

KILL YOUR AUDITOR

You'll want to vent your frustration somehow when you start dealing with the latest wave of regulations.

THE SARBANES-OXLEY ACT is the most significant overhaul of US corporate governance in nearly 70 years. A host of questions remain over the legislation, not least how significant it will be for directors and businesses outside the US. It also highlights how different the US approach to financial reporting is from the UK's. In the same way that we like to cling to the idea of the "special relationship," we like to believe that we share much with American accounting. In fact, our approach is radically different.

In the US the financial reporting regime is run by lawyers, not by accountants. Everything is allowed unless it is specifically banned. There is no keeping to the spirit of the agreement. There is just the letter of the law. Hence Enron's use of hundreds of special purpose entities (SPEs) that kept just within the definition of "legal" but way outside what most people would call honest.

In contrast, the UK has a principles-based approach. The idea is that reports and accounts show a "true and fair" view. I know this has been dissipated recently as extra guidance has been produced to cope with increasingly complex issues such as financial instruments. But the so-called "cookbook" approach of the US is still scorned over here.

In the US they love detailed guidance. And Sarbanes-Oxley 2002 adds to their mountain of regulation. The new act ushers in a system of federal oversight of public auditors through a Public Company Accounting Oversight Board; a new set of auditor independence rules; new disclosure requirements applicable to public companies and



Congressmen Paul Sarbanes (right) and Michael Oxley accept the thanks of President Bush for helping dean house in the US. But UK FDs caught up in their act might not be so grateful.

insiders; and harsh civil and criminal penalties for persons who are responsible for accounting or reporting violations.

For public companies, the act's most noticeable effects relate to corporate governance, an area of regulation traditionally left to state corporation laws. The act will force many companies to make significant changes to their internal controls and the roles played by their audit committees and senior management in the reporting process. CEOs and CFOs come in for special treatment.

Audit committees will be subject to heightened independence standards, including a prohibition of any non-independent members. And companies will be required to grant their audit committees specific levels of control over the company's relationship with its auditors.

The act stipulates that periodic reports must include disclosures regarding the issuer's internal controls, non-audit services provided by

the issuer's auditor and material off-balance sheet transactions or obligations. Company reports must say whether the issuer has adopted a code of ethics for senior financial officers, and if not, why not. Any change to the code or any waiver of its provisions must be disclosed.

Can you see the pattern? It looks like a case of closing the stable doors after Enron and WorldCom have bolted, run amok and been put down.

Over the coming months, the SEC will issue rules implementing the changes, including prohibiting accounting firms from providing most non-audit services to public companies they are auditing. That looks like a massive blow to the big firms. But an audit committee can pre-approve some roles including provision of tax services; appraisal or valuation projects; design and implementation of financial IT systems; and legal and expert services unrelated to the audit. Similar moves proposed this side of the

Atlantic have been given short shrift by the audit firms.

But the act is already here. It applies to all companies listed in the US, including UK firms with American Depository Receipts (ADRs) listed in New York. Foreign companies active in the US are also obliged to comply with US laws.

For example, many of you will be the FD of a UK subsidiary of a US corporation. It's not clear yet whether directors of subsidiaries will be asked to certify the reports relating to their own companies. But if any of you UK-based FDs are asked to sign any such statement, you'd be well advised to take legal advice before putting pen to paper. For now, experts say you shouldn't sign until the last possible moment.

And Sarbanes-Oxley might just be the start. Corporate governance experts are warning that further US legislation could be on its way. At the same time, the European Commission is expected to produce its own directives on corporate governance which will have to dovetail into the UK's white paper on the Company Law Review (CLR).

"I am quite surprised by the size of the fines and the level of imprisonment associated with the legislation," a corporate governance expert told me. "As the US law stands, you could face a far lower level of punishment for killing your auditor than signing a piece of paper erroneously stating your accounts are accurate." Well, it's a thought isn't it?

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