

Advisory Committee on the Auditing Profession

Considerations from 40 Years of
Observation

By

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My Background

- BS and MS in Accounting
- Big 8 and Regional firm Audit and Accounting Experience Since 1968
- Current Chair and President of Hemming Morse, Inc., CPAs, a firm of 105 persons headquartered in San Francisco
- Past Chair of the 31,000 member California Society of CPAs

My GAAP and GAAS Expert Testimony Includes

- Parmalat
- Enron
- Xerox
- Sunbeam
- PharMor
- MiniScribe
- Peregrine
- Many of the S&L and Banking scandals of the 1980 and 1990s

Consistent Findings of My Testimony

□ The Auditing Procedures Worked

- GAAP violations were detected, generally at the staff level
- Violations were brought to the attention of the partner(s)
- Issues were communicated within the audit firm and to members of client management

□ The Violations were either not communicated to the Audit Committee or the Board or were communicated improperly to these entities

Why Were These Violations Not Properly Communicated?

- ❑ Feared adverse effect on the client's financial statements, resulting in negative impact on:
 - Earnings trends
 - Borrowing relationships and liquidity
 - Key employee bonuses, stock and options value
- ❑ Perceived risk of harm to the audit firm's client relationships, and/or the key partners' relationships with the client

Conclusions

- Auditing procedures are working
- A few audit partners and managers are willing to risk an audit failure in exchange for personal rewards
- Court decisions like the recent Stoneridge decision have reduced the risks to auditors from audit failures
- To offset the impact of (3), Congress should make appropriate revisions to the securities laws regarding third parties, such as auditors.