**PAPER TIGERS: THE U.S. ACCOUNTING OVERSIGHT REGIME**

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An entire generation has seen their dream of retirement shattered by the failure of the accounting profession. CPAs are supposed to be the “watchdogs” and “gatekeepers” that make sure company financial statements are what they say they are. Instead, the past 15 years have dealt us a “dot-com” crisis, the 2002 financial reporting frauds (with Enron, WorldCom, Adelphia, Tyco, Computer Associates, etc.), and now the 2008 banking debacle, all aided and abetted by the failure of the accountants to do their jobs. These three crises have collectively [wiped out the savings and retirement funds](http://www.scandalsblog.com/corporate-scandals/recent-corporate-accounting-scandals/) of the baby boomer generation, and accountants share a major part of the blame.

While you and I were working hard to save for our retirement, large accounting firm partners grew their wealth by charging high fees for poor quality audits of their global clients. And why should these audit partners care? ***After all, there are no meaningful consequences to their audit malpractice.***

Take the case of former Deloitte partner, [James Louis Fazio](http://pcaobus.org/Enforcement/Decisions/Documents/12-10_Fazio.pdf). Mr. Fazio was the engagement partner on the Ligand Pharmaceuticals audit. According to the Public Company Accounting Oversight Board (PCAOB), he failed to adequately assess whether the Ligand had the ability to estimate future product returns, and moreover, he failed to assess the reasonableness of the product return estimates made by the company. For a Big Four audit partner, such behavior is clearly unacceptable. His blunder understated the company’s reported loss by 250 percent. Clearly, this impacted investors like us. So, what consequences did he suffer? A slap on the hands:

* PCAOB barred him from associating with a firm that does public company audits for two years.
* The California State Board of Accountancy revoked his license, but stayed the revocation and put him on only three year’s probation. Oh, it did suspend his license for 9 months.

Also, note the timeline. The audit in question was for 2003, the PCAOB took action in 2007, and California took action in 2008. How many other audits did Mr. Fazio botch before his temporary license suspension?

Maybe the case of [Stephen J. Nardi](http://pcaobus.org/Enforcement/Decisions/Documents/12-14_Nardi.pdf), a partner in the Philadelphia office of BDO, will excite you more. His was a case of actually cooking his own “audit books.” What makes this example so interesting is that he was THE practice office assurance director for the Philadelphia office. His sin was altering audit documentation on the Hemispherx Biopharma, Inc. 2004 audit. As engagement partner, he failed to ensure that the work performed by the audit senior and other BDO staff was subjected to a detailed review as required by BDO policy, PCAOB standards and generally accepted accounting principles. Moreover, when he found out that his audit was going to be subjected to a quality review, he altered the working papers to give a false impression of the nature, timing, and extent of the review procedures employed in the audit, and a false impression that the manager had completed a timely detailed review of the work performed by more junior members of the engagement team.The PCAOB called this an:

*"intentional or knowing conduct, including reckless conduct, that results in a violation of the applicable statutory, regulatory, or professional standard."*

And what were the consequences? Not many:

* Not surprisingly, he was asked to resign from BDO.
* The PCAOB barred him from associating with a firm that audits public companies for only one year, after which he could petition for reinstatement.
* The Pennsylvania Board of Accounting only temporarily suspended his license.

As with Fazio, years passed (2004 through 2007) before Nardi suffered any consequences.

Then there is [Todd D. Chisholm](http://pcaobus.org/Enforcement/Decisions/Documents/Chisholm.pdf), whose accounting firm violated numerous professional standards including the failure to detect fraud. As with Fazio, he also placed numerous questionable documents in the audit files when he learned that his firm’s audits were to be examined. What was his punishment?

* His accounting firm was permanently barred by PCAOB from auditing publicly traded companies.
* The PCAOB permanently barred him from associating with any accounting firm that audits public companies, but his partner was only suspended for five years and then can reapply for reinstatement as an approved auditor.
* The SEC issued a cease and desist order and barred the firm and the two partners from practicing before it.
* The Utah state board simply put his license on probation for 3 years with conditions and restrictions.

If these cases are not outrageous enough for you, consider [Gregory M. Dearlove](http://www.sec.gov/litigation/admin/34-52537-o.pdf), the Deloitte partner, who failed to detect the fact that Adelphia:

* Fraudulently excluded billions of dollars in liabilities from its consolidated financial statements by hiding them on the books of off-balance sheet affiliates;
* Falsified operations statistics and inflated earnings to meet Wall Street's expectations; and
* Concealed rampant self-dealing by the Rigas Family, including the undisclosed use of corporate funds for Rigas Family stock purchases and the acquisition of luxury condominiums in New York and elsewhere.

The SEC concluded that he engaged in improper professional conduct and the New York State Board of Accounting issued a “partial actual suspension in certain area for no less than four years and until successfully complete course of retraining in said certain area, upon termination of partial actual suspension.” He also was put on two years’ probation and fined $1000. That’s it…a slap on the wrist for Dealove and a slap in the face for the investing public.

Finally, there is the case of [James P. Gately](http://pcaobus.org/Enforcement/Adjudicated/Documents/Gately.pdf) which highlights the lack of communication between the state and federal regulatory agencies. Gately performed audits of public companies when his license had been declared null and void. Practicing without a license was nothing new to him…he had been accused before of doing exactly the same thing and that allegation was dismissed. The PCAOB ultimately banned him and his firm from auditing public companies and banned him from associating with any firm that audits public companies.

Yet, the Florida Board of Accountancy (FBA) in this matter stated “While decisions of the PCAOB and SEC may not directly impact a licensee’s status, information obtained from the entities may result in a department investigation that could result in disciplinary action by the Florida Board of Accountancy.” This suggests that the FBA may yet again decide to “punt” when it comes to Gately.

All of these examples show that accountants can shirk their audit responsibilities to the public with little or no lasting harm to themselves…surely, not as much harm as they caused the investing public. The public should be outraged that not one of these accountants lost their license permanently, and that they continue to prey on the trust of the unsuspecting investor.

*Additional insights regarding audit malpractice can be found at:*

[re: The Auditors – The Case Against the Auditors](http://76.12.174.187/?cat=11)

[The Accounting Onion - Auditing](http://accountingonion.typepad.com/theaccountingonion/auditing/)

[The Summa - Auditing](http://profalbrecht.wordpress.com/category/accounting/auditing/)

[Dirty Secrets Fester in 50-Year Relationships by Jonathan Weil](http://www.bloomberg.com/news/2011-06-09/dirty-secrets-fester-in-50-year-relationships-jonathan-weil.html)

[What Vikram Pandit Knew, and When He Knew It by Jonathan Weil](http://www.bloomberg.com/news/2011-02-24/what-vikram-pandit-knew-and-when-he-knew-it-commentary-by-jonathan-weil.html)

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