The Implications of the Sarbanes-Oxley Act of 2002

Research Project for Emerging Issues/Advanced Topics Course

Diploma in Investigative and Forensic Accountants

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1.0 INTRODUCTION

1.1 Purpose

This report is a research project in partial fulfillment of the requirements for the Diploma in Investigative and Forensic Accounting (DIFA) program and the main purpose is to examine "The Implications of the Sarbanes-Oxley Act of 2002 for Investigative and Forensic Accountants" (IFAs).

The report is prepared solely for academic purposes, is not intended for general circulation and may not be appropriate for any other purpose.

1.2 Objective

The objective is to examine significant disclosure changes affecting public companies as a result of the enactment of Sarbanes-Oxley of 2002 ("Act"), the responses through similar regulations proposed by Canada and European Union, the pros and cons, and the implications of these changes to the opportunities and general work requirements of IFAs.

2.0 BACKGROUND

The impact of the events at Enron and others, initiated actions towards reform in financial reporting within the United States of America ("US") and Sarbanes-Oxley Act was passed. This is seen as that country's legislative response "to protect investors by

improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws".[1]

Introduced in 2002 largely to address deficiencies in audit reporting, corporate governance and accountability which surfaced in highly publicised corporate frauds and accounting scandals, the main objective of the Act is to restore investor confidence by strengthening corporate governance.

It is of great importance to the world's financial markets as the US investors are not alone in experiencing profound failures and the introduction of the Act has influenced or expedited the adoption of similar regulations in Canada and the European Union ("EU").

The Act has far reaching implications for various professional bodies, including IFAs within and outside the United States because it generally makes no distinction between U.S. and non-U.S. issuers.

The implications for IFAs are reviewed within the context of the type of services generally provided and no distinction is made as to nature or size of the practices such as individual practitioners, boutique firms or larger firms previously or still associated with major accounting firms.

[1] Sarbanes-Oxley Act 2002

3.0 THE SARBANES-OXLEY ACT

The principal objective of the Act is to protect investors by improving the accuracy and reliability of corporate disclosures through stricter standards set by the securities laws. This, it is hoped, would restore trust and confidence in the public securities market and enhance transparency and completeness of financial statements, raise the standards of corporate accountability and punish financial fraudsters.

The Act requires compliance with a comprehensive set of accounting procedures for publicly held corporations in order to promote and improve the quality and transparency of financial reporting by both internal and external independent auditors. The Act is divided into three sections and eleven titles listed as follows:

- Title I – Public Company Accounting Oversight Board
- Title II – Auditor Independence
- Title III – Corporate Responsibility
- Title IV – Enhanced Financial Disclosures
- Title V – Analyst Conflicts 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

Section 1 outlines the title of the Act and its table of contents, section 2 definitions of specific terms and section 3 the commission rules and enforcement. Provisions relating to each title will be examined with concentration on those areas having greatest impact on the work of the IFA.

3.1 Title I – Public Company Accounting Oversight Board

The Act creates the Public Company Accounting Oversight Board ("PCOAB or Board"), "to oversee the audit of public companies that are subject to the securities laws"[2]. The composition of the Board is specified within the Act, "The Board shall be a body corporate, operate as a non-profit corporation, and have succession until dissolved by an Act of Congress"[3] . The number and composition is stated as five financially-literate members, two of whom must be or have been certified public accountants ("CPAs"), and the remaining three must not be and cannot have been CPAs. The members will be appointed for a five-year term period and must serve on a full time basis. The Chair may be held by one of the CPA members, provided that he or she has not been engaged as a practicing CPA for five years.

The main duties of the Board are described as:

- Registering public accounting firms that prepare audit reports.

[2] Sarbanes-Oxley Act 2002, Sec. 101
[3] Ibid, sec. 101

- Establish or adopt, by rule, auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for issuers.
- Conduct inspections, investigations and disciplinary proceedings on registered public accounting firms
- Impose sanctions on registered public accounting firms

The significance of the creation of this Board is the shift in the responsibility for monitoring and setting of standards for the accounting profession to an organization independent and external to the accounting group.

Foreign accounting firms that audit U.S. companies are subject to the provisions of the Board and must comply as the local firms. This includes foreign firms which perform some audit work for an overseas subsidiary of a U.S. company and where such report is relied upon by the primary auditor.

3.2 Title II – Auditor Independence

The Act excludes an auditor from providing certain non-audit services and all other services including the audit and attest engagements must be pre-approved by the audit committee. The non-audit services which the Act identifies as outside the scope of the auditor, unless an exemption is granted by the Board, are:

- Bookkeeping or other services related to the accounting records or financial statements of the audit client
- Financial information systems design and implementation
- Appraisal or valuation services
- Actuarial services

- Internal audit outsourcing services
- Management and human resources functions
- Broker or dealer, investment adviser, or investment banking services
- Legal services and expert services
- Any other service that the Board determines, by regulation, is impermissible.

The Act also prohibits an accounting firm from auditing the financial statements if the chief executive officer, chief financial officer, controller, or chief accounting officer, or any other person serving in an equivalent position at the company, had been employed by the accounting firm and had participated in any capacity in the audit within a preceding one-year period. The mandatory rotation of the lead audit partner is set at every five years. These are efforts to address the areas of conflict of interest and strengthen independence.

3.3 Title III – Corporate Responsibility

The Act brings into prominence the Audit Committee of public companies. Under new rules adopted by the Securities and Exchange Commission all publicly traded companies must comply no later than October 31, 2004 and certain foreign companies and small businesses must comply by July 31, 2005[4]. The provisions under the Act are as follows:

- Each member of the audit committee shall be a member of the board of directors of the issuer, and shall otherwise be independent.

[4] http://www.aicpa.org/info/sarbanes_oxley_summary.htm

"Independent" is defined as not receiving, other than for service on the board, any consulting, advisory, or other compensatory fee from the issuer, and as not being an affiliated person of the issuer, or any subsidiary thereof.

- The audit committee of an issuer shall be directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by that issuer.
- The audit committee shall establish procedures for the "receipt, retention, and treatment of complaints" received by the issuer regarding accounting, internal controls, and auditing.
- Each audit committee shall have the authority to engage independent counsel or other advisors, as it determines necessary to carry out its duties.
- Each issuer shall provide appropriate funding to the audit committee.

