuation of IPO of listed companies. The ICAB council members sit at committees like Executive Committee, Examination Committee, disciplinary, ethics and independence, and award committee on evaluation of financial reports. There is widespread criticism on the state of transparency, governance, and accountability of the Institute of Chartered Accountants of Bangladesh and practicing accounting firms. History provides ample evidence that when regulatory institutions run by elected body it cannot perform efficiently and miserably fails in dealing with conflicting situation and right handling with the independence and maintain profession ethics and ultimately lead to moral hazards. At the end of the day those who are engaged in such profession became greedy and did anything they wish to do.

There exists evidence that large number of partners of public accounting firms is engaged actively in the ownership of Brokerage Companies in the Stock Exchanges, conduct tax practice in the prevailing corrupt environment of revenue department of Bangladesh. Many practicing partners public accounting served as Board members of the clients and used their transport logistics. In case of foreign clients they use international travel facilities and other logistics including the local clients.

Taking disciplinary action against those who are involved in violation of code of ethics, principles of independence, certification of false financials (one for bank, one for tax and regulators and other unprofessional actions) is not politically feasible by the elected council (vote seekers). Consequently, like other institutions, ICAB as professional body has failed to establish regulatory norms within its members. Most of the practicing members are involved in share business which is restricted in other market economy countries as they are treated as insider having access to confidential and price sensitive information. In the recent time many CA firms as auditors have merchant bank and member of brokerage firm which is their important window of revenue. These are the few of the of the justifications for establishing a oversight institution over the public accounting profession.

There is a competitive bidding who becomes the Chairman of Award for Best Financial Reporting Evaluation Committee on annual basis. There is a rumor that in the market that listed companies remains busy to make happy Chairman and Committee members of ICAB and ICMAB. Listed companies perceive that with high marking market value of their share will increase. Critics argue that this is unethical and market sensitive. Partners of public accounting firms lobby to enter in this committee to help their audit client getting higher score. In the context of price sensitive information the BSEC need to interfere against all these unethical activities that can adversely affect the general investors of Bangladesh.

Big international public accounting firms Deloitte, Ernst & Young, KPMG, PWC and StephenMoore started their creating liaison with Bangladeshi public accounting firms in different nomenclature followed in line with their own culture. However, out of current big four, only KPMG has their member firm in Bangladesh with 3 partners and other 3 do not have their relationship with Bangladesh local firms. In the recent time Grant Thronton and BDO is known to establish their practice with the Bangladeshi local firms.

All these information on the current state of public accounting profession justifies the creation of an independent authority to have oversight for establishing transparency governance to promote generation of reliable financial report.

Section VII: Summary and Recommendations

This paper dealt with public accountancy (audit) profession. This paper reviewed literature how public accountancy emerged as a highly prestigious profession and positioned itself as one of the critical component of market economy. As a self regulatory body of public accountancy profession it gained social respect being respectful and compliant to their own prescribed code of ethics, independence and by gaining professional skill and competence. Public accountancy played its role differently compared to Government Accounting, education accountancy, and non-Government accountancy. Governments provided legal and institutional support for creation of professional accountancy bodies through rules and acts with economic growth under different development models at the time of money being used by the Government as well as in private sector. Public accountancy profession played crucial role in establishing oversight by reporting to stakeholders which is very significant for the investors.

The paper presented a chronology on the state of oversight on the public accounting profession. Initially, the oversight of audit firms was self regulatory meaning the institutes elected council used to regulate their Public Accounting Practicing firm based on certain principles like Stock Exchanges in pre-demutualization period. In the post II world war period USA become the engine of capitalist development and Public Accounting profession positioned as the critical component of market economy. Financials of listed companies, public entities, banks and financial institutions and other components financial, capital and bond markets are certified by the public accountants. The paper dealt with public accountancy (audit) profession. Literature review reveals how public accountancy emerged as a highly prestigious profession and positioned itself as one of the critical component of market economy. Public accountancy profession played crucial role in establishing oversight by reporting to stakeholders which is very significant for the investors. Summary of this paper is documented in the following.

1. **Failure of Public Accounting Profession**: Public accounting profession in delivering required due diligence with regards to ethics, independence, dealing with conflicts of interest, maximization of personal greed and lacking core professional competence, has proven failed to protect public interest. Consequently, social confidence and public perception regarding their integrity decreased. After every incidence of share market crash, economic recession, financial scandals, the public accountancy came under scrutiny. These events put a dent mark on the self regulatory right of the profession. The era of self regulation started getting reduced and oversight on the public accounting profession got upper hand.

