The Sarbanes-Oxley Act of 2002: An Analysis of and Comments on the Accounting-Related Provisions

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This paper reviews the most significant aspects of several accounting provisions (Titles I, II, III, and X) of the Sarbanes-Oxley Act of 2002, discusses some of their underlying rationale, and reflects on what appear to be some potential pitfalls in the Act or its enforcement. Finally, the ability of the Act to accomplish its goals is addressed.

INTRODUCTION

Lack of independence. Subversion of professional responsibilities. Financial irregularities. These phrases have, unfortunately, become common in today's business climate—so common, in fact, that the United States government could no longer sit idly by and listen to public outcries. It was time for an overt and decisive response to pressures for legislation addressing the wide-spread and financially devastating business scandals that had taken place in the preceding twelve-to-eighteen months: Enron, Global Crossing, Tyco, Adelphia, and WorldCom, to name just a few. After a gathering storm of momentum, Congress passed the Sarbanes-Oxley Act (SOX or the "Act") to address accounting reform, improve corporate governance, and restore investor confidence. The Act was signed into law by President George W. Bush on July 30, 2002.

The Sarbanes-Oxley Act is named for Senator Paul Sarbanes (D., Maryland) and Representative Michael Oxley (R., Ohio). This Act is probably the most monumental piece of legislation to impact corporations, their executives, and their independent auditors since the Securities and Exchange Act of 1937.

Sarbanes-Oxley has eleven specific provisions or titles (Table 1). However, for purposes of this paper, only the four starred sections (Titles I, II, III, and X) are discussed because of their direct relevance to the accounting profession. Although the section on financial disclosures with an emphasis on special purpose entities (SPEs) is also accounting-related, a discussion of SPEs is beyond the scope of this paper.

TITLE I: PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

The Public Company Accounting Oversight Board (PCAOB or "Board") has replaced the recently disbanded (March 31, 2002) Public Oversight Board, a regulatory body that was funded by public accounting firms. The PCAOB is a full-time, independent, nongovernmental, not-for-profit body that will oversee the audit function for public companies that are subject to securities laws. To fund its start-up, the Board received a $1.9 million loan from the Treasury Department in 2002. Primary funding for the PCAOB will be provided by assessing a mandatory fee on publicly-held companies, mutual funds, and public accounting firms.

TABLE 1
Titles of the Sarbanes-Oxley Act of 2002

Provision	Section Heading
Title I	Public Company Accounting Oversight Board*
Title II	Auditor Independence*
Title III	Corporate Responsibility*
Title IV	Enhanced Financial Disclosures
Title V	Analyst Conflict of Interest
Title VI	Commission Resources and Authority
Title VII	Studies and Reports
Title VIII	Corporate and Criminal Fraud Accountability
Title IX	White-Collar Crime Penalty Enhancements
Title X	Corporate Tax Returns*
Title XI	Corporate Fraud and Accountability

Fees can be assessed and collected from companies having an average monthly market capitalization of more than $25 million and on mutual funds having a net asset value of more than $250 million. It is estimated that approximately 87 percent of the Board's funding will be provided by corporations and the maximum annual corporate fee will be approximately $1.3 million (Burns, 2003) and the largest fee for accounting firms is $390,000 (Norris, 2003).

The Board is to be comprised of five people (two practicing or non-practicing Certified Public Accountants (CPAs) and three non-CPAs who understand financial statements, financial reporting, and audit responsibilities). Appointments will be made by the Securities and Exchange Commission (SEC) in consultation with the Federal Reserve Chairman and Treasury Secretary. Board members cannot hold other positions nor receive any payments, except for retirement benefits, from public accounting firms.

Constitution of the Board was shaky from the start. First, the annual salary levels for board personnel ($556,000 for the chairman and $452,000 for board members) was hotly debated, given that the President of the United States is paid only $400,000; however, approval for the salaries was finally gained. Second, finding a chairman for the Board created additional difficulties. The first person selected for that position was former Federal Bureau of Investigation Director William Webster, who resigned quickly because of "a flap over his watchdog role at a company now facing fraud accusations" (Gordon, 2003). Webster's resignation required the appointment of Charles Niemeier as acting chairman. In April 2003, the SEC chose William McDonough, chief executive and president of the Federal Reserve Bank of New York to head the Board; Mr. McDonough was confirmed in June 2003. The remaining members of the newly constituted Board are Daniel Goelzer (term to expire in 2006), Kayla Gillan (2005), Willis Gradison, Jr. (2004), and Charles Niemeier (2003).

