No Eulogy upon the Demise of the Public Oversight Board

Kara Bravick

Faculty Sponsor: Ashley Burrowes, Department of Accountancy

ABSTRACT

The AICPA created the SEC Practice Section in 1977 to monitor and regulate the profession. The SECPS established a peer review program with the objective of assuring the public that auditing and accounting firms complied with GAAP, and that the firms had effective quality control systems in place. That same year, the Public Oversight Board (POB) was created to oversee the SECPS and "assure that the public interest is carefully considered" (Mautz 1990).

Throughout its existence, the POB purported to be independent and autonomous. Despite their self proclaimed independence, the POB was merely a puppet of the profession meant to soothe public doubts. The POB mainly issued reports proclaiming the effectiveness of the profession's self regulatory system whenever the profession experienced difficulties. The objective of this project was to examine the actions taken by the POB to recover from the crisis events experienced by the accounting profession and discover the causes for its isomorphic behaviors. Deconstruction and crisis management theories were used to describe these isomorphic actions by examining several documents issued by the POB as well as investigating other related publications.

INTRODUCTION

In the 1970's, the U.S. accounting profession experienced scandals, bribery, bankruptcy and audit failures. Public confidence in the profession plummeted. The Senate Subcommittee on Reports, Accounting and Management of the Committee on Government Operation conducted an investigation of the profession in 1976. The Subcommittee Chair, Lee Metcalf expressed concern for the SEC's delegation of its duties to private groups as well as a lack of independence in CPA firms. The Subcommittee's recommendations included increased regulation of the profession and that private sector standard setting be relinquished to the government (Oliverio 2005). Congress was, however, apparently satisfied with the profession's suggested solution: self regulation. To avoid legislation and regain the public's confidence, the American Institute of Certified Public Accountants (AICPA) and the Securities and Exchange Commission (SEC) created a self-regulatory framework for the accounting profession (Bowsher 2002).

In response to the Senate Subcommittee's findings, the AICPA created the SEC Practice Section (SECPS) in 1977 to monitor and regulate the profession. The SECPS established a peer review program with the objective of assuring the public that auditing and accounting firms complied with GAAP, and that the firms had effective quality control systems in place (AICPA 2002). That same year, the Public Oversight Board (POB) was created to oversee the SECPS and "assure that the public interest is carefully considered" (Mautz 1990). The POB was to serve as the foundation of the profession's self regulation system by monitoring and commenting on issues affecting "public confidence in the integrity of the audit process" (Bowsher 2002).

Throughout its existence, the POB purported to be independent and autonomous. The Board repeatedly stated that they could hire and compensate their members, select the chairman, set their budget and establish operating procedures ("About the POB", "In the Public Interest", "Evolution of the QCIC"). Despite their self proclaimed independence, the POB was merely a puppet of the profession meant to soothe public doubts. The POB's funding came from dues paid by members of the SECPS- the CPA firms the POB was supposed to oversee. The SECPS withheld funding from the POB in May of 2000. The actions of the SECPS were intended to prevent the POB from conducting an SEC recommended special investigation of CPA firms' independence issues (Morris 2003).

Aside from its independence issues, some may see the POB as "a monument to the profession's failures" (Kahn 2002). The POB had no enforcement power and oversaw a review process in which the major accounting firms examine one another's procedures (Kahn 2002). The Board had "no authority to investigate, no subpoena power and no power to punish infractions" (Byrnes 2002). The system has received criticism "because no large accounting firm has ever been given an unfavorable review" (Paltrow 2002). Rather than protecting the public interest, the Board focused its efforts on defending the profession and its existing self regulatory system.

CRISIS MANAGEMENT THEORY

A number of events that lead to the demise of the Public Oversight Board can be examined through crisis management theory and the crisis cycle developed by Shrivastava (Smallman 1999). This theory, developed to describe industrial crises, was applied to business failures by Stead and Smallman and is suitable to apply to the failure of regulatory bodies in business. A study of the POB's actions under the microscope of crisis management theory will help explain why the POB failed.

Organizations in crisis often take actions that are inappropriate and lead to future crisis events. Organizations first "attempt to contain the effects of the crisis" and limit possible damage. The organization may blame others for the crisis in order to defend their pre-crisis behaviors. Actions taken to recover from a crisis often simply treat symptoms and not the root problem, creating a less than permanent solution. The pattern of recurring crisis events is described as an isomorphic feature that can only be corrected through learning (Smallman 1999, Toft 2006).