A summary of this provision is sated as follows: "The CEO and CFO of each issuer shall prepare a statement to accompany the audit report to certify the "appropriateness of the financial statements and disclosures contained in the periodic report, and that those financial statements and disclosures fairly present, in all material respects, the operations and financial condition of the issuer." A violation of this section must be knowing and intentional to give rise to liability."[5]

This responsibility is extended to include "Improper Influence on Conduct of Audits" which is summarized as follows: "It shall be unlawful for any officer or director of an issuer to take any action to fraudulently influence, coerce, manipulate, or mislead any

[5] http://www.aicpa.org/info/sarbanes_oxley_summary.htm, Sect. 302

auditor engaged in the performance of an audit for the purpose of rendering the financial statements materially misleading."[6]

The Act stipulates conditions that result in forfeiture of certain bonuses and profits. If the financial statements have to be restated as a result of misconduct then the CEO and CFO must reimburse the company for:

- Any bonus or other compensation received during the twelve month period following the first public issuance or filing with the Commission
- Any profits realized from the sale of securities during that twelve month period.[7]

3.4 Title IV – Enhanced Financial Disclosures

Section 401 stipulates that "each financial report that is required to be prepared in accordance with generally accepted accounting principles ("GAAP") ….. and filed with the Commission shall reflect all material correcting adjustments . . . that have been identified by a registered accounting firm . . . ."

Off balance sheet transactions must also and pro forma reports should not be misleading. A summary of these provisions is given as:

[6] http://www.aicpa.org/info/sarbanes_oxley_summary.htm, Sect. 303
[7] Sarbanes-Oxley Act 2002, Sec. 304

"Each annual and quarterly financial report . . . shall disclose all material off-balance sheet transactions" and "other relationships" with "unconsolidated entities" that may have a material current or future effect on the financial condition of the issuer."[8]

"The SEC shall issue rules providing that pro forma financial information must be presented so as not to "contain an untrue statement" or omit to state a material fact necessary in order to make the pro forma financial information not misleading."[9]

The Act places responsibility on the CEO and CFO of a company to certify the accuracy of annual and quarterly reports and makes them responsible for establishing and maintaining internal controls, evaluating those controls and reporting their conclusions about the effectiveness of those controls. The certification is required each time a report is filed and must contain an internal report where the CEO and CFO certify that:

- They are responsible for establishing and maintaining their company's disclosure controls and procedures.
- They have designed the disclosure procedures and controls in order to ensure that material information is made known to them
- They have evaluated the effective of these procedures and controls within ninety days of the filing date of the report which contains their conclusions of their evaluation.

  Additional provisions include:[10]

  - "Each issuer's auditor shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this section shall be in

[8] AICPA, Summary of Sarbanes-Oxley Act of 2002, sec 401
[9] AICPA, Summary of Sarbanes-Oxley Act of 2002, sec 401
[10] AICPA, Summary of Sarbanes-Oxley Act of 2002, sec 404

accordance with standards for attestation engagements issued or adopted by the Board. An attestation engagement shall not be the subject of a separate engagement.

- The language in the report of the Committee which accompanies the bill to explain the legislative intent states, "--- the Committee does not intend that the auditor's evaluation be the subject of a separate engagement or the basis for increased charges or fees."
- Directs the SEC to require each issuer to disclose whether it has adopted a code of ethics for its senior financial officers and the contents of that code.
- Directs the SEC to revise its regulations concerning prompt disclosure on Form 8-K to require immediate disclosure "of any change in, or waiver of," an issuer's code of ethics."

3.5 Title V – Analyst Conflicts of Interest

This section titled "Treatment of Securities Analysts by Registered Securities Associations and National Securities Exchanges" amended the SEC 1934 Act to mandate these organizations to adopt conflict of interest rules for research analysts who recommend equities in research reports. Compliance must be within one year of enactment.

3.6 Title VI – Commission Resources and Authority

The necessary funds required by the Commission to carry out its functions, powers and duties are stated including the number of employees "to provide enhanced oversight of auditors and audit services".

It also provides the Commission with the authority to: [11]

- "Censure any person, or temporarily bar or deny any person the right to appear or practice before the SEC if the person does not possess the requisite qualifications to represent others, lacks character or integrity, or has wilfully violated Federal securities laws.
- Conduct a study of "securities professionals" (public accountants, public accounting firms, investment bankers, investment advisors, brokers, dealers, attorneys) who have been found to have aided and abetted a violation of Federal securities laws.
- Establish rules setting minimum standards for professional conduct for attorneys practicing before it."

3.7 Title VII – Studies and Reports

This section commands a study to determine the factors and effect of the consolidation of public accounting firms since 1989 in order to determine current and future impact and recommend corrective measures.

3.8 Title VIII - Corporate and Criminal Fraud Accountability

The destruction, alteration or falsification of records is considered in this section. A summary of the provisions are: [12]

[11] AICPA, Summary of Sarbanes-Oxley Act of 2002, sec 602

- "It is a felony to "knowingly" destroy or create documents to "impede, obstruct or influence" any existing or contemplated federal investigation.
- Auditors are required to maintain "all audit or review work papers" for five years.
- The statute of limitations on securities fraud claims is extended to the earlier of five years from the fraud, or two years after the fraud was discovered, from three years and one year, respectively.
- Employees of issuers and accounting firms are extended "whistleblower protection" that would prohibit the employer from taking certain actions against employees who lawfully disclose private employer information to, among others, parties in a judicial proceeding involving a fraud claim. Whistle blowers are also granted a remedy of special damages and attorney's fees.
- A new crime for securities fraud that has penalties of fines and up to 10 years imprisonment."

3.9 Title IX – White-Collar Crime Penalty Enhancements

The types of crime and related penalties are described in this section summarized as follows:[13]

- "Maximum penalty for mail and wire fraud increased from 5 to 10 years.
- Creates a crime for tampering with a record or otherwise impeding any official proceeding.

[12] AICPA, Summary of Sarbanes-Oxley Act of 2002, sec 801-7
[13] AICPA, Summary of Sarbanes-Oxley Act of 2002, sec 901-6

- SEC given authority to seek court freeze of extraordinary payments to directors, offices, partners, controlling persons, agents of employees.
- US Sentencing Commission to review sentencing guidelines for securities and accounting fraud.
- SEC may prohibit anyone convicted of securities fraud from being an officer or director of any publicly traded company.
- Financial Statements filed with the SEC must be certified by the CEO and CFO. The certification must state that the financial statements and disclosures fully comply with provisions of the Securities Exchange Act and that they fairly present, in all material respects, the operations and financial condition of the issuer. Maximum penalties for wilful and knowing violations of this section are a fine of not more than $5,000,000 and/or imprisonment of up to 20 years."

3.10 Title X – Corporate Tax Returns

The objective of this section is to ensure responsibility is maintained and requires that the Federal income tax return of a corporation should be signed by the chief executive officer of such corporation.

3.11 Title XI – Corporate Fraud and Accountability

The Act seeks to make it a criminal offence to tampering with documents which will affect official investigations. The main provisions are:

- "Makes it a crime for any person to corruptly alter, destroy, mutilate, or conceal any document with the intent to impair the object's integrity or availability for use in an official proceeding or to otherwise obstruct, influence or impede any official proceeding is liable for up to 20 years in prison and a fine.
- The SEC is authorized to freeze the payment of an extraordinary payment to any director, officer, partner, controlling person, agent, or employee of a company during an investigation of possible violations of securities laws.
- The SEC may prohibit a person from serving as an officer or director of a public company if the person has committed securities fraud.