The SOX requirements for PCAOB registration seem to be having an impact on the availability of public accounting firms that want to audit publicly-held companies, making some people, including Senator Paul Sarbanes, wonder about the "increasing concentration" of the audit "industry" (Solomon, 2003). As of the end of August 2003, fewer than 90 of the 850-plus firms that performed public company audits for the prior year had registered (*CPA Firms*, 2003). Although the deadline for U.S. public accounting firms is October 22, 2003, there is an approximate 45-day review period for the registrations. Additionally, once a firm registers with the PCAOB, withdrawal from the practice of public company auditing may not be necessarily a quick and easy task: under a proposal made in July 2003, "accounting firms facing disciplinary action will be automatically barred from discontinuing registration with the Board ... [which] will have authority to delay other requests for registration withdrawal by as much as two years" (Rankin, 2003).

The PCAOB may be viewed by some as the savior of financial reporting and terminator of corporate fraud; others may view this body as the guardian of government interference and the annihilator of the auditing profession. One of the most important duties for the Board is the establishment of standards for auditing and related attestation, quality control, ethics, and independence standards to be used by public accounting firms that prepare and issue audit reports for SEC companies. In determining these standards, the Board may adopt auditing or other professional standards that have been issued or proposed by certain "designated" or "recognized" professional groups of accountants. The wording in the Act indicates that the Board could wholesale adopt, amend, or reject pronouncements such as the current American Institute of Certified Public Accountant (AICPA) Statements on Auditing Standards. It would seem likely that it would not behoove the Board to take a "start from scratch" attitude—but given the apparent failures in recent audits, there are likely to be some new recipes for audit preparation and implementation. However, at a public meeting on April 16, 2003, Board members "voted to take control of the auditing and other professional standard setting processes, effectively ending the 60-plus year era of self-regulation of the profession" (*Era of* ..., 2003).

Given the Arthur Andersen LLP paper-shredding situation that occurred in the Enron Corporation case, it is no surprise that retention of audit work papers is specifically mentioned in the Act. Partially in response to the Enron fiasco, the Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 96, Audit Documentation, in January 2002. This SAS replaced SAS No. 41, but retained that statement's record retention policy: audit documents should be kept long enough to meet the firm's needs and "to satisfy any legal or regulatory requirements of record retention" (ASB, 2002). It appears, however, that SAS No. 96 did not provide substantial enough guidance. Under Sarbanes-Oxley, public accounting firms are mandated to "prepare, and maintain for a period of not less than 7 years, audit work papers, and other information related to any audit report, in sufficient detail to support the conclusions reached in such report" (Congress, Sec. 103(a)(2)(A)(i)). Section 802 of the Act discusses penalties for destruction of corporate audit records.

While this retention mandate appears reasonable on the surface, there are at least two potential underlying difficulties. First, who makes the determination of what documentation should be retained? This decision has generally been under the purview of the partner in charge of the engagement; when items are questionable, engagement partners typically

utilize the extensive consultation networks that exist in their firms. Possibly, document decisions of a "keep or kill" nature will need to be made by the audit engagement partner in conjunction with the concurring partner or independent reviewer who is required to be part of the audit process under the Act. If the parties agree on the relevance of a document, it would seem obvious that the document would be retained. However, if both parties agree to destroy documentation because it does not appear to be essential to support the audit opinion, will the engagement partner be more liable than the reviewing partner in the event that the documentation is requested in the event of an investigation? Or will the reviewing partner be more liable because of the oversight role?