The authors describe the nature and structure of crisis events as the crisis cycle. The cycle consists of pre-conditions, a triggering event, the crisis event, recovery and learning. Pre-conditions may build over time, causing an organization to become predisposed to crises. Triggering events expose the pre-conditions and set the course towards a crisis event. The period of recovery often involves a great deal of struggle for an organization. The actions taken during the recovery period determine whether an organization will learn from the event, preventing similar events in the future or setting the stage for further crises.

The POB exhibited many factors that encourage the development of pre-conditions for crisis events. The POB and the profession assumed that they knew better than anyone else how to regulate the profession by repeatedly opposing regulatory intervention. The Board's rigid institutional beliefs could not be shaken by any outside organization. The Board neglected outside complaints and repeated investigations, disregarding warning signs of problems in the profession and peer review system. The actions the POB did take to address problems with the profession look like 'decoy phenomena' where a problem is perceived, but actions taken to remedy the problem actually draw away from the actual cause of the issue.

Throughout its existence, the POB faced numerous 'crisis' events; the Board was even created as a result of crisis events. These numerous crises were all answered in the same manner; a report was issued mainly defending the profession's actions and flawed system of self regulation. As learning requires "questioning and changing beliefs, norms and behaviors" the POB failed to learn from these events further perpetuating the problems that eventually lead to its demise (Smallman 1999).

Table 1. Example of crisis cycle elements

Preconditions	Economic pressures on businesses and auditors. Lack of regulation and an ineffective peer review system. Independence issues.
Triggering Event	Failed audits. Exposed financial troubles.
Crisis Event	Business failures causing the loss of public confidence and increased threat of regulation.
Recovery	Issue reports to gain public confidence.
Learning	NONE. Repeated investigations regarding independence and repeated attempts at regulation were all disregarded.

The profession suffered a major loss of public confidence after the Penn Central Railroad bankruptcy and the Equity Funding collapse. These events triggered an investigation by the Senate's Metcalf Subcommittee. The Subcommittee's report 'Accounting Establishment' criticized the profession, especially in the area of auditor independence. The Subcommittee recommended increased regulation of the profession and government takeover of private sector standard setting (Moussalli 2005). As a result, the profession's self regulatory framework was created and the POB was formed (Bowsher 2002).

Another investigation was launched in 1985 after the collapse of the Savings and Loan industry. Representative John Dingell led the investigation which once again recommended government takeover of accounting standards and auditor oversight (Moussalli 2005). It was after this investigation that the Board began its issuance of defensive and reaffirming reports to bolster public confidence.

ISOMORPHISM

The very name of the Board, "*Public* Oversight Board", suggests an interest in and responsibility to the public. The Board seemed more interested, however, in creating and maintaining its image to uphold public confidence. The actions the Board took to maintain confidence in the profession represent isomorphic behaviors.

Isomorphism is described as a "constraining process that forces one unit in a population to resemble other units that face the same set of environmental conditions" (DiMaggio 1983). DiMaggio and Powell argue that this movement towards similarity in organizations is due to institutional forces rather than market driven processes (Lodge 2005). Decision makers may simply learn appropriate responses and make adjustments to their behavior rather than make changes necessary for progress. The occurrence of isomorphism may deter organizational efficiency and large or old organizations may simply "dominate their environments rather than adjust to them" (DiMaggio 1983).

Isomorphism occurs under three mechanisms: coercive isomorphism, mimetic isomorphism and normative isomorphism. Coercive isomorphism is a result of organizations being pressured by other organizations on which they depend or by cultural expectations of society. Uncertainty may cause imitation under mimetic isomorphism or modeling. Normative isomorphism results primarily from professionalization in an organization (DiMaggio 1983).

The isomorphic behaviors of the Board represent coercive isomorphism. "As pressures from the outside grow, organizations are led to find ways to either diffuse or eliminate this pressure by changing their practices" (Frumkin 2004). The Board experienced growing pressure from Congress and the public after each accounting crisis. The Board merely made adjustments to survive instead of delving into the problems that caused the crises it faced.

The Board created panels and committees within itself to perform functions made to look like separate and distinct issues. This is another symptom of isomorphism in that these panels and committees were nothing more than the POB with different names. These entities were created to issue reports and create a perception of legitimacy and authenticity regarding the Board's actions.

DECONSTRUCTING THE DOCUMENTS

The objective of this project was to examine the actions taken by the POB to recover from such crisis events and discover the causes for its isomorphic behaviors. Deconstruction was used to describe these actions by examining several documents issued by the POB as well as investigating other related publications. Review of these publications finds mainly praise of the profession's self regulatory system and opposition to change or regulation. The reports begin by affirming the Board's concern for the public interest but then go on to address concerns regarding the accounting profession and the public perception of its performance.

