

Statement on proposed abolition of US audit regulator



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US Congress is proposing to shut down the Public Company Accounting Oversight Board (PCAOB), a move which we believe could harm both investors and the public.

If we cast our minds back to autumn 2001, Enron Corporation (the energy trading giant and seventh-largest US listed company at the time) was in free fall. Enron was accused and ultimately convicted of massive accounting fraud. By December 2001, Enron filed for bankruptcy, leaving thousands of staff unemployed, customers out of pocket, and trust in corporate accounting wounded. It was not long before eyes turned to Enron's auditor, Arthur Anderson, for failures in exposing the accounting gimmickry. Within months, Arthur Andersen closed shop with its credibility destroyed.

It was against this backdrop that US lawmakers from all political persuasions united behind regulatory reforms to strengthen auditor independence, including the creation of an independent audit regulator, the PCAOB. Until that point, a self-regulatory model had prevailed, which was vulnerable to substantial conflicts of interests.

Fast forward to today and it seems the lessons we learned are at risk of being forgotten. Buried within [Section 50002 in the House budget reconciliation bill](#) making its way through Congress is a proposal to shut down the PCAOB and move its responsibilities to the SEC. This would, in our view, be a retrograde step.

We underline our concerns with the proposed action below:

- **Loss of independence** – The establishment of the PCAOB was intended to create an independent regulator that would act robustly to deliver high audit quality, while remaining subject to SEC oversight. A move to fold the PCAOB into the SEC would likely reduce its independence.
- **Unclear budget** – If the goal is cost cutting, this action would obviously not help. The PCAOB is currently funded by charges on companies, not the taxpayer [\[1\]](#). By moving the responsibility to the SEC, additional resources would be required from the federal government.
- **Reduced enforcement** – If this funding was not forthcoming, then the activities to enforce standards would be cut. [Some auditors and companies complain](#) that investigations and new disclosure requirements are excessively onerous. While it is important to ensure

proportionality, investigations will inevitably demand management and board attention. This process delivers accountability. [Recent audit quality reviews](#) by the PCAOB point to ongoing high levels of deficiencies, despite recent improvements. This is not the moment to remove checks in the system.

- Weaker oversight of foreign issuers, notably China. The PCAOB has negotiated several cross-border agreements to permit PCAOB investigations and thereby ensure non-US companies' meet minimum audit standards. The current agreement made with the Chinese authorities was notably hard-won and permits PCAOB inspections of Chinese audit firms. With the proposed abolition of the PCAOB, new agreements may be required, resulting in potentially extended periods of non-enforcement.
- Brain drain – It is unclear whether staff would be transferred, but a major concern is that many may choose to leave either way due to lower pay levels and concerns over increased politicisation of audit oversight.

All of the above could threaten audit quality. As recently [pointed out](#) by a founding PCAOB board member, Dan Goelzer: *“Restatement rates have dropped substantially since the early 2000s. [Since leaving the board] I spent 11 years chairing a group of five outsiders that advises one of the Big Four firms on audit quality. Just looking at it from that perspective, I know the firms devote tremendously more resources and leadership thought to audit quality, and maintaining audit quality, than they did before the PCAOB and the risk of inspections.”*[\[2\]](#)

Investors are speaking up to set out the dangers of the proposed action. The CFA Institute has published an excellent [letter](#) outlining why the proposal would harm investors and capital markets. More recently, the International Corporate Governance Network, of which Sarasin & Partners is a member, also published their [letter](#) to the House Finance Committee.

While these voices carry the weight of trillions of dollars of savers' assets, there is a danger that they get drowned out by a narrow group who are keen to return to light-touch regulation. Ultimately, weaker audit enforcement will not just put investor capital at risk, as was so dramatically evidenced with Enron's demise. It will likely raise the costs of capital to all businesses listed in the US and undermine trust in audit, which will be in no-one's interest. On this, we should all be aligned.

We would, therefore, like to call on the audit profession, audit committee directors and companies to join investors in calling for the PCAOB to be strengthened, not abandoned, to support capital market stability and long-term economic growth.

[\[1\]](#) According to SOX Section 109(c)(1) the accounting support fees charged on companies to cover the cost of the PCAOB are not considered public monies of United States.

[\[2\] https://www.capitolaccountdc.com/p/an-original-pcaob-board-member-makes?utm_source=post-email-title&publication_id=854774&post_id=163242190&utm_campaign=email-post-title&isFreemail=false&r=1kzhii&triedRedirect=true&utm_medium=email](https://www.capitolaccountdc.com/p/an-original-pcaob-board-member-makes?utm_source=post-email-title&publication_id=854774&post_id=163242190&utm_campaign=email-post-title&isFreemail=false&r=1kzhii&triedRedirect=true&utm_medium=email)

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