Second, when is second-guessing allowed as to the propriety of the decision to destroy documents? Most auditing firms have document retention (or, depending on the viewpoint, document destruction) policies in place. Such policies, as well as basic common sense, would recognize that shredding documentation after an investigation has begun would be construed, at a minimum, as an audit flaw; at maximum, shredding has been legally designated as an obstruction of justice. But, in the general process of performing an audit engagement, the idea of retaining all drafts, e-mail, or staff review notes seems both impractical and overly burdensome. What might originally have been prepared as an innocent comment or question could, under this "pack-rat provision," become a smoking gun in the eyes of the courts. Will *all* supporting documentation of *every* audit engagement need to be retained for seven years because there *may* be a possibility that a court case could ensue? Or will the probable, reasonably possible, and remote designations of the Financial Accounting Standards Board SFAS No. 5 on Accounting for Contingencies apply—although those designations certainly never would be considered to have conclusive and incontrovertible definitions? Additionally, there is an issue of who will bear the costs for storing and retrieving the documents or their electronic counterparts. Although approximately 95 percent of information in organizations is currently electronic in nature, electronic storage "creates its own headaches: as operating systems and other technologies evolve, there is no guarantee that records stored electronically will be able to be read in the future" (Violino, 2003).

The issue of document retention/destruction has already reached the legal battlefield. The first case of obstruction of justice prosecution based on the document destruction provisions of SOX occurred in September 2003 when federal agents arrested a former Ernst & Young audit partner for allegedly destroying audit work papers related to the NextCard, Inc., audit engagement (Bryan-Low & Weil, 2003); the outcome of this case remains to be seen at the time of this writing.

Under the Act, the audit report must describe the scope of testing performed on the client's internal control structure and procedures. The audit report, or a supplemental report, is required to (1) describe the findings from the tests, (2) evaluate whether the internal controls would provide reasonable assurance that transactions are properly recorded and are made with management authorization, and (3) describe any material weaknesses in the internal control system. This provision likely stems from the numerous instances in the recent business scandals of improper accounting, especially for revenues (such as Dynegy's illusory swap trades) and expenses (such as WorldCom's capitalization of current expenses). It is likely that these disclosure requirements will generally be included in a separate report because of the potential length of the discussion and be the cause of substantially greater compliance

and substantive testing by the auditor. The potential impact of this provision is difficult to assess, however, given that the PCAOB "has yet to issue standards regarding how many controls must be tested, in what manner, and according to what criteria" (Nyberg, 2003b).

It will be interesting to assess how, or whether, this provision creates a radically different audit process than that which currently exists—especially as it changed after the issuances in the 1970s of the "books and records" provision of the Foreign Corrupt Practices Act of 1977 (FCPA). At what point will the auditing firm be able to have finished its internal control tests and *not* be liable if, at some future time, it is found that one or more individuals at the client company did "knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account" (FCPA, 1977)?

Lastly, under this provision of Sarbanes-Oxley, the Board is mandated to conduct inspections of public accounting firms and their personnel to assess compliance with the provisions of the Act. The frequency of the inspections depends on the number of publicly-held company audits that are conducted by the firm. The Act, however, does not indicate in what depth the reviews are to take place—will "spot checks" or superficial, cursory reviews meet the letter (or the spirit) of the Act? If violations are found during these inspections, the Board can require testimony by audit firm members and production of audit documentation as well as institute remedial sanctions or disciplinary actions, including suspension or revocation of practice and civil monetary penalties. At least the first of these requirements was possibly driven by the reluctance of Arthur Andersen LLP personnel to testify about audit engagement activities.

AUDITOR INDEPENDENCE

The second accounting-related element in Sarbanes-Oxley places major restrictions on public accounting firms' ability to engage in certain types of services, two of which have become main-stream activities for most large firms: (1) financial information systems design and implementation and (2) internal audit outsourcing. An exception exists if the total amount of non-audit services is less than five percent of the annual revenues obtained from a client firm. The presumption underlying an external audit is that the auditing firm is independent from the client. This presumption may be weakened (or destroyed) if the firm is auditing an accounting or internal control system designed by its own personnel or developing external audit tests and procedures after relying on internal audit activities that were performed by its own personnel—regardless of the fact that consulting, internal audit, and external audit divisions may not be commingled in an office or a firm.