Scope of Services

The POB's first major report was issued in 1979 in response to a request by the SECPS. "Scope of Services by CPA Firms" investigated the proposed limitation of management advisory services provided by auditors. This report was developed after a two day public hearing and from written statements from people both within and outside the accounting profession. The report focused not on the details of management advisory services but rather on auditor independence and its effects on the public interest as well as public perceptions of the professional image of accounting.

This report served mainly as a reinforcement of the current system and regulations. In the midst of criticism and failing public support, the POB issued this report to assure the public and Congress that nothing was wrong. The report expresses a desire to resist change and additional regulation but the POB does make some recommendations.

The POB recommended limiting only those services that have been shown to impair an auditor's independence. The report claims that services that are "incompatible with the profession of public accounting" and those that impair the profession's image should not be prohibited. The Board was very transparent in its desire to avoid further governmental intrusion into the area of regulating the accounting profession. Other than outright impairments of independence, the POB recommended leaving the scope of services to be provided by firms to the judgment of the clients' audit committees and board of directors.

Even with the issuance of this report, the POB disregarded the warnings raised by numerous prior investigations. After assuring the SECPS that the subject of management advisory services being provided by CPA firms cannot be ignored the POB claims in the body of the report that MAS only warrants the sounding of an alarm. This report happened to be the tenth alarm in less than 15 years. The board claims there is no need to change any arrangements, just allay suspicions.

In the Public Interest

Wavering confidence in the profession once again sparked an investigation and subsequent report by the POB in 1993. The investigation was made at the request of accounting firms to determine if the public interest was being adversely affected by a so-called "litigation crisis." The report, "In the Public Interest" addresses the litigation crisis as well as the profession's self regulatory program. The 'litigation crisis' suffered by the profession is considered a public interest because as the report states, liabilities suffered by accounting firms ultimately have a negative effect on the public. The Board reasoned that excessive litigation has a negative impact on the public's perception and trust of the profession which thus impacts the economy and the public. "In the Public Interest" turns to fixing the public perception of the profession, not the problems that caused the loss of confidence.

The analysis of the litigation crisis mainly discusses the fairness of assigning blame to auditors for financial failure. The Board also discusses the reluctance of auditors to provide services due to the fear of litigation. The report states that "management, investors, creditors and government agencies make decisions of enormous magnitude in reliance upon … statements" issued by auditors and that audit opinions are "relied upon heavily in financially huge transactions." Later, the report states that auditors should only bear responsibility for their "*Legal* failings and shortcomings" [emphasis added] failing to consider professional and judgmental shortcomings.

The report goes on to assess the profession's self regulatory programs. The introduction explains that the report will discuss the program and its "documented success." The POB claims that their assessment provided "abundant evidence that [the Peer Review Program] is a success." The report discusses the effectiveness of the POB, SEC Practice Section and the Quality Control Inquiry Committee. The board even considered other models for regulation that could better serve the public interest but found them all to be inadequate.

An interesting point in the report's evaluation of the National Transportation Safety Board Model, the Board states that "The gathering of factual information surrounding alleged audit failure does not require immediacy" reasoning that the records "are all accessible at a later date and the passage of time does not impede the inquiry." This seems counter-intuitive in that each passing moment allows for the shredding and destruction of vital data and evidence. The report compares the evidence from automobile accident scenes to audit failures, remarking that evidence from an accident cannot be reconstructed. While some accounting data can be reconstructed, the attitude that recovering evidence as soon as possible is not important seems irresponsible.

Lastly, the Board makes recommendations to improve the self regulatory program. The first recommendation is that the SECPS expand its membership requirements and share information regarding failed audits. The Board also recommends that guidance be provided regarding specific situations that auditors may face and numerous improvements to standards for financial statements and audit reports.

Strengthening the Professionalism of the Independent Auditor

This latest report issued in 1994 was commissioned by the POB and presented by the Advisory Panel on Auditor Independence. The report's introduction states that the integrity, objectivity and independence of the accounting profession are examined through review of prior reports as well as interviews and written comments. The Panel chose to structure the report with suggestions to strengthen professionalism in lieu of detailed recommendations.

In describing the environment of the profession, the report calls public goodwill and confidence the profession's greatest assets. These are jeopardized if integrity, objectivity and independence are questioned. The report states that these cornerstones of the profession are threatened by *alleged* audit failures and "improper financial practices by *companies*" [emphasis added]. There is no mention of any possibility that the profession may be responsible for the loss of public goodwill and confidence.

