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'Out of the Box' Ideas for Audit Independence

Business Panel Brainstorms Governance Reform

By Mark Lilling

It could take more than the current round of government and corporate reforms to fully and permanently restore investor faith in the nation's accounting and auditing systems, speakers told attendees of a New York University Stern School of Business conference.

More than 135 practitioners, regulators and academics in the auditing field convened for the May conference to discuss the impact of auditor conflicts on the accounting profession, to propose recommendations to foster auditor independence, and to help prevent future accounting scandals.

Speaker Art Siegel, former executive director of the Independence Standards Board, said that despite the Sarbanes-Oxley Act and the creation of Public Company Accounting Oversight Board, among other reform initiatives, there hasn't been enough "thinking out of the box." The system still relies on auditors as gatekeepers. But, Siegel said, "The gatekeeping function is one of the main culprits in the recent debacles."

Others echoed that point in discussing auditor independence.

"The reason for the corporate governance failure is the inherit conflict of interest that exists because of the cozy relation between auditors and the management of their clients who hire their services," said Joshua Ronen, NYU Stern professor of accounting.

The standing-room-only forum featured experts representing differing perspectives from corporate America. Commentators included John Biggs, former chairman and CEO of TIAA-CREF; John O'Connor, vice chairman and services leader at PricewaterhouseCoopers; Thomas J. Ray, deputy chief auditor for Public Company Accounting Oversight Board; and Melvyn Weiss, senior partner at the law firm of Milberg Weiss Bershad Hynes and Lerach LLP.

The panelists addressed some of the major issues confronting the auditing profession and put forth several recommendations. First, nonaudit services should be limited, and corporations should consider various types of auditor rotation, e.g., changing firms or engagement staff to ensure independence.

L to R: Mark Lilling, Melvyn Weiss, Art Siegel, John Biggs, Thomas Ray, & John O'Connor

Panelists suggested that SEC guide-lines for auditors have not prevented scandals. They averred that Sarbanes-Oxley should also provide a set of objectives, not just rules, to assist auditing committees and auditors in implementing and adhering to standards, and to prevent the common practice of "if it's not prohibited, it's permitted."

They also said auditors should proactively search for fraud, adding that this was a duty of inherent in the profession.

In his presentation, Ronen suggested engaging insurers to achieve greater quality and honesty in the auditing process and provide management with strong incentives to improve the reliability and transparency of their companies' financial statements.

Ronen coined the name Financial Statement Insurance (FSI), a plan that would require insurers to hire the auditors and set coverage and premiums for companies based on an initial risk evaluation. Whether the coverage becomes effective would depend on the results of the audit. The insurance premium and other policy terms would be disclosed publicly for all investors to see. Insurers would be liable if their client's shareholders sustained losses due to omissions or misrepresentations in the financial statements.

Separately, Shyam Sunder, a professor of accounting, economics and finance at the Yale School of Management, proposed using corporate tax returns as the publicly reported income statement to reduce both earnings management and aggressive tax reporting.

Sunder argued that management and auditors legally game the tax and accounting systems by decreasing taxable income to lower taxes while at the same time increasing financial statement income they report to the shareholders, placing heavy burden of auditing and oversight on the IRS and directors.

According to Sunder, using the same statement for both purposes would discourage manipulation in either direction.

The conferences yielded interest in a book on improved corporate governance and auditor independence. ➨

NYSSCPA member Mark Lilling is a graduate of NYU's Stern School of Business. Managing partner of the Audit Committee Consulting Team LLC and Lilling & Company LLP in Great Neck, N.Y., he sponsored and moderated the May 10 conference.