The independence element contained in Sarbanes-Oxley is not a new issue. As early as the 1950s, management consulting services were being addressed in professional literature. In 1957, a *Journal of Accountancy* article included the following comment: "On the question of maintaining independence and auditing work for a client who regularly seeks the accountant's advice upon management problems or for whom various other management services are rendered, it is probable that all doubts as to complete independence cannot be avoided" (Mednick & Previts, 1987). However, as consulting became a more and more important primary revenue generator for the large public accounting firms, the following quote seemed to encompass the auditing industry's attitude:

> The SEC appears concerned about the potential lack of independence created by large consulting and internal audit relationships at audit clients. Apparently, the Commission believes the pure audit model would best serve the public interest. We do not believe there is any evidence that these relationships create actual independence conflicts. ... While the SEC may be genuinely trying to improve the audit process, in my view, they currently look confused and are taking a very simplistic approach to the independence issue. Unless it wants a legacy of destroying the best financial reporting, financial watchdog and capital formation system in the history of the planet, they need to step back and seriously assess long-term ramifications of their actions and opinions (Emerson, 2000).

The eyes examining this conflict of interest became more near-sighted and focused on the issue of independence in fact rather than the public's view of independence in appearance. In 2000, Enron reported paying Andersen $25 million for audit services and $27 million for non-audit work; a review of filings for 25 of the 30 companies comprising the Dow Jones Industrial Average indicated that their auditing firms were paid "2.73 times as much for non-audit services as they did for audit services" (Editorial Staff, 2002). After reviewing the audit-to-non-audit service fee disclosures (or proxy fee multiples) of reporting companies, then-Acting SEC Chairman Laura Unger pondered whether the auditor who is supposed to be the corporate watchdog could really be "in a situation to bark should the company attempt to steal some biscuits" (Editorial Staff, 2001). In hindsight, it sometimes seems that accounting firms' near-sightedness about independence issues looks more like total blindness.

On the other hand, the ratios being bandied about concerning the proportion of audit fees to non-audit fees may be slightly askew. Based on the SEC fee disclosure requirements, many client charges for items that will, in fact, find their way to the financial statements (such as accounting research performed to support the handling of a complicated tax issue) are currently classified as non-audit charges. Possibly, if the SEC classification standards were revisited and amended, the ratios might not look so disproportionate and a more meaningful and accurate calculation of audit fees would be determinable.

Additionally, it must be noted that non-audit work for audit clients should not necessarily be presumed to be inappropriate. Some non-audit services may, in fact, be invaluable in helping the auditing firm obtain a better understanding of the client than could be gained from simply performing a periodic audit. Such services may dramatically improve the auditors' ability to exercise professional judgment in performing audit. It is essential that auditing firms be able to continue to provide non-audit services that enhance audit preparation and performance as well as provide value to client management, while excising non-audit services that could impair independence in fact or in appearance. For example, tax services have been pointed to as generally being "appropriate" non-audit services as long as these services are approved by the company's audit committee; tax services (including tax planning activities) can assist in the audit process in the determination of the reasonableness of interperiod tax allocations and the recognition of deferred tax assets and liabilities.

A second major item under the independence provision is that the partner in charge of an audit engagement must be rotated every five years. This rotation provision is unsurprising, given one Enron juror's comment that "There was a lack of auditor independence. David

Duncan, we believe, got too close to Enron" (Weil, Barrionuevo, & Bryan-Low, 2002). Such a rotation process will, however, be costly. There will definitely be a learning curve as new partners take over engagements with which they have no familiarity. In case partner rotation may not be sufficient to inhibit fraternization with clients, the Comptroller General of the United States has one year from the enactment of Sarbanes-Oxley to study and report on the possible implications of requiring mandatory auditing firm rotations. Even if mandatory rotation is not required, some companies are beginning to think that it is a good idea. For example, in April 2003, Intel's audit committee indicated that it would consider changing auditors regularly in order to obtain "a fresh look" at its financial accounting and internal controls and would also "consider the advisability and ramifications of a formal rotation policy" (Hill, 2003).