Concerns relating to the protection of employees against retaliation in the cases of fraud are addressed in this section under "Whistleblower Protection for Publicly Traded Companies".

No company registered under Securities Exchange Act of 1934 or any employee, officer, contractor, subcontractor, or agent of the company may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against any employee in the terms and conditions of employment because of any lawful act done by the employee-[14] "to provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation...."

[14] Employee Whistleblower Claims-A Legal Overview, Heidie Goldstein Shepherd, James W. Nagle, PC; Goodwin Procter LLP

3.0 SCOPE, DEFINITIONS AND LIMITATION

3.1 Scope

I reviewed the Sarbanes-Oxley Act of 2002, reference materials listed in the bibliography and the most recent professional reports, newspaper and magazine articles written on the subject.

My discussions are limited to the provisions of Sarbanes-Oxley and related legislation which, in my opinion, have impacted the work of IFAs generally.

3.2 The Investigative Forensic Accountant (IFA)

For the purposes of the ensuing discussion the definitions of IFA and forensic investigations are as follows:

An investigative forensic accountant refers to an accountant who "utilizes accounting, auditing and investigative skills when conducting an investigation. Equally critical is the ability to respond immediately and to communicate financial information clearly and concisely in a courtroom setting. He or She is trained to look beyond the numbers and deal with the business reality of the situation".[15]

Forensic investigation means "the utilization of specialized investigative skills in carrying out an inquiry conducted in such a manner that the outcome will have application to a court of law. A Forensic Investigation may be grounded in accounting, medicine, engineering or some other discipline".15

[15] http://www.forensicaccountant.com/

3.3 Limitation

The scope limitations are as follows:

- The discussions are limited to information gathered and reviewed in the preparation of my report
- The discussions are limited to my understanding and personal interpretation of the implications of the Sarbanes-Oxley Act for the IFAs.
- This report does not seek to address changes to securities law brought by Sarbanes-Oxley that do not, in my opinion, have significant implications for the IFAs.

4.0 METHODOLOGIES AND DOCUMENTATION

4.1 Research

- Information was collected from Sarbanes-Oxley, reference materials, accounting magazines, and newspaper articles following its enactment.
- The corporate fraud and accounting scandals that occurred prior to Sarbanes-Oxley becoming law was reviewed along with more recent occurrences and cases
- Discussions were conducted with a forensic accountant and investigator in securities fraud.

4.2 Documents available

The documents researched and relied upon are listed in the bibliography.

5.0 DISCUSSION AND FINDINGS

The Sarbanes-Oxley Act acknowledges the importance of stockholders' value strengthens the role of directors as representatives of stockholders and reinforces the role of management as stewards of the stockholders' interest.

The following table lists the main provisions that are in effect and developed by François Janson Robert Lando in his article on "The Sarbanes-Oxley Act One Year Later" in relation to the relevance to Canadian companies.

These provisions are applicable to all non-US companies that have securities listed on NASDAQ, the New York Stock Exchange or another U.S. stock exchange and those having previously made registered offerings of debt or equity securities in the United States.

Status of Rules under the Sarbanes-Oxley Act[16]

SECTION NUMBER	TOPIC ADDRESSED	DATE OF PROPOSED RULE	DATE OF FINAL RULE AND EFFECTIVE DATE
102 106	Registration of accounting firms with the PCAOB	June 5, 2003	July 16, 2003. Registration must be completed by October 22, 2003 for U.S. accounting firms and April 25, 2004 for Canadian accounting firms
103	PCAOB professional auditing standards	April 18, 2003	Interim professional auditing standards effective April 25, 2003.
201	Prohibited non-audit services	December 2, 2002	January 28, 2003, effective May 6, 2003. Prohibited services may

[16] http://www.osler.com/

SECTION NUMBER	TOPIC ADDRESSED	DATE OF PROPOSED RULE	DATE OF FINAL RULE AND EFFECTIVE DATE
			continue until May 6, 2004.
202	Pre-approval of audit and non-audit services	December 2, 2002	January 28, 2003, effective May 6, 2003. Expanded disclosure requirement applies to annual filing for first fiscal year ending after December 15, 2003.
203	Audit partner rotation	December 2, 2002	January 28, 2003, effective May 6, 2003. For Canadian issuers, time spent on the engagement prior to the effective date is not counted toward 5-year or 7-year limit.
204	Auditor reports to audit committee on critical accounting policies	December 2, 2002	January 28, 2003, effective May 6, 2003. However, only applies to a "registered public accounting firm" that has been registered with the PCAOB.
206	Conflicts of interest resulting from former employment relationships	December 2, 2002	January 28, 2003, effective May 6, 2003. Employment relationships entered into prior to May 6, 2003 are exempt.
301	Audit committee requirements	January 8, 2003	April 9, 2003, effective April 25, 2003. Stock Exchange listing requirements must be in compliance by December 1, 2003. All U.S. listed Canadian companies that qualify as foreign private issuers must be in compliance with the new requirements by July 31, 2005.

SECTION NUMBER	TOPIC ADDRESSED	DATE OF PROPOSED RULE	DATE OF FINAL RULE AND EFFECTIVE DATE
302	CEO and CFO certification (civil)	None required	Final rule of August 29, 2002 remains in effect until final rule of June 5, 2003 comes into effect (in part on August 14, 2003 and in part concurrently with the first annual report required to contain an internal control report of management).
303	Improper influence on conduct of audits	October 18, 2002	May 20, 2003, effective June 27, 2003.
304	Forfeiture of bonuses and profits by CEO and CFO	None required	Effective July 30, 2002.
306	Insider trades during pension fund blackout periods	November 6, 2002	January 22, 2003, effective January 26, 2003.
307	Rules of professional responsibility for attorneys	November 21, 2002 and January 29, 2003 (new proposals regarding "noisy withdrawal" requirements)	January 29, 2003, effective August 5, 2003. Effective date for "noisy withdrawal" proposals, if any, not yet determined.
401	Disclosure of off-balance sheet transactions	November 4, 2002	January 27, 2003. Applies to financial statements for fiscal years ending on or after June 15, 2003. Table of contractual obligations required for fiscal years ending on or after December 15, 2003.
401	Rules for use of pro forma financial information (Regulation G and new Item 10(e) of Regulation S-K)	November 4, 2002	January 22, 2003 and applies to all public disclosures as of (and for fiscal periods ended after) March 28, 2003.