The possibility of adopting additional rules and legislation is discussed through an analysis of the Office of the Chief Accountant (OCA) of the SEC's "Staff Report on Auditor Independence." The Panel mainly concurs with the findings of the OCA and recommends that no changes be made. Regarding independence rules and interpretations; the Panel "found no evidence of a need for actions by the SEC or by the AICPA to add to or amend" the rules and regulations. The Panel also found it to be unnecessary to change the rules regarding the provision of management advisory services because there is a "lack of apparent, dramatic increase in MAS provided to SEC audit clients."

The actual recommendations made by the Panel are superficial at best. Firms should emphasize to their staff their public responsibility and the importance of auditing. Firms should also focus on how the audit function may be enhanced rather than lost in consulting practices. Technical offices and processes for developing positions should remain independent from partners influenced by clients. The Panel also suggests that the POB encourage the adoption of policies and procedures to help professionals remain independent.

CONCLUSION

Review of the previously discussed literature and events surrounding the collapse of the POB has revealed that the Board and its numerous committees and panels played an ineffectual and self serving role in the accounting profession's self regulatory framework. The events that threatened the profession were answered by the POB with reports that deflected the blame for such crises and dealt praise to the system of self regulation in place. The reports continually claim there is no need for change and recommend only minor enhancements to regulations and their enforcement. Had the POB been more accepting of the criticisms the profession received and admitted some fault the profession could have held its role of standard setting and self regulation. The POB and the profession must learn from the crises they face to ensure the public interest as well as the integrity of the profession.

REFERENCES

AICPA, "A Brief History of Self-Regulation." 2002. AICPA.org. http://www.aicpa.org/ info/regulation02.htm

Bowsher, C. 2002. Statement of the Hon. Charles A. Bowsher Chairman, Public Oversight Board Before the Senate Banking Committee. http://www.publicoversightboard.org/news_03_19_02.htm

Byrnes, N. et al. 2002. Accounting In Crisis. Businessweek. http://www.businessweek.com/magazine/content/02_04/b3767712.htm

DiMaggio, P and W Powell. 1983. "The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in organizational Fields." American sociological Review 48(2):147-160.

Frumkin, P and J Galaskiewicz. 2004. "Institutional Isomorphism and Public Sector Organizations." Journal of Public Administration Research and Theory 14, 3; ABI/INFORM Global pg 283.

"In the Public Interest: A Special Report by the Public Oversight Board." 1993. Released by the POB.

Kahn, J. 2002. One Plus One Makes What? Fortune 145(1):88. http://search.epnet.com/ login.aspx?direct=true&db=bsh&an=5783796.

Lodge, M and K Wegrich. 2005. "Control Over Government: Institutional Isomorphism and Government Dynamics in German Public Administration." The Policy Studies Journal 33(2):213-233.

Mautz, R and C Evers. 1990. "Evolution of the Quality Control Inquiry Committee." Released by the SEC Practice Section.

Morris, T. 2003. A New Vision of Oversight, The Accounting Credibility Crisis. CPA Journal 73(5). http://www.nysscpa.org/cpajournal/2003/0503/features/f054003.htm.

Moussalli, S. 2005 Accounting for the Journal's First 100 Years: A Timeline From 1905 to 2005 AICPA.org. http://www.aicpa.org/pubs/jofa/oct2005/timeline.htm

Oliverio, M. E. 2005. "Is the Public Accounting Profession in Decline?" The CPA Journal.

Paltrow, S. and Weil, J. 2002. Accounting Industry Review Board Votes to End Its Existence in Protest. Wall Street Journal A.2. http://proquest.umi.com/pqdweb? did=101519738&Fmt=3&clientId=3845&RQT=309&VName=PQD.

POB, "About the POB". 2001. Public Oversight Board. http://www.publicoversightboard.org/about.htm

POB, 1990. Evolution of the Quality Control Inquiry Committee. http://www.publicoversightboard.org/Evolution_of_Quality.pdf

POB, 1986. Public Perceptions of Management Advisory Services Performed by CPA Firms For Audit Clients. http://www.publicoversightboard.org/Public_Perceptions.pdf.

"Scope of Services by CPA Firms." 1979. Released by the POB.

Smallman, C and E Stead. 1999. "Understanding Business Failure: Learning and Un-learning Lessons from Industrial Crises." Understanding Business Failure 7(1).

"Strengthening the Professionalism of the Independent Auditor." 1993. Released by the Advisory Panel on Auditor Independence.

Toft, B and S Reynolds. 2006. Learning from Disasters 3rd Rev. Ed. Palgrave Macmillan.