The final important item in the independence title of the Act is a "red-shirt" provision. An auditing firm is barred from doing any audit work for a client if that client has hired, in an executive-level position (i.e., CEO, controller, CFO, or chief accounting officer), a member of the auditing firm who worked on the client's audit within the past year. This provision recognizes that audit firm alumni bring to their new positions substantial knowledge of how the audit engagement is planned and implemented, including details of audit testing that could be used to circumvent the audit process. This prohibition severely impacts the often-lauded aspect of working for a public accounting firm: the ability to move into client operations in high-level positions. A valid example of why such a provision might be seen as necessary is that, until 1997, every CFO and chief accounting officer in Waste Management's history had previously worked as an auditor at Arthur Andersen. The accounting fraud at Waste Management revealed "exaggerated" earnings of $1.4 billion from 1992-1997, causing investors to lose approximately $26 billion (Levitt, 2002).

CORPORATE RESPONSIBILITY

One provision in this title of the Act requires that each publicly-held company have an audit committee, comprised of a majority of independent members, which will be responsible for appointing, compensating, and overseeing the work of the company's public accounting firm (Congress, Sec. 301). In theory, the idea of an independent and responsible audit committee is commendable. In practice, it may be difficult to achieve because the rash of corporate problems have caused "regulators, legislators, and litigious investors [to blame] directors for letting so much slip by" (Thornton & Lavelle, 2002). Prior to the passage of Sarbanes-Oxley, a McKinsey & Co. survey of 200 directors sitting on a total of 500 boards indicated that one-fourth either refused a new board seat or quit because of liability issues (Thornton & Lavelle, 2002). Since the Act, an executive recruiter has estimated that "90% of director candidates are turning down invitations to sit on boards" (Dunham, 2002). If the prestige of a board seat is not enough to entice outsiders to help manage a company, why would they now be willing to accept a position on the audit committee and be held responsible for the one entity (the public accounting firm) that has been considered, at least in part, the enabler of the majority of corporate evils that have occurred recently?

Additionally, this title of the Act contains the "Boy Scout oath" requirement for CEOs and CFOs. Certifications must be made periodically that each quarterly or annual report issued is truthful, does not omit any material facts, and *based on the officer's knowledge*, fairly

represents all significant aspects of the company's financial condition and results of operations for that reporting period. The italics were added in the last sentence because, in the event of misstatements in the future, it is important to note that finding an executive guilty of making a false certification rests with proving what he or she had knowledge of and when that knowledge arose. If executives certify the information knowing that it is false, they face fines under Section 906 of Sarbanes-Oxley of as much as $5 million or imprisonment for as long as 20 years, or both. There seems to be a definite potential for corporate executives to adopt the military "don't ask, don't tell" rule as well as "if you don't tell, I can't either."

Certifications were first required under a June 27, 2002, SEC order directed at firms with annual revenues of $1.2 billion or more (SEC, 2002a). Statements by top executives at about 700 of 950 firms with annual revenues of $1.2 billion or more were due August 14, 2002, because those companies had calendar year-ends. The certifications can be viewed at the SEC web site (www.sec.gov) under the "CEO, CFO certifications" tag-line. These one-time oaths are not part of the Sarbanes-Oxley Act. The Act makes the filing of certifications mandatory for all SEC-registered companies, domestic and foreign, as well as mutual funds (Schroeder, 2002). Executives who were unable to meet the certification deadlines were required to file a statement of explanation, such as those that were filed by 16 company executives whose reports were due on August 14 (SEC, 2002b).

On August 14, 2002, two of the individuals who submitted such attestations were Richard M. Scrushy and Weston L. Smith, the CEO and CFO respectively, of HealthSouth Corporation. Both swore that "To the best of my knowledge, ... no covered report contained an untrue statement of a material fact as of the end of the period covered by such report ..." (HealthSouth, 2002). On March 20, 2003, the SEC charged HealthSouth (SEC, 2003a) and Mr. Scrushy with a $1.4 billion accounting fraud; on April 1, 2003, fraud charges were filed against Mr. Smith (SEC, 2003b). Such a circumstance following in less than one year after the enactment of Sarbanes-Oxley makes one wonder about the effectiveness of the sworn statements.