SECTION NUMBER	TOPIC ADDRESSED	DATE OF PROPOSED RULE	DATE OF FINAL RULE AND EFFECTIVE DATE
404	Management assessment of internal controls	October 22, 2002	June 5, 2003, effective August 14, 2003. Internal control report and related requirements will apply to fiscal years ending on or after April 15, 2005 for Canadian companies that qualify as foreign private issuers.
406	Code of ethics for senior officers	October 22, 2002	January 23, 2003, effective March 3, 2003. Disclosure requirements apply to annual reports for fiscal years ending on or after July 15, 2003.
407	Disclosure of audit committee financial expert	October 22, 2002	January 23, 2003, effective March 3, 2003. Disclosure requirements apply to all annual reports of Canadian companies qualifying as foreign private issuers filed on or after July 31, 2005.
409	Rapid and current disclosure	None yet proposed, except for new requirement to file earnings release.	Requirement to file earnings releases effective March 28, 2003 for U.S. issuers.
501	Analyst conflicts of interest	August 2, 2002	February 20, 2003, effective April 14, 2003.
906	Certification by CEO and CFO (criminal)	None required	July 30, 2002.

This summary shows that while the Act focuses on financial reporting, disclosure and corporate governance it has impacted the nature of work of non-audit professionals such

as IFAs. Canada and the European Union have themselves reacted with similar legislation because of the interest to improve investors' confidence worldwide.

5.1 The Canadian Response

Among Canada's share of corporate fraud and scandals are Bre-X and YBM Magnex. In July 2002, federal and provincial financial and securities regulators, as well as Canada's chartered accountants, announced the creation of the Canadian Public Accountancy Board ("CPAB"), a new independent public oversight body for accountants and accounting firms that audit reporting issuers[17].

The stated mission of the CPAB is "to contribute to public confidence in the integrity of financial reporting of public companies by promoting high quality, independent auditing". The main responsibilities are to:

- Develop and implement an oversight program
- Have regular and rigorous inspections of the auditors of Canada's public companies
- Develop new quality control requirements for accounting firms auditing public companies

There will be annual reporting to the public by the Board of its activities which is given a mandate to:[18]

- Promote, publicly and proactively, high quality external audits of public companies.

[17] www.cpab-ccrc.ca/About CPAB
[18] www.cpab-ccrc.ca/Mission and Responsibilities

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[17] www.cpab-ccrc.ca/About CPAB
[18] www.cpab-ccrc.ca/Mission and Responsibilities

- Establish and maintain participation requirements for public accounting firms that audit public companies.
- Conduct inspections of public accounting firms that audit public companies to ensure compliance with professional standards and participation requirements.
- Receive and evaluate reports and recommendations resulting from the inspection process, including, if appropriate, reports from provincial accounting organizations regarding auditors of public companies that are not inspected directly by the CPAB.
- Impose, where appropriate, sanctions and restrictions on public accounting firms that audit public companies and, where necessary require remedial action.
- Maintain a register of public accounting firms that audit public companies.
- Refer matters, as appropriate, to provincial accounting organizations for discipline purposes.
- Refer matters, as appropriate, to securities regulators.
- Provide comments and recommendations on accounting standards, assurance standards and governance practices to relevant standards-setting and oversight bodies.
- Provide recommendations to securities regulatory authorities.

However the setting of auditing standards remains the responsibility of the Auditing and Assurance Standards Board (AASB) which is monitored by The Auditing and Assurance Standards Oversight Council (AASOC), a body established by Canada's Chartered Accountants. The CPAB tests for compliance with these standards as part of its quality control responsibilities.

5.2 Europe's Response

The Commission from 1996 had focused on finding a harmonized approach to statutory auditing functions in the EU and in 1998 proposed the creation of a Committee on Auditing to make recommendations applicable to member states. By year 2002 two recommendations were issued.[19] These are:

- Quality Assurance for the Statutory Auditor in the EU (2000)
- Statutory Auditors' Independence in the EU (2002)

The Commission believes that further initiatives are necessary to reinforce confidence in capital markets and to enhance public trust in the audit function in the EU. The proposed new Directive on statutory audit by the European Commission is being dubbed as Europe's Sarbanes-Oxley Act. It addresses audit weaknesses exposed by Europe's own corporate scandals of Parmalat and Ahold.[20]

"Strengthening shareholders rights, reinforcing protection for employees and creditors and increasing the efficiency and competitiveness of business are the main aims of the European Commission's Action Plan on Modernizing Company Law and Enhancing Corporate Governance in the EU"[21]

[19] Communication from the Commission to the Council and the European Parliament, Reinforcing the statutory audit in the EU, (2003/C 236/02)
[20] http://www.accaglobal.com/publications/student accountant, Apr.7, 2004, Paul Gosling
[21] Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward

The modernized Directive is expected to clarify the role and position of the auditor, define requirements for the audit infrastructure in order to ensure high quality audits. The provisions of the Directive will include: [22]

- Public oversight of the audit profession
- Corporate governance in relation to statutory audits, audit committee and internal control
- Code of ethics
- Auditor independence
- Quality assurance
- Education and training
- Systems of disciplinary sanctioning
- Transparency of audit firms and their networks
- Auditor Liability

In spite of the strengthening of its rules the SEC and PCAOB have not recognized the concept of equivalence as a basis for general EU wide exemptions and EU audit firms must register with the US PCAOB by April 2004.

5.3 Evaluation survey

A survey performed by PricewaterhouseCoopers found that the Act was viewed less favourably within a year of implementation. The percentage of executives at U.S.

[22] Communication from the Commission to the Council and the European Parliament, Reinforcing the statutory audit in the EU, (2003/C 236/02)

multinational companies with a favourable opinion dropped to 30 percent down from 42 percent when the same group was interviewed in October 2002[23].

However 91 percent of executives indicated that their company has made changes in control and compliance practices.

The findings of the survey regarding the overall assessment of the Act are summarized in the table below.

Table 1

ASSESSMENT MEASURES	OCTOBER 2002	JUNE 2003
A good and adequate response to problems in accounting and reporting	9%	7%
A good first step in company accounting and reporting, but more needs to be done	33%	23%
A well-meaning attempt, but will impose unnecessary costs on companies	42%	49%
Ill-considered and hastily-passed legislation that won't make any difference	15%	15%
Will actually harm rather than improve the capital	1%	5%

[23] PricewaterhouseCoopers: Senior Executives Less Favourable On Sarbanes-Oxley, July 23, 2003.

ASSESSMENT MEASURES	OCTOBER 2002	JUNE 2003
markets		
Somewhat higher long-term costs expected	59%	58%
Higher risk for their audit committee, CEO, CFO, and other executives providing sub-certifications	48%	55%

The author also reported "Certification-related risks, and the growing number of executives who must now sign off have clearly contributed to the sense of discomfort with Sarbanes-Oxley regulations at the top. The increased risk has caused many companies to schedule more-frequent meetings of their audit committee, to devote more time to the issues of audit risks and quality."

The above indicates the extent to which corporate managers are resigned to meet the provisions of the Act and are willing to incur the additional expenses required for improving and changing business processes in order to ensure compliance.

This new approach which may be influenced by the desire either to improve operational effectiveness and transparency or deflect possible penalties under the Act has opened new opportunities for IFAs which are examined in the next section.