2. **Whistle blow from the USA**: The USA being the engine of capitalist development after World War II, took the lead on the oversight of public accountancy profession compared to their English counterpart which once was considered as the nucleus of public accounting profession. The Securities and Exchange Commission (SEC), Senate Committee, Politicians & Policy makers, Public interest groups raised their concern and started chalking out regulation for oversight of public accountancy profession. Rules and procedures were developed for compliance to deal with the accounting and auditing standard setting, principles of corporate governance, ethics and independence, conflict of interest, separation of statutory audit service from consulting services on tax, human resources, ICT and other areas. The public accounting profession gradually lost their image and prestige.

3. **Role of Big Accounting Firms:** The big public accounting firms started influencing major government policy decision including framing laws to serve their interest just like syndicate in capturing business. They influence in Accounting and Auditing Standards, fiscal and commercial codes in favor of their clients jeopardizing public interest. Perception is that public profession as institutional body and firm negotiate with government and policy makers in favor of their clients but not in the public interest. Evidence from Bangladesh company law 1994 can be seen that the big public accounting firms (in disguise) influenced to keep a provision putting a restriction on change of auditors protected big accounting firms from losing their big multi-national private companies which is a violation of constitutional rights of citizens. For example since creation of KFCO in 1982 the audit firm was not change as of today the same also applies to Lever Brothers of Bangladesh. Foreign banks also falls in such category still the foreign banks and MNCs use the same technique in a different way by appointing a dummy auditor they keep their old ally audit firms in different capacity. Critics claim that public accounting firms in Bangladesh could not attract the international firms affiliation. For experimental basis, few have been associated, however they (PWC, Ernest &Young and Deloitte) left witnessing bitter experience of bad corporate governance within their associate firms regarding disputes on fake partnership deed, partners' involvement in share brokerage business, certification of false financials, keeping the firm within family limit to keep fake financials of the firm.

4. **Accounting Scandals:** Series of accounting scandals took place in different parts of the world including Bangladesh. These scandals resulted in huge loss to the economy and lead to the recession. Issuing of false financials with underground support of public accounting firms, the record of Bangladesh is proven more black after the share market crash (2010), and Banking Scams. Politicians and other policy makers became alert after each scandal and shocks routed from *excessive greed and growth at any cost syndrome*, increasing trend in violation of self regulatory code of conduct spread among public accounting firms. Allegation began to surface that fierce competition among firms for clients became more intense and vicious. Critics claim how big or small of the firm does not matter, for winning client, Bangladeshi firms started paying bribe to the clients to win audit assignments at higher figure than professional service fees.

5. **Taking over of standard setting to independent body:** In the public interest, the policy makers took initiative for oversight of public accounting profession from principle based to rule base by creating independent regulator like public oversight Board in USA. The standard setting process was taken over by separate independent body to monitor the public accounting practitioner.

6. **Professional accounting bodies under Gun:** Reform of the professional accounting bodies took place under gun from the regulators of market and the USA took lead. Attack congress and public representative became more and more fierce in case of more accounting scandals and audit failures.

7. **Conflict of interest and separation of statutory audit and other professional services** : Restriction are imposed as the public accounting firms with regards to statutory audit tax, consulting, system design, ICT, Human Resources and any other consulting services, employment of relatives and former employees of the auditor firm in the client companies. The SOX has sharpen this separation to get rid of conflicting situation. The SOX requires the auditor of subsidiary companies outside USA to enlist in the Stock exchange in the jurisdiction where the parent company is located. For example auditor of Bangladesh subsidiary of a foreign parent company listed in the US stock exchange need to meet eligibility criterion of PCAOB prescribed rules of that stock exchange.

8. **Impact of SOX on the public accounting profession:**. SOX and PCAOB has changed the land scope of public account profession. Conflicts of interest, partner rotation, employment of

relatives, separation of audit consulting and taxation services including any other consulting services have been prohibited starting from USA all other market economy countries have followed and others are set to follow the process of creation of oversight bodies to oversee and control professional accounting bodies solely run by the elected council members. The public accounting firms earlier considered the watch dog on management of publicly listed and public interest entities from the stakeholder side and the Government are now surveillance by another watch dog in different name in different countries. The self regulatory regime of public accounting profession is shifted to oversight bodies under the defined professional code of conduct, conflict of interest regulation, firewall between audit and non-audit services. In accepting audit assignments the audit firm partners are to be careful whether they have any share holding in such client, in case of bank audit the auditor cannot be a borrower of that bank, auditor cannot be a director of stock brokerage firm, merchant bank including his family members and partners. Like the BSEC, central bank, insurance regulator, BTRC and other regulator including Proposed Financial Reporting Council in Bangladesh shall do surveillance on the ICAB and ICMAB like other country practice.

