

ACCOUNTING TODAY

Published by Thomson

e-mail: AcToday@amgpubs.com

www.webcpa.com

ACCOUNTING TODAY: OCTOBER 6-19, 2003/www.webcpa.com

ASSURANCE

Technical developments, professional issues and engagement changes

Profit vs. audit integrity: Should the price matter?

by Mark Lilling

In the rash of audit failures over the past few years, a startling trend has emerged that can seriously dilute the value and accuracy of the audit. It's a practice that may well be at the root of eroding public trust — and misunderstanding — of the audit process.

It would seem that a growing number of accounting firms are relating the robustness of the audit to the fee. In fact, partners of two of the Big Four accounting firms were heard to say that they could perform a "more stringent, tougher audit" if the audit fees were higher.

One wonders if this peculiar view of the scope and performance of the audit, as defined by the size of the fee, is limited to just the Big Four.

At the same time, the audit fee has become a bargaining tool — witness Arthur Andersen's substantially undercharging WorldCom for an audit, allegedly to sustain a relationship that went beyond the audit. According to reports, the audit team spent about 15,000 hours and charged only \$2 million, a fraction of its standard fee.

A Wall Street Journal article reported that Andersen limited the amount of substantive testing of individual transactions,

and relied instead on simply looking for patterns of irregularity. The report noted that, "In the face of pricing pressures ... some auditors began scaling back the more rigorous testing they once did."

In another case, the health care company HealthSouth (many of whose officers are under indictment for fraud) paid Ernst & Young \$2.6 million for janitorial inspections of the company's facilities, and then classified the expenditures as "audit-related fees."

If this practice of defining the scope and depth of the audit by fee is pervasive, doesn't it make a mockery of the audit? If the definition of audit-related fees can be used to alter a view of a company's finances, doesn't it demean the concept of professionalism?

Professionalism in accounting means bringing an accountant's best skills to bear, according to the needs of the client, on any engagement. It means adhering to the philosophy of performing a strong, conservative audit that allows the auditor, and ultimately the public, to have confidence in the audited financial statements, regardless of the fee. There is no way to hedge that professionalism. Moreover, the very definition of an audit precludes straying from its meaning and validity.

Unfortunately, the highly competitive environment of the past few years has put an undue focus on growth and profitability. Increasingly, many firms have performed engagements at discounts to earn other,

more profitable, non-audit fees, such as from consulting or tax shelter sales. It is this practice that the Sarbanes-Oxley Act seeks to end, causing most of the large accounting firms to dispose of their non-audit practices.

Regardless of other services performed, the sanctity of the audit must be reestablished, if the new law is to have real value. Certainly, in the name of professionalism, the auditors must go to the spirit of the law, for both pride in their work and to

**The sanctity of the
audit must be
re-established.**

protect their firm's name and reputation. To do otherwise will, over the long run, erode the integrity of the audit and the auditor. It's evidence of this erosion that contributed to the account-

ing profession's loss of self-regulation.

Profitability for accounting firms is indeed important, but it cannot and should not be earned at the expense of the integrity of the audit. If there is a case for more work and higher fees, it should be made as such, but not by using the scope of the audit as a bargaining chip.

Profitability and growth are long-term projects for any accounting firm, and a reputation for quality, with the strongest internal quality control policies and procedures, will attract the most desirable clients, the best professionals and the greater profit in the long term. Ask Andersen partners today if, in retrospect, they would rather have had stronger controls over their audit practice.

The auditor's primary responsibility,

Mark Lilling is managing partner of Lilling & Co. LLP, in Great Neck, N.Y. He is the author of "The Audit Advantage," an auditing and accounting manual used by CPA firms to document accounting and auditing procedures.

ASSURANCE

Technical developments, professional issues and engagement changes

clearly stated in the Statement of Accounting Standards, is to express an opinion on the fairness of financial statements, particularly on how those statements present, "... in all material respects, financial position, results of operations and cash flows in conformity with generally accepted accounting principles."

At the same time, the rules state that generally accepted auditing standards must be followed. GAAS allows auditors to use their judgment to determine the scope, timing and extent of audit procedures based on the company's internal controls. Fee pressure can motivate the auditor to limit their detail tests of balances and rely on "softer tests," such as analytical procedures.

Nowhere in the rules does it say, however, that the scope of the audit is a function of fees. The standards don't address fees, and, in fact, the nearest relationship to fees is the requirement of independence, which is quite clearly spelled out in the Statement of Accounting Standards. It

says, "In all matters relating to the assignment, independence in mental attitude is to be maintained by the auditor or auditors."

Fees are not mentioned in professional standards, and auditors are required to establish an understanding with the client. Fees are mentioned as an "additional item that can be documented."

These principles are well known to every auditor, and should be made known as well to the chief executive and chief financial officer of every corporation. Certainly, these standards should be a guiding force to the audit committees of boards of directors in selecting and retaining auditors.

Deficiencies in auditing performance that violate professional standards have a way of creeping into practice. Certainly, the recent frauds and audit failures have demonstrated that fact, until these excesses led to the saturation point that produced the Sarbanes-Oxley Act of 2002. Audit failures during the era of savings

and loan frauds instigated self regulation by the American Institute of CPAs that required mandatory peer reviews by other audit firms. Sarbanes-Oxley has put a new spotlight on the lapses in audit practices.

But only the auditor's own sense of professionalism can eliminate such practices as using the fee to define the scope and robustness of the audit.

For some time now, there has been talk of the audit as a commodity. To an auditor, the integrity of an audit is a reflection of the firm's reputation. It has meaning and validity. It clarifies management's view of its ability to monitor and control its financial picture, and it gives investors and the financial community the full sense of security in considering a company's financial position.

To dilute the audit by relating it to fees — or to any other activity that diminishes full professionalism — is to undermine the vast world of finance and management.

The result is tangible. Ask any company caught in the maelstrom of fraud.