5.4 IMPLICATIONS FOR IFAS

In November 2003, the SEC approved the final versions of corporate governance listing standards proposed by the New York Stock Exchange and the NASDAQ Stock market[24]. This standard expanded upon the Sarbanes-Oxley Act and the SEC rules to impose significant new requirements on listed companies. As seen in the previous section, similar standards are emerging globally and companies are taken the necessary steps to be compliant in order to avoid penalties. The implications for IFAs are reviewed within the general context of the range of services provided regardless of the type of entity such by individual practitioners or accounting firms. No distinction is given as to where the IFA activities are based although the analysis will relate mostly to those operating in the US. The distinction was not deemed valid because other countries are enacting similar regulations and therefore the effect can be considered universal. Examples will not be based solely on the US experience.

Corporations has changed the way they conduct business and are looking for ways to transform compliance into opportunity by evaluating the overall success of their financial systems and performance management strategies.

The implications for IFAS are best demonstrated by the paper titled "Sarbanes-Oxley Readiness" prepared by PricewaterhouseCoopers. It claims, "Companies subject to Sarbanes-Oxley must now implement antifraud programs and controls that are evaluated annually during the integrated audit."

[24] A New Strategy for Success Through Integrated Governance, Risk and Compliance Management, PriceWaterhouseCoopers

The development of such programs can be seen as major opportunities for IFAS whose role is now pushed to the fore front as their skills are required to develop and implement preventative or pre emptive measures and not merely focused of investigation and correction.

It indicates that although most companies already have components of an antifraud program in place (e.g. codes of ethics and conduct), they will need to take supplemental action in the following areas:

- The definition of "fraud"
- Board, audit committee and senior management oversight
- Fraud risk assessments
- Linking control activities to identified fraud risks
- Fraud monitoring
- Fraud auditing, and
- Knowledge management.

These are all areas of expertise for and IFA and therefore new opportunities for expansion of services. The opportunity extends beyond the IFA developing programs to meeting the new legal requirements but to provide effective services that can generate cost savings opportunities that directly impact the bottom line.

Similarly, John Smart[25], partner in global investigations and dispute advisory practice at Ernst & Young, recognized the benefit the ACT will have on IFA practice and wrote "the increased reliance on forensic accountancy was a significant and growing trend. There are at least two factors working in favour of forensic accounting,

- The focus on corporate governance has raised awareness of criminal detection, whereas in the past it was a risk that people chose to ignore.
- The other factor is that there are signs that the police are taking financial crime more seriously and putting more money into fighting it. One example is the Assets Recovery Agency, which is using forensic accountants. And the police are doing more to get these skills internally." 25

The major implication for IFAs lies in the increased demand for their skills that is expected in order to promote an effective implementation of the provisions of the Act thereby raising the standard of corporate accountability and making it more difficult for those who would seek to employ fraudulent practices.

Other implications and the related responses are reviewed in more detail.

5.4.1 Public Company Oversight Board Implications for IFAS

[25] Student Accountant, April 4, 2004, Paul Gosling-Fighting crime

The main implication is the policing effect on auditing firms which was previously done within the relevant accounting association and bodies. This external scrutiny for accounting firms and the limitations placed on certain duties they can perform for their audit clients are of particular significance to IFAs especially in audit-related investigations as tests relating to auditors' independence and working papers have to be revised. Similarly procedures relating to the assessment of the ethical environment and quality control for investigations have to incorporate the requirements of the Act. The main impact for IFAs in this instance is on the work process during investigations as new standards have to be employed.

In endorsing the need for external monitoring of accounting firms and auditing standards, ACCA President Sam Wong offered: "We believe global problems need global solutions. There has been much EU condemnation of the impact outside the US of the Sarbanes-Oxley Act, but the Auditing Practices Board (APB) seems intent on joining the standards 'arms race'. This is particularly surprising as the EU is moving rapidly towards the introduction of International Standards on Auditing."

"National standard setting bodies should recognize that the public interest in global capital markets must be met by application of high quality international standards in all jurisdictions. Undoubtedly, ethics for auditors does not stand still. But to play their part in its evolution, national standard setters should seek international influence rather than issue national rules which fragment the market and confuse the users of financial

statements. The Auditing Practices Board should be a strong voice for harmonization aligning its agenda with that of IFAC, the international standard setter."[27]

In Canada the setting of auditing standards remains within the responsibility Canadian Institute of Chartered Accountants (CICA) through a body established by that organization, the Auditing and Assurance Standards Board (AASB). The critical improvement is the tests for compliance with the relevant oversight agencies which are created outside of the profession with appropriate powers for disciplinary action.

Under the Norwalk Agreement, FASB and the International Accounting Standards Board (IASB) have made a commitment to increase the comparability and quality of accounting standards. International convergence on auditing standards is considered necessary in order to develop a high quality set of accounting standards. However, as Bob Herz, chairman of the Financial Accounting Standards Board (FASB) explained, "convincing the US business community that a universal accounting language is worthwhile will be the greatest challenge"[28].

The impact on IFA investigations lies in the strengthening of rules that avoids or eliminates aggressive application of generally accepted accounting principles (GAAP) that normally results in a manipulation of the results.

An example of how this aggressive application was used is demonstrated in the table below which examines WorldCom's accounting for certain transactions.

[27] Mistake to go it alone on auditor ethics, says ACCA, By A Healy, Mar 15, 2004
[28] http://www.accaglobal.com/news/centenary/ International convergence - facing the challenge

Table 2

EXPENDITURE	GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)	APPLICATION BY WORLDCOM
Acquisition/Merger Costs	Record expenses in the period in which they were actually incurred.	▪ Recorded these expenses in future quarters, thereby inflating earnings.
Reserves	Record estimated reserves, with support or business reason.	▪ Recorded significantly larger reserves ▪ Dipping into the reserve fund whenever it needed to increase earnings.
Goodwill of MCI Business	Normally, goodwill could be amortized over estimated 40 years. If the fair value of assets equal the book value of the assets acquired, the premium paid should be expensed over slightly more than 4 years.	▪ MCI's hard assets acquired for $3.4 billion over the book value. ▪ The $3.4 billion was recorded as goodwill ▪ WorldCom slowly reduce its earnings by much smaller amounts.
Line costs(Sub-contract fees paid to telephone companies	Expense to be recorded in the period incurred. Fees must be expensed, may	▪ Reduced line costs offset by a corresponding decrease in other reserve accounts.

EXPENDITURE	GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)	APPLICATION BY WORLDCOM
for calls)	not be capitalized.	▪ Reclassified line cost expenses as an asset.

The fraud was not possible without the collaboration of WorldCom's management team, the auditors, market analysts and the underwriters.

A more recent event is the widely reported investigations of Shell by both the US's Securities and Exchange Commission (SEC) and the UK's Financial Services Authority (FSA).[29]

In his article in the April 2004 issue of the Student Accountant, Paul Gosling reported that the US, law firm Milberg Weiss has begun a class action suit against Shell on behalf of shareholders alleging that in overstating the reserves the company breached accounting rules in the preparation of its financial reports. Key directors - including van der Veer, Boynton and Watts - are named defendants alongside Shell.

