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# Accountants — Audit Standards 'Sarbanes-Oxley' Needs Fixing

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**O**n July 30, 2002, President Bush signed the Sarbanes-Oxley Act of 2002, a law designed in large part to assure the public that the certified financial reports of public companies are reliable. To do so it seeks to eliminate auditor conflict, an important goal that the Act will not achieve unless Congress amends it in two significant respects.

Although it should go without saying, and as recent shameful events remind us, the obligation of an auditor is to maintain a single focus, with a loyalty that is undivided. The auditor's service and fidelity must be dedicated to the public investor and not to the company it is auditing. To that end the Act prohibits an auditor from performing non-audit services for its audit clients. In listing the non-audit services that it covers, the Act includes "legal services and expert services unrelated to the audit," services that are often grouped under the term "consulting." The Act does, however, permit an auditor to provide tax services to its audit client if the company's audit committee gives its approval. The purpose of tax advice and tax planning in connection with a company's prospective transaction is, of course, to save it taxes. Frequently such consulting activity is successful, and it attains its objective legitimately, but at times it does so questionably or even illegitimately. The line between the questionable and the legitimate is sometimes clear, sometimes fuzzy.

## **Tax Services Should Be Banned**

Those who sell tax shelter plans to corporations do so for big dollars. When it can find them, the IRS will often have reason to disallow the shelters and will do so. Investors and prospective investors in those companies should be able to tell from looking at a company's financial statements whether the auditor thinks that the tax shelters in which the company has invested are vulnerable to IRS attack. If the auditor thinks so, it should make sure that the company's reserve for taxes is large enough to account for the additional taxes the company may have to pay if the IRS disallows the

shelter. At the least, a footnote to the financials should note the prospect. No auditor who has sold a company a tax shelter or other tax minimization plan should audit that company because clearly the auditor would be conflicted. Either the auditor would have to indicate that the plan it sold the client was vulnerable or it would have to hide something from public investors that they need to know. Just as the prohibition of an auditor's rendering non-tax expert services to an audit client may not be waived by the audit committee, so the conflict posed by tax planning should not be subject to waiver. There is too much at stake to permit otherwise, and the Act should be amended promptly to correct this flaw. The amendment should not ban an auditor's tax services other than those involving transactional tax advice and planning, since there is no need to prohibit an auditor's preparation of tax returns or its performance of tax compliance work for its audit clients.

### **Other Consulting Services Too**

Although auditors are prohibited from performing non-audit services for audit clients, the Act allows them to do so for everyone else. At first blush this may sound reasonable, yet it is anything but. A serious problem lies in the fact that the Big Five accounting-consulting firms are dominant when it comes to the audit of public companies. The Big Five audit more than 90 percent of them. Moreover, all five sell essentially the same types of consulting services and products. Even those that proclaim that they have rid themselves of much of their consulting activity have retained all of their tax consulting. And so, for example, if Deloitte and Touche audits Coat Co. and sells a tax shelter plan to Hat Co., audited by KPMG, there would be no violation of the law. But to allow that result would be naive at best because Arthur Andersen or Ernst & Young or KPMG or PwC has sold Coat Co. a tax shelter similar in all major respects to the one that Deloitte sold to Hat Co. It would, therefore, be unlikely, indeed bizarre, for Deloitte to require Coat Co. to footnote the vulnerability of the plan it bought from, say, PwC, when Deloitte has been marketing the same kind of shelter to Hat Co. as well as to every other company that it does not audit. The reality is that conflict of interest is present whenever the auditor of a public company renders non-audit services to anyone, not just to its audit clients.

As enacted, Sarbanes-Oxley will fail to secure auditor independence, but a simple amendment will correct the failure. First, the amendment should include tax services (other than return preparation and compliance work) among the expert services that are prohibited to auditors, not permitting the prohibition to be waived by an audit committee, just as all the other expert services may not be waived. Second, the amendment should prohibit an auditor from performing non-audit services for anyone, not just for its audit clients, thereby requiring that auditors stick to their auditing.

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