Sarbanes-Oxley and audit failure
A critical examination

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Keywords Auditing, Audit committees, Fatigue, Auditing standards

Abstract The highly publicized accounting scandals of the recent past seriously damaged the credibility of the accounting profession. In an effort to restore public confidence in the capital markets, the US Congress passed the Sarbanes-Oxley Act of 2002. A central theme of this new law is the attempted reduction of major audit failure by stricter governmental regulation of the accounting profession and the creation of the Public Company Accounting Oversight Board. This paper discusses the likely effectiveness of the Sarbanes-Oxley Act in the reduction of major audit failures. Four root causes of audit failure are identified, and issues not addressed by the Sarbanes-Oxley Act that may have audit failure implications are discussed. Recommendations for improvements that potentially further reduce the likelihood of audit failure are presented.

Introduction
The collapse of Enron in 2001 and the subsequent discovery that its auditor, Arthur Andersen, had shredded audit documents after notification of a Securities and Exchange Commission (SEC) investigation of Enron sent shock waves through the financial markets. Exacerbating this situation was the revelation that besides Andersen’s $25 million audit fee, Andersen earned another $27 million from Enron that year for consulting, thus raising questions about conflict of interest. The legal and regulatory community also noted that many CPA firms were regularly performing significant consulting services for their audit clients. For example, Disney’s audit fee for 2001 was a mere $8.7 million compared to the $32 million Disney paid PricewaterhouseCoopers for consulting services. These revelations brought the accounting profession under the scrutiny of Congress and the SEC. The scrutiny increased after apparent audit failures were reported at Worldcom, Adelphia, Xerox, and Global Crossing. Lawmakers believe that the accounting profession has failed to regulate itself in a manner that promotes confidence in the published financial statements of public corporations.

In June 2002 Congress passed the Sarbanes-Oxley Act (SOX), creating the Public Company Accounting Oversight Board (PCAOB) and prescribing new requirements and restrictions for auditors of publicly traded companies (Congress of the United States of America, 2002). The SOX intends for the SEC (via the PCAOB) to police the accounting profession’s audits of publicly traded companies, thereby restoring some lost confidence in corporate America. The restoration of investor confidence, however, will ultimately depend on the effectiveness of the SOX to alter the auditor-client relationship in such a way as to eliminate or greatly reduce the incidences of high-profile corporate failures. Certainly one aspect of assessing the SOX effectiveness is its impact on the likelihood of major audit failures. However, a careful examination of SOX reveals significant unaddressed issues about minimizing the likelihood of audit failure in publicly traded companies. This article evaluates the SOX’s ability to reduce...
the likelihood of audit failure. Additionally, cost-effective improvements to further reduce the likelihood of audit failure in publicly traded companies are proposed.

**The causes of audit failure**

The scenario has become all too common in corporate America. A large, publicly traded corporation receives an unqualified audit report, and shortly thereafter collapses with the news that the financial statements are grossly misstated. How can this occur time and again unless there is something wrong with the way these companies are audited? Such is the question going through the minds of the public and regulatory community. Audit failure occurs when there is a serious distortion of the financial statements that is not reflected in the audit report, and the auditor has made a serious error in the conduct of the audit (Arens, 2002). Audit failure does not occur if the auditor has followed Generally Accepted Auditing Standards, regardless of the fairness and accuracy of the financial statements. A properly done audit does not guarantee that serious distortions of the financial statements have not occurred. However, a properly done audit does make serious distortions unlikely. Thus, audit failure cannot occur unless there is serious auditor error or misjudgment.