In a statement issued by the law firm Milberg Weiss for the plaintiffs

- "The complaint alleges that the defendants' deliberately violated accounting rules and guidelines relating to oil and gas reserves which resulted in a shocking and unprecedented overstatement of oil and gas reserves, the eventual disclosure of which

[29] Dispatch by Paul Gosling, Student Accountant,07 Apr 2004, Shelling out

damaged purchasers of Royal Dutch and Shell Transport securities and rocked the investment community".

- "The complaint alleges that Royal Dutch and Shell Transport had classified and reported, in SEC filings and other public documents, certain reserves as "proved reserves" from a project off the western coast of Australia called the Gorgon Joint Venture, and various projects in Nigeria. In fact, unbeknownst to investors, the reserves did not meet SEC and industry requirements necessary to be classified as "proved", and were improperly reported as proved reserves in Royal Dutch's and Shell Transport's financial reports, thereby materially artificially inflating a key measure of the companies' financial position and competitive standing. As a result of these material misrepresentations, Royal Dutch and Shell Transport's true value in the marketplace was severely overstated and misunderstood."

The effect of the correction of the misreporting is a drop in the share values by more than 7%. It is commonly felt that the error is no accident given the SEC and industry guidelines. Audit responsibility for Shell split between two major accounting firms which generally believes that "the responsibilities of auditors are clearly defined and do not extend to the level of [mineral] reserves."29

This demonstrates that in spite of more stringent measures of reporting and quality control with the introduction of the Act, there are areas where regular accounting principles will continue to fail investors.

This is possible where auditors believe aspects of the operations of companies they audit "is beyond their responsibility and their technical competence...."

Activities of IFAs can fill this void in order to ensure full application of the provisions of the Act because they are generally held to a higher standard in the quality of their work which is defined by developed legal principles and requirements. Secondly, IFAs are not shielded by reduced responsibility of any engagement as "competence and ability to handle the assignment" are common prerequisites.

Regulatory role and IFAS

The new powers given to the regulatory agencies to oversee the audit of public companies means that they will need qualified staff to execute their mandate. The nature of the work required by these agencies favour the IFAs because one of the objective as stated by the SEC chairman, William Donaldson is "....the government's prosecution of corporate abuse and the pursuit of redress for harmed investors...."[30] This is within the specialized skills of IFAs which will lead to a higher demand for their services which will lead to an expansion of this group of specialist because more persons will be attracted to this area of practice.

Similarly, corporations in an effort to become compliant will need to employ the services of IFAs in order to implement and design the appropriate systems or provide advice on procedures in order to avoid being a subject of an investigation in the future.

The role of the regulatory agencies as stipulated in the Act will therefore create a demand for the skills set of IFAs which will not only provide increased employment

[30] SEC Chair Addresses Corporate Abuse Cases, Associated press, June 2003

opportunities but heightened awareness of their work generally and greater desire for specialization in this area which will now compete directly with the traditional auditing.

5.4.2 Auditors independence requirements Impact on IFAS

In its effort to promote true independence, the Act prohibits the auditor from performing specific services which includes IFAs services. The IFAs employed to the major public accounting firms will be most affected by this provision as their clients are mostly public companies. The IFAs who provide litigation support, quantification of damages and valuation services will also be severely affected.

An interpretation of the rule is given by Morrison and Foerster as follows:[31]

"The old rules do not prohibit an auditor from providing expert services to an audit client. The new rules state that an auditor will not be independent if the auditor provides expert opinions for an issuer in connection with legal, administrative, or regulatory proceedings or acts as an advocate for an issuer in such proceedings. This prohibition would include providing consultation and other services to legal counsel in connection with litigation (for example, forensic accounting services in connection with SEC enforcement investigations). However, the new rules do not prohibit an auditor from assisting the audit committee in conducting its own inquiries into accounting misdeeds at the issue."

[31] http://www.mofo.com/news/SEC Adopts Final Rules Regarding Auditor Independence, March 2003

This clearly impacts the performance of related services where the client is an attest client. The impact is recently demonstrated by the following announcement from one of the major accounting firms.

"KPMG said today that it will stop providing full-scope legal services, and that it's associated legal network – KLegal International – is to be discontinued.

Member firms of the KLegal International network are now discussing the formation of a new legal grouping that will be completely independent of KPMG, and which will work with KPMG member firms - where appropriate - on a non-exclusive basis.

The announcement reflects changed market conditions, including the U.S. Sarbanes-Oxley Act – which restrict the provision of non-audit services to audit clients, particularly legal services"[32]

This announcement demonstrates the extent to which these large firms have to review their operations in operations to ensure compliance with the Act. This will not affect IFAs who specialize solely in forensic investigations but can adversely impact the extent to which they can provide assistance to identify key risk areas and develop anti-fraud programs for auditors to be used in audits.

[32] Strategic Planning for Sarbanes-Oxley 20005-7-Ongoing Aspect of Law Means We Must Look Ahead, Robert Hirth

[86] http://www.coso.org/key.htm

5.4.3 Corporate Responsibility Requirements Implications for IFAS

One of the earlier attempts to address fraudulent financial reporting is the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in 1985. An independent private sector initiative, it was implemented in order to:

- Study the causal factors that can lead to fraudulent financial reporting
- Develop recommendations for public companies and their independent auditors, for the SEC and other regulators, and for educational institutions.

It provided a definition for internal control which is used by the Act. The definition is given as follows:[86]

"Internal control is a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations"

This is the framework that auditors are required to use for Section 404 evaluations and guide them in the reporting of operational effectiveness of the fraud prevention and detection efforts.

In response to a concern relating to the effectiveness and suitability of this framework during an interview with Fraud Magazine Douglas R. Carmichael, the first chief auditor and director of professional standards of the PCAOB responded:[87]

"COSO is clearly an acceptable framework. The SEC has indicated that it is but I think any company using it has to recognize that the COSO framework was created in an earlier environment and companies should update it when implementing it. In other words, COSO's framework was developed before audit committees were given the role they have today under Sarbanes-Oxley. As there have been innovations in fraud prevention and detection since then, so it's certainly incumbent upon companies to implement the COSO framework within the current environment and not to view it as something static that doesn't require improvements."

This indicates additional impact on IFAs by way of increased opportunities because they can target those public companies whose external auditors are barred under the Act from helping their clients to implement and redesign a framework adapted to the current environment.