Another important provision of the corporate responsibility section relates directly to the certifications issued by executives. The Act states that CEOs and CFOs must forfeit both bonuses or incentive-based pay received from the company and profits realized from the sale of company securities in the year following a restatement of earnings due to material misconduct or noncompliance with securities laws. This stipulation in the Act, as well as the one that denies executives the right to trade company stock during black-out periods required by employee retirement plans, should be lauded by everyone who has ever been harmed by the fall-out of management fraud. Executives will now be required to surrender the monetary benefits reaped from their misdeeds.

Previously, the right of "Pinocchio CEOs" to retain "their loot" was "an incentive to steal" rather than to perform (Lowenstein, 2002). In this provision, however, the Act, may not go far enough: who is the ultimate arbiter of whether the restatements result from "material misconduct or noncompliance" and when will the determination be made? Consider the arrest of the five executives at Adelphia Communications (Markon & Frank, 2002) and the indictment of two executives at WorldCom (Solomon & Pulliam, 2002) for organizational fraud as well as the trials of the CEO and CFO of Tyco International for "using the company

as their personal piggy bank" (Sorkin, 2003): will the ill-gotten gains still be available for access from the executives when all is said and done?

The issue of restitution has become more visible and, quite likely, more important to the investing public since the passage of Sarbanes-Oxley. However, there is a recent example of how restitution—even that which is not required by law—could fail to properly compensate the investment community. Gary Winnick, founder of Global Crossings (a collapsed "high-flyer" and, like Enron, an Arthur Andersen audit client), sold 25 percent of his shares for over $730 million, while creditors and small investors suffered losses in the billions of dollars when the company filed for bankruptcy (Fabrikant & Romero, 2002). Accounting practices were investigated at the company, but the Justice Department announced that its investigation into Global Crossing would not lead to criminal charges (Hopkins, 2002). However, in October 2002, Mr. Winnick (who resigned on December 31, 2002) volunteered to use a mere $25 million of his own funds to help "pay back pensioners who lost money in Global Crossing" (O'Shea, 2002). Given Winnick's reported compensation of $512 million from 1999 to 2001 (Citizen Works, 2003), the paltry $25 million probably should not be viewed as restitution, but merely an attempt to throw a bare bone to the starving investors, who are looking to regain a small portion of what they lost.

As to Richard Scrushy, the ousted CEO of HealthSouth, whose restitution will actually fall under the provisions of Sarbanes-Oxley, the SEC has, at least temporarily, frozen his assets. Mr., Scrushy earned $68 million in salary and exercised $55.5 million of stock options in 2002; but the SEC could seek $785 million or more in damages and disgorgement of ill-gotten gains—more if insider trading is found (Reeves, 2003). Whether these restitution amounts can actually be obtained is one issue, and whether they are severe punishment or merely a slap on the wrist for Mr. Scrushy is yet another.

CORPORATE TAX RETURNS

Title X is the shortest provision of Sarbanes-Oxley and states that the chief executive officer of a corporation *should* sign the corporate tax return. Unfortunately, the term *should* does not mandate the same degree of necessity as the term *must*. What recourse is there if a corporate executive refuses to sign the return? How can the board of directors (if that is the appropriate body) force executives to sign the tax returns? Should the corporate board of directors establish a mandate that insists on the signing of the tax return by the CEO and, if he or she does not sign, the CEO is admonished/penalized/terminated?

Potentially this wording will be clarified in that Section 511 of Senate Bill No. 1971 of the 107th Congress suggests changing the wording from "should" to "shall." Will such a change, though, cause wrongdoers such as Richard Scrushy to be any less leery of signing the tax return than did the provision to certify the accuracy of the financial statements? Or will the change make things more complicated and hard to enforce, given that a Deloitte & Touche survey indicated that "96 percent of corporate tax directors ... stated 'their CEO was not very knowledgeable' about [tax] issues reflected in the corporate tax return" (Nyberg, 2003a)?

CONCLUSION

In the early part of the 20th century, when auditing was first developing into a profession, the "most important objective of audits was the discovery of errors and irregularities or even fraud, if it existed or was suspected" (Roth, 1969). As the profession changed and evolved, so did the audit objective until it arrived at an objective of providing "reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud" (ASB, 1997). However, the investing public's concept of an audit's purpose, for the most part, still resides in that objective from a century ago.