9. **Legal challenge of creating oversight body**: In many countries creation of watch dog for the watch dogs was challenged in the court by the public accounting firms which was denied by the highest court of the country. For example, Free Enterprise Foundation challenged the formation the formation of Public Accounting Oversight Board in the USA but the Supreme Court awarded verdict against this challenge. This rejection by the Supreme Court has become a demoralizing case reference to countries where public accounting firms were preparing for legal action against the proposed oversight bodies to oversight public accounting profession.
10. **Updates on institutionalization of oversight bodies:** Obviously, USA took the lead in post Enron collapse and demise of Arthur Anderson, one of the mighty big five. After enactment of SOX and establishment of PCAOB which is now doing surveillance on the public accounting firms and profession in parallel to Securities and Exchange Commission. Most of the West European Countries including Scandinavian countries made quick response to such change countries of East Asia. The Mediterranean and European countries also responded to the establishment of oversight body for watching watch dogs of public accounting profession. In South Asian region, Bangladesh is going to be the first country to respond to the call for watching the watch dogs of public accounting profession. This is going to happen (although late) by accepting the draft bill on Financial Reporting Act and establishing the Financial Reporting Council.

Recommendations:

1. **Implementation of Financial Reporting Act and Financial Reporting Council:** Government of Bangladesh should form a task force stipulating time limit to make rules and regulation i.e. Standard Operating Procedure and rules of business to function and activate Financial Reporting Act and Financial Reporting Council without any further delay to stop harmful routes damaging for operation of efficient financial and capital market.
2. **No objection on auditor appointment:** BSEC, Central Bank and relevant regulators before issuing of no objection certificates to the appointment of public accounting firms as auditors mandatorily take a declaration in appropriate form that partner of audit firm (or his close relative as defined by central bank in case bank director) his shareholding in the listed entities, borrowings, directorship (sponsor or nominated). Original copy of the partnership deed of the firm certified by the ICAB need be submitted.
3. **Separate auditor for Statutory, Branch and Incentive Audit**: In case of Bank audit, statutory auditors should not be allowed to audit the Export Incentives Audit. Appoint separate auditor to audit bank branches. Specific Terms of Reference for Statutory Audit and Export Incentive

Audit need to be drawn recommended by the audit committee, approve by the Board and then forward to the central bank for information.

4. **Standard Methodology for Evaluation of Public Accounting Firms:** Central Bank, BSEC and other regulators must work out methodology for evaluating the institutional, intellectual, ICT and logistical capacity of public accounting firms counting also audit failures on yearly basis to determine who can handle what volume of clients. Currently central bank has a three year term while SEC and other regulators do not have such practice. The partnership deed (registered with RJSC) of public accounting firms is like that of memorandum and articles of association of public and private limited companies should be submitted to the Bangladesh Bank for scrutiny by the bank for transparency. This would give indication to who can do what.
5. **Signing the Audit Report:** Critics argue that currently audit report is signed in the name of firms which is ridicules and not acceptable and creates confusion in terms of legality. There is ample scope for forgery of signature. There is a requirement that signing partner must put his name below which is not followed in most reports. To have a check on this kind of forgery the ICAB on issuing of practicing license to a public accountant should preserve specimen signature card mandatorily like bank keeps their customers specimen signature. The regulators should also maintain specimen signature of public accounting firms specimen signature to stop forgery in audit report signing. There are many instances that audit repots are signed by the manager, articled students which clients can not detect, however, as per mandate, the audit report can only be signed by a partner.
6. **Limit on Bank audit and listed entity**: Critics argue that there should be maximum limit for audit of complex and economically sensitive clients like Banks FIs and list companies in particular year. There is say, a public accounting firm accepts assignment beyond their capacity and at end they cannot deliver the reliable and quality service and depending on less/inexperienced staff. The central bank, BSEC and other regulators can establish monitoring process over the issue to reduce the possible scam. Critics also argue that currently more than 90% of the listed companies are audited by those public accounting firms who do not possess the institutional capacity.

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The precise definition and composition of public interest entities (PIEs) varies across economies. Conceptually, a PIE is an entity of significant interest to the public because of its size, business nature, and range of stakeholders. Listed companies typically fall under the classification as a PIE.

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