Commenting on the issue of Federal Sentencing Guidelines for Organizations, where the commentary states that "Failure to prevent or detect the instant offence, by itself, doesn't mean that that [compliance] program was not effective." [USSG Section 8A1.2, comment (n 3(k))]; he offered the following:

[87] http://www.thewhitepaper.com/FeatureArticle.asp

"As far as litigation, the key issue is that responsibilities established by standards should be specific and definitive. When a professional doesn't know his or her responsibilities, that's when there are unfortunate litigation problems. If you can be clear about the responsibilities, naturally people are going to be held accountable for meeting those responsibilities and if they don't there will be consequences - from the PCAOB and from people pursuing private rights of action. However, the cause will be their own failure to meet clear requirements.

As far as the sentencing guidelines - our objectives and the objectives of internal control over financial reporting are different from the sentencing guidelines. We emphasize the importance of the "tone at the top" of an organization. Unless there's an effective internal control environment then the rest of the controls are not going to be effective. That was our reason for highlighting any fraud by senior management as being so critical. Fraud by senior management is incontrovertible evidence of a poor tone at the top. It is the case that a fraud by senior management could result from management overriding the controls but we think that in a good organization there will be controls in place to deal with management override. It's critical that those controls include, for example, the audit committee.

In contrast to past practice there is a strong incentive to identify fraud by senior management as a material weakness. However, if there is a fraud by senior management it's possible for the auditor of the company to conclude that there's not a material weakness. We identify it as a strong indicator but stop short of saying that it is presumptively a material weakness. But by saying that it is a strong indicator we shifted

the responsibility to those who take that position to be able to substantiate and be comfortable with it not being a material weakness.

Companies have a substantial period of time to improve things and avoid an opinion that their systems aren't effective. I think that the issue will be whether companies will go ahead and do that. A lot of companies have not had good control systems or haven't adequately documented them or tested in the past. That's going to have to change. Generally, I think public companies recognize that's the case, and it's going to be necessary to make improvements so they can say that by the time the reporting starts their systems are effective."87

Based on this response the determination of the regulators to promote an ethical corporate environment as well as adequate internal controls implies that severe penalties will be imposed where investigations uncover any fraudulent activities. This is a clear indication where IFAs services are impacted by the Act because its requirements for compliance overlap the steps and procedures normally used in IFA engagements.

Audit committee requirements

Another area of concern where questions were fielded to the chairman is the requirement for public companies to put a "financial expert" on their audit committees or tell the agency why they do not have one and that auditors judge the effectiveness of audit committee members who have the power to hire and fire them.

The PCOB standard requires that auditors review the effectiveness of the audit committee in its oversight with respect to financial reporting and internal control over financial

reporting. Where the auditor determines that the audit committee is ineffective in its oversight, it must be reported and is a strong indicator that a material weakness exists.

It also requires the auditor to evaluate the audit committee as a part of his or her assessment of the overall control environment and entity-level monitoring process. If the auditor determines the audit committee is ineffective, that is to be considered a significant finding that must be reported.

The chairman believes that the Act takes care of any conflict the auditors will have with management by making the audit committee the group that hires and fires the auditor. The auditor given the responsibility to report on the audit committee is not considered an area for concern because the chairman describes the distinction as follows: "I think it's not the same (conflict) because management's performance is reflected in the financial statements that are being audited. It's not the audit committee's performance. The audit committee doesn't have the kind of vested interest in exaggerating its performance in the financial statements that management might have. And, therefore, the conflict is not the same kind of conflict at all.

The Sarbanes-Oxley Act did place critical importance on the role of the audit committee. Some people said the audit committee is the responsibility of the board of directors. However, we believed that if the audit committee wasn't doing its job it was because the board wasn't doing its job. And if that were the case there would be no one in that whole process - the management, the board, the audit committee - blowing the whistle. Really, the only objective party in that whole process that can stand up and say there's a problem

when the audit committee isn't doing its job is the independent auditor. Therefore we felt that it was important that the independent auditor have that responsibility.

We believe the auditor would have the knowledge and experience to do it because auditors have exposure to a great number of audit committees and the different kind of practices that audit committees follow. So we didn't think it would be difficult. We were not expecting the auditor to make some kind of scaled evaluation to grade the audit committee but when the audit committee is not doing its job to stand up and say so."87

The impact for IFAs is the importance of the audit committee and how best they can provide assistance to this newly elevated group to execute their role as "financial expert" as well as provide them with the basis to improve the monitoring process, fraud prevention and detection so that they will be favourably judge by their auditors and perform the role as intended under the Act.

Audit committees are required under the Act to pre-approve all non-audit services which in effect means they are not only given the responsibility to hire auditors but also other professionals.

The impact for IFAs is for this group to expand its network activities to ensure that persons who are likely to be sitting on these committees or boards become fully aware of the nature of their work in order to recognize the kind of assistance available to help in the execution of their duties especially in the area of conducting investigations.

The Internal Auditor's Role

The passing of the Act highlights the importance of internal audit which was underutilized in the past. It presents a significant source of information to management in relation to the adequacy of an organization's control environment and governance

process. This presents an opportunity for IFA to be employed directly to companies in internal audit to design and test internal controls as well as help with fraud investigations. The use of IFAs in such roles is seem as critical as the final PCAOB recommendation allows independent auditors to more broadly determine whether and how they may use the work done by others.[88]

The auditors are allowed to exercise professional judgment and ask:

- Who did the work?
- How was it done?
- How competent and objective were the people who performed the work?
- What were the results?

It is clear that where IFAs are performing the internal audit functions the external auditor will be in a better position to rely on the work they performed internally.

The PCAOB in allowing independent auditors to rely on the work of others demonstrates its recognition of the quality, competency and objectivity that internal audit can deliver. The effect is that companies will be encourage to invest in internal audit since external auditors can rely on some of their work and this will in turn helping in managing compliance costs while provide new areas where IFAs can use their skills .

Where the auditor decides to rely on the work of others he would be accepting responsibility for it because the standard requires that the auditor's own work must provide the "principal evidence" for his or her opinion.

Foreign compliance

[88] http://www.ey.com/global/Content.nsf/US/AABS_-_Assurance_-_Audit_Committee_-_Preparing_for_Internal_Control_Reporting

The March 2004 report of Accounting and Business explores the readiness of European companies in complying with the Act. The reports suggest that many European companies with US operations are unprepared for incoming regulations that strengthen reporting requirements.

The article outlines that a study from software company, HandySoft, found the following:

- European companies listed on US stock exchanges face a 35% increase in audit fees as a result of mandatory compliance with the Sarbanes Oxley Act.
- Three-quarters of affected companies are likely to have in place systems and procedures that provide the required internal financial controls by the deadline date of 2005
- Implementation of the key requirements of the Act will increase external audit costs for a US-listed European company by approximately 1.35m euros over current average audit costs.
- The boards of large European multi-nationals are behind US companies in improving corporate governance standards as only one-third of European boards while almost two-thirds of US boards had increased their focus on governance.
- There was an increased focus on improving the effectiveness of audit committees in both Europe and the US, approximately 44% of European audit committees increased their time and effort over the past year, compared with 68% in the US.

