Opinion **Accountancy**

Weakening the oversight of US auditing is a very bad idea

Folding the regulator into the SEC would make it much harder to scrutinise how audits are performed

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The PCAOB was created in response to the Enron accounting scandal, the collapse of its auditor Arthur Andersen and a series of financial scandals that emerged when the dotcom bubble burst © Bloomberg

Francine McKenna FEBRUARY 17 2020

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US president Donald Trump's deregulatory drive has a new target in its sights: auditing.

Tucked on page 179 of the administration's budget last week was a proposal to fold the functions of the American auditing regulator, the Public Company Accounting Oversight Board, into the country's main financial regulator, the Securities and Exchange Commission.

This is a very bad idea. The PCAOB was created by the Sarbanes-Oxley Act of 2002 in response to the Enron accounting scandal, the collapse of its auditor Arthur Andersen and a series of other financial scandals that emerged when the dotcom bubble burst. Congress forced the remaining Big Four global accounting firms — Deloitte, EY, KPMG, and PwC — to give up self-regulation and required them to start auditing not just the numbers but also the quality of internal controls at public companies.

The PCAOB has not been the most effective regulator, it must be said. On its watch, the auditing profession has been buffeted by scandals. The Big Four firms have repeatedly had to settle claims that they failed to oversee companies including Bear Stearns, Lehman Brothers and MF Global. In 2018, a federal judge said PwC's auditing of Colonial Bank was so negligent that it missed a massive fraud and should pay $625m to the Federal Deposit Insurance Corporation, which stepped in to protect depositors. The two sides eventually settled for $335m. And last year KPMG was fined $50m for altering audits after receiving tipoffs on impending inspections by the PCAOB.

The solution is not to submerge the PCAOB into the SEC. The commission already oversees the auditing watchdog and, if anything, is part of the problem. Combining the two would make it much harder to scrutinise how well audits are performed, reducing individual accountability of auditors and their overseers. The SEC would never be able to replicate the focus and activity of a dedicated regulator and the administration's proposed budget increase is much smaller than the amount of funding the PCAOB currently receives. The practical effect would be to reduce the budget of auditing oversight and push accounting issues below those the SEC considers more pressing. In addition, the SEC is full of lawyers and accountants who previously worked for either law firms that defend auditors or the audit firms.

Furthermore, the UK, which has also experienced a chronic level of fraud and wrongdoing, is moving in the opposite direction. Britain is tightening its regulatory grip on the audit firms, as it responds to concerns that its watchdog, the Financial Reporting Council, has been too slow to investigate misconduct, handed out sanctions that are too lenient and has a board that is too close to the industry it supervises. The UK is set to replace FRC with a more forceful regulatory body with expanded powers.

Democrats in the House of Representatives are unlikely to approve the full elimination of the PCAOB, but the Trump administration could push forward by having the SEC dismiss PCAOB members or fail to fill vacancies.

While the Big Four would almost certainly enjoy halting the PCAOB's slow efforts to improve auditing standards and insist that auditors document their work, they should not start celebrating too quickly. The watchdog provides the auditing industry cover from all kinds of criticism, and allows it to blame "regulatory bureaucracy" for higher fees. Since 2002, the largest firms have invested in costly legal and compliance functions. That required infrastructure creates additional barriers to entry, making it that much harder for smaller firms to challenge the power of the Big Four.

Without a dedicated independent regulator, audit firms and the SEC will find themselves squarely in the line of fire after the next catastrophic accounting fraud. And that is not a comfortable place to be.

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