

31 March 2005

To: Securities and Exchange Commission

From: Mary Ellen Oliverio

Subject: File 4-497: Implementation and Evaluation of Section 404 of the Sarbanes-Oxley Act of 2002

How appropriate that you are seeking opinions about a critically discussed aspect of SARBOX. There are three comments I wish to make: 1. Responses a colleague and I received to a investigative survey related to THE VALUE OF AN AUDIT which was completed in the Fall of 2004; 2. The importance of diagnosis which seems not to have been undertaken; and 3. A general comment about the need to reconsider the total implementation of the Act.

1. **Survey responses:** In the summer of 2004, we completed a survey that, for the most part, replicated a survey we had done in 1984 on the subject of the value of an audit. However, in the 2004 survey, we added three additional questions about SARBOX. Respondents were primarily CFOs, controllers, and chief accounting officers. Summaries of responses to the three SARBOX questions are:
  - Q. What is your assessment of the impact of the Sarbanes-Oxley Act at this point? (multiple responses were allowed)
  - R. While 30.4 percent of the respondents felt credibility of an auditor's report would be enhanced, 69.6 percent didn't think there would be much difference in credibility. While 25 percent of the 54 respondents felt the cost of additional requirements was justified, there were 71.4 percent (40 respondents) who did not think the additional cost was justified.
  - Q. What is your current judgment about the value of the attestation related to internal control?
  - R. While 25 percent (of the 56 who responded to this question) believed this requirement was excellent, there were 69.6 percent of the respondents who either were uncertain that the requirement will add much value or questioned the value of the requirement.
  - Q. As you think of your next annual external audit (as of August 2004) , what is your current judgment about what this audit will cost? (an open-end question)
  - R. While 42.6 percent estimated that costs would be no more than 20 percent higher, there were 42.6 percent who estimated costs would be between 31 percent and somewhere over 50 percent.
2. **The Lack of Diagnosis:** The speed with which the Sarbanes-Oxley Act of 2002 was developed and implemented was understandable. The cascade of accounting scandals was indeed shocking. However, there are serious questions about the reasons for the failure of what I would say was good guidance for auditing, notwithstanding what some critics have stated. (I recall reading an essay about the early days of medical services in the United States. One theme that appeared throughout that essay and was supported was essentially: Until medicine turned to diagnosis of the reasons for the illnesses, there was little progress.)

There was an impressive effort at diagnosis with the December 1938 disclosure of the McKesson and Robins case. Only four years earlier, the SEC had determined that the public accounting profession could be delegated rule making. . . The thorough investigation, reported in two volumes, reflected an earnest effort to discover why the fraud had occurred and what changes were necessary in professional guidance.

To date, there has been no objective, thorough analysis of even one of the alleged audit failures, to my knowledge. Why is such diagnosis of value? Primarily, because there have been many efforts to

enhance responsibility of auditors. Isn't astute knowledge needed of why such efforts have failed to achieve anticipated consequences? Among the efforts:

The Foreign Corrupt Practices Act of 1977 amended the 1934 Securities Exchange Act to include a requirement for internal controls. Why did U. S. companies not implement that requirement and maintain the implementation?

The establishment of a Public Oversight Board that after a rather slow start began to require peer reviews. That Board was established in the final years of the 70s. Several of my students studied the results of the peer reviews in the early 80's (primarily through reading the public reports that were available at the AICPA) and concluded that if spelling errors and inappropriate punctuations were the only problems noted, was such a mechanism warranted? That Board was abolished at the end of March a few years ago! Why was this Board ineffectual?

In the early 90's . . . I believe it was August 1992, the major public accounting firms issued a white paper in which they stated essentially that they had done nothing wrong, but had yet paid large penalties for alleged failures in the performance of audits. When I wrote to the heads of the firms and asked if they could share studies that concluded that the audit firm had completed an audit appropriately, yet paid penalties related thereto. I heard from some of them. The response was: "Such information is proprietary and cannot be shared." Why was there no objective challenge to the claim of this group of public accounting firms?

The Auditing Standards Board issued a series of revised and new standards in the late 80's including the enhanced guidance related to internal control (later revised to include the components as established by COSO) and a new standard that required communication with audit committees. (AU380) Why was the guidance seemingly ignored?

The GAO did a study of the accounting profession in the second half of the 90's that pointed out problems and weaknesses. There was essentially no response to the criticism in the professional/practitioner literature about the findings. Why the indifference?

Should there not be a serious attempt to find out why all such efforts have essentially been materially ineffective? Is the skepticism of many today about the requirements of 404 reflecting a sense that we have not yet discovered the basic roots of our contemporary problems? Some former students have informed me that all the new documentation is not likely to change the culture of public accountants which has clearly been exposed in the scandals of the last five years.

Will all the documentation required by 404 likely to be as effective in changing behavior as all the clearly stated codes of ethics in U. S. businesses?

Is not probing, sensitive study warranted? A study that uses the best talent from psychology, sociology, and other human behavior specialists may be useful? What has happened since the summer of 2001 in terms of thoughtful criticism and investigation seems primitive when viewed with what happened after the earlier noted case of 1938!

2. **Is an overall review warranted?** A general review of the total Act's and its implementation would seem worthwhile. Is there a flaw in combining rule making and enforcement, for example? Is it wise to have stripped public accounting of all rule making? Technically some question can be raised that the public accountants who audit publicly-owned companies are "professional" if we adhere to the traditional criteria for professional status? (I am attaching a brief opinion piece that I wrote about the need for such review.)

Best wishes for a successful roundtable discussion on April 13.

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