The growing compliance worldwide means that IFA practices will be expanded to cover the demand because they are the group of professionals with the comprehensive training and expertise to provide the necessary support. The range of IFA services will therefore be broadened over current scope even though it is considered costly.

Ethics

A code of ethics is required of companies subject to the Sarbanes-Oxley Act and a newly released research from Deloitte & Touche LLP, finds that most companies have taken the initial steps toward establishing a code of ethics[89]. It also found a limited number are actively monitoring adherence to the programs.

In this study a detailed questionnaire was sent to 5,000 directors of the top 4,000 publicly traded companies in the US the following results were reported:

- Of the firms responding eighty-three percent have established formal codes of ethics and conduct
- Of the firms which have established codes of conduct twenty-five percent is not actively monitoring compliance.
- Only approximately fifty-five percent had an ethics officer whether on a full or part-time basis.
- More than ninety-five percent of the companies said their code of ethics applied to every member of their organization, including senior management and board members.

The National Director of Corporate Compliance and Ethics Consulting at Deloitte expressed confidence of improvement and possible reasons for the challenges facing the companies as follows:[90]

"Our data shows that there are several business and operational challenges facing many companies which are working towards implementing ethics and compliance programs.

[89] http://www.srimedia.com/artman/publish/article_814.shtml, Sarbanes Oxley code of ethics requirements not there yet
[90] http://www.srimedia.com/artman/publish/article_814.shtml Sarbanes Oxley code of ethics requirements not there

We believe that these challenges are not insurmountable and that corporate ethics initiatives will continue to gain momentum."

The issues that are among those impacting the implementation and sustainability of successful ethics and compliance programs as identified by the survey are:

- Communication – For more than half of the firms responding the board became involved when there is a failure and only approximately fifty two percent actually distributes the code to shareholders, suppliers and customers.
- Reporting Mechanism - Less than thirty-five percent of the companies surveyed had an outside third party manages their reporting mechanism. This will affect the anonymity requirements of Sarbanes-Oxley where a third party is not does not manage whistleblower help lines. It found that the help lines may not be promoted effectively, or that people are uncomfortable using them.
- Training - Two-thirds of the respondents indicated that their company supports ethics and compliance programs through ongoing training.

The National Director of Corporate Compliance and Ethics Consulting at Deloitte concluded:

"Sarbanes-Oxley, combined with investor pressure, has been an effective catalyst in generating awareness of the critical need for corporate ethics and compliance programs, which are key components of a strong corporate culture.

In turn, having a strong corporate culture strengthens the control environment which is the foundation for Section 404 compliance. We believe that as deadlines pass and new

internal control and corporate governance measures become integrated into the everyday activities of companies, ethics and compliance programs will assume their rightful prominence."90

This sentiment reflects one of the implications for IFAS services because of the increasing need for their skills which is driven by compliance to the Act as corporations work to strengthen their control environment and include fraud prevention measures and programs into operational procedures and practices.

Education and training

One implication of the Act for IFAs is the increased training and education programs that are now being devoted to fraud. The AICPA has developed new fraud initiatives that will enhance the skills of auditors so that they can identify fraud risks and be in a position to change audit procedures to handle the situation. [91]

The initiatives include:

- Establishing an Institute for Fraud Studies, in conjunction with the University of Texas at Austin and the Association of Certified Fraud Examiners, to explore the origin of and circumstances surrounding fraud so that its frequency and effects can be minimized.
- Designing anti-fraud criteria and controls intended for public corporations.

[91] http://www.aicpa.org/pubs/cpaltr/nov2002/fraud.htm

- Urging stock exchanges to mandate effective anti-fraud training for management, boards of directors and audit committees and making available training to directors and other corporate officials free of charge.
- Calling on CPAs to dedicate 10% of their CPE to fraud.
- Recommending the Auditing Standards Board enhance existing attestation standards for CPAs to test and report on client anti-fraud controls and criteria.
- Hosting a fraud summit to identify ways to reduce the incidence of fraud.
- Working to ensure college textbook authors incorporate anti-fraud education in programs and text materials.

This provides new resources for IFAs to develop training which will help to increase the pool of professionals available to assist in the implementation and compliance of the Act.

Whistleblower protection provision

The whistleblower provisions of the Act include protection for those employees who make either internal or external charges of fraud against their employers. The Act requires audit committees to set up procedures for complaints to be handled in a confidential and anonymous manner.

This provides a source for IFAs to conduct preliminary reviews either for direct investigations or assistance to others. The value of this provision is best outlined in the following article[92]

[92] www.camagazine.com, Oct. 2003.,

"The most common and frequent way of detecting fraud is through tips from employees, vendors and others involved in corporate activities. Sometimes whistle-blower communication is anonymous. It can be an unsigned note that's slipped under the CFO's door or an anonymous letter alleging fraud or corruption mailed to the company president. These letters are often written by someone who is close to the corporation with specific knowledge of fraudulent or unethical transactions. Sometimes the anonymous submission outlines suspicions that a senior company official is stealing. Such communication usually indicates it has been sent by an employee. Anonymous submissions alleging a payoff or kickback is required to be successful on a contract are most likely sent by an unsuccessful bidder."

"Employees are often in the best position to spot fraud," says Tim Williams, vice-president, corporate security of Nortel Networks and co-author (with W. Steve Albrecht and Gerald W. Wernz) of *Fraud: Bringing Light to the Dark Side of Business*. Williams notes that, as the majority of corporate fraud is perpetrated by employees, it makes sense that co-workers will eventually figure out what is happening. "But employees are often hesitant to come forward with this kind of information for a number of reasons," Williams says. "Sometimes it isn't possible to know for sure if a fraud has occurred. The tipster sees red flags but not actual proof." For example, an employee may see a manager who appears to be living beyond his means or will see aspects of a particular business transaction that he doesn't understand. "Whistle-blowers may also be concerned about reprisals. They may feel intimidated by their superiors ... or may feel that the organization does not make it easy to bring forward their suspicions."

Given this protection employees will be emboldened to report their suspicions which will in most cases be investigated thereby increasing the use of IFA services. IFAs either actively participating in the investigation or providing expert advice on the how to conduct investigations or implement the required procedures, their services will be solicited.

6.0 CONCLUSION

The Sarbanes-Oxley Act has undoubtly ushered a new era in corporate governance as companies move to ensure compliance. The main implications for IFAs are the direct or indirect effect on the nature of practce in terms of types of engagements and new demands for updated procedures, standards and process relevant to the changing attitudes towards the control environmant, fraud prevention and fraud investigations. The implicataions are mostly positive and be summarized as follows:

- Improved and higher standard of independence for IFAs as greater reliance are placed on their services.
- Increased demand for sevice generated by fraud awareness.
- Improved information source as provded through avenues such as whistlerblower protection provisions
- Improved pools of documents which will impact the scope and sophistication related to data mining during investigations
- Improved methods of gathering evidence because of the longer period required to retaind documents and the penalties attached to intimidation of persons willing to provide information.

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