The Sarbanes-Oxley Act is not the first attempt to address corporate fraudulent financial reporting. The National Commission on Fraudulent Financial Reporting, generally known as the Treadway Commission, was created in 1985 to address issues of what then seemed to be a significant increase in corporate financial reporting frauds. Relative to public accountants, the Commission recommended a higher level of responsibility for detecting fraudulent financial reporting, improvements in audit quality especially relative to high-risk audit areas, and enhanced communications in the audit report about the limitations of finding fraud during an audit engagement. The 1992 Report by the Committee of Sponsoring Organizations (COSO) focused on the issues of internal control systems as a comprehensive means by which management may become more aware of, in part, the reliability of financial reporting and legal compliance.

The Auditing Standards Board, in recognition of the necessity for auditors to be a part of any widespread effort to minimize fraud in audited companies, issued Statements on Auditing Standards No. 54 (Illegal Acts by Clients, 1988), No. 82 (Consideration of Fraud in a Financial Statement Audit, 1997), and No. 99 (Consideration of Fraud in a Financial Statement Audit, 2002), which supersedes No. 82. Although it has always been the opinion of the accounting profession that management "is responsible for the prevention and detection of fraud and plays a significant role in deterring fraud by establishing a positive control environment and appropriate control activities" (Barnett, 1998), SAS No. 99 provides more detailed guidance on effective ways to detect fraud in financial statement audits in accordance with generally accepted auditing standards (GAAS) than its predecessors. Two important purposes of SAS No. 99 are to (1) enhance an auditor's awareness of warning signs of fraud and (2) enforce a company's awareness that the independent audit is simply one in an entire collection of tools that can be used to aid in the prevention and detection of fraud (Thomas and Porter, 2003).

The earlier attempts (exclusive of SAS No. 99) to create a basis from which the potential flood of fraudulent financial reporting might be stemmed obviously were less than successful. Neither the government, accounting profession, nor stock exchanges could possibly have foreseen the calamitous events that would occur in the bastions of business enterprise after the turn of the new century. SAS No. 99 was promulgated by the auditing profession and Sarbanes-Oxley was enacted by the government to embrace earlier directives and expand their scope. Businesses and auditors have been catapulted onto a stage with spotlight scrutiny under the Sarbanes-Oxley Act. SOX can either be viewed as a beam that will highlight all the flaws and ugliness in these entities or as a medium for illuminating the potential for guiding the way to a better market. Hindsight is a good thing: if only more attention had been

paid to the events of the 1980s and 1990s, some of the recent disasters might have been preventable.

The "expectation gap" that exists between what the public believes and what the profession (with limited audit engagement time and fees) can do looms large. Regardless of the fact that the majority of audits are performed with care and expertise and that the majority of executives are honest, the lack of public trust in what the auditing profession does is like a cancer that is metastasizing. Given the massive abuses that have battered the profession in recent years, it would seem that there are only two means of eliminating the expectation gap problem. The first alternative is to allow auditing firms to charge an audit fee that is large enough to cover all costs necessary to detect *any* instances of material fraud or misstatement in an organization and to earn a reasonable profit in addition to those costs. The second alternative is to educate the investing public (regardless of their financial literacy levels) as to why an audit is not a "Good Housekeeping Seal of Approval" that all is absolutely and undeniably right with the financial reporting in an audited firm. Unfortunately, neither of these alternatives is really feasible: thus, there will always be an expectation gap between what an audit is and what much of the public believes it to be. It is unlikely that the SOX legislation will eliminate the gap, but potentially time and education can help minimize it. Maybe instead the focus should not be on eliminating the expectation gap but eliminating financial fraud in organizations.

Laws such as Sarbanes-Oxley can be enacted to help curtail the financial shenanigans taking place in both the auditing firms and corporate offices. But laws, corporate codes of conduct, and professional codes of ethics are not, and have never been, substitutes for ethics. Maybe the solution is, in fact, to find ways to instill higher levels of ethics in the people in boardrooms and auditing firms. To quote Emerson, "There can be no high civility without a deep morality."

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