The nature of this auditor error has only four systematic causes. First, the auditor can blunder by misapplying or misinterpreting GAAS. Such a blunder is unintentional and could be caused by fatigue or human error as in the case of *ZZZZ Best Company v. Ernst & Whinney* (Akst, 1990). Second, the auditor can commit fraud by knowingly issuing a more favorable audit report than is warranted. This may occur when the auditor accepts a bribe or bows to client pressure or threats as in the case of *ESM Securities v. Alexander Grant* (Maggin, 1989). Third, the auditor can be unduly influenced by having a direct or indirect financial interest in the client. For example, an auditor who is performing significant consulting engagements for an audit client may be reluctant to insist on accounting adjustments because of the fear of losing the client to another CPA firm as in the case of *Enron v. Arthur Andersen* (Powers, 2002). Another example of this occurs in a weaker form when the auditor is not performing any consulting but is still reluctant to stand up to the client on accounting issues for fear of being fired. Fourth, the auditor can be unduly influenced because of having some personal relationship with the client beyond what is expected in a normal audit between independent parties. For example, it is common for staff members of the CPA firm to leave the firm for employment by a previously audited client. Since this staff member has switched sides, it is possible that personal relationships with their previous employer could have an unfavorable impact on the current audit as in the case of *AMRE v. Price Waterhouse* (SEC, 1992). Another more subtle factor is the auditor’s vulnerability to unconscious bias (Bazerman, 2002). Under this theory auditors, as normal human beings, tend to uncritically accept the judgments and interpretations of ambiguous information exercised by others with whom they associate. This is especially the case in a typical auditing environment where the auditor can subconsciously perceive that the client’s positions are aligned with their own self-interest.

Thus, we can summarize the root causes of audit failure into the following four types:

1. auditor blunders caused by unintentional human error;
2. auditor fraud;
The distinction between actual auditor independence and the appearance of auditor independence is critical. The AICPA Code of Professional Conduct contains multiple interpretations of the appearance of auditor independence. The appearance of auditor independence is obviously important because the true product of an audit is the increased credibility attached to the financial statements by the independent audit. However, changing the mere appearance of auditor independence (as opposed to changing actual independence) has no impact on the likelihood of audit failure and is therefore omitted as a cause of audit failure. Thus, regulatory actions which only affect the appearance of independence never reduce the likelihood of audit failure.

The Sarbanes-Oxley Act
The SOX will dramatically impact the public accounting profession and alter the way CPA firms do business. There can be little doubt that the SOX will have a favorable psychological impact on investor confidence in published financial statements. However, to what degree does the SOX reduce the likelihood of audit failure in publicly traded companies? The key provisions of the SOX that have the potential to reduce the likelihood of audit failure can be summarized as follows:

- activities of the PCAOB;
- new rules for audit committees;
- new criminal penalties and protection for whistle-blowers;
- limits on auditor consulting; and
- new financial reporting and auditing procedures.

PCAOB
The PCAOB has significant rule making and regulatory power. It can establish or change any of the standards, procedures, and rules used to audit publicly traded companies. Moreover, the PCAOB will conduct annual inspections of CPA firms for quality review purposes, and it is empowered to impose disciplinary and remedial actions against CPA firms for violations of board rules or any professional standards that apply to auditing. The result of this power will only be known when the newly created board has implemented a significant portion of its agenda. However, we can, a priori, use deductive reasoning to assess the board’s potential to lessen the likelihood of audit failure. The PCAOB’s power can be summarized into its ability to make rules, audit auditors, and impose sanctions.

The PCAOB’s capacity to set new rules and auditing standards is a significant and potentially important step in the advance of Generally Accepted Auditing Standards. However, it seems unlikely that this rule-making power will cause a reduction in the likelihood of audit failure. A careful examination of the major audit failures that have occurred in the US in the past 30 years shows the cause of the failure was not because of the absence of a needed auditing rule or technique. In the overwhelming majority of cases these auditing failures are caused by the auditor neglecting to apply the auditing rules and techniques that already exist. Simply enacting more rules and auditing
standards seems unlikely to make any meaningful reduction in the likelihood of audit failure.

The PCAOB’s ability to review the operations of registered CPA firms for quality control purposes is an interesting development and has the potential to make a significant reduction in the likelihood of audit failure. Under the current standards, CPA firms auditing publicly traded companies require peer reviews of their work by other CPA firms. However, judging by the recent rash of major audit failures, these peer reviews do not appear to be effective at preventing audit failures. The problem with the current peer review process is that it is conducted by persons who work in the same industry and may be sympathetic to the needs of the reviewed firm for obtaining favorable peer reviews. This is consistent with the unconscious auditor bias theory (Bazerman, 2002). If the audits of CPA firms were subject to a substantive review by an independent agency such as the PCAOB for quality control purposes, CPA firms would have to significantly strengthen their own quality control audit procedures. This would cause a significant reduction in the likelihood of audit failure.

However, as of this date, the PCAOB does not have the necessary staff to conduct in-depth reviews of auditing operations on a wide scale. A large staff of professional auditors would have to be hired and trained by the PCAOB to audit even a small sample of the audits performed on publicly traded companies. Without this large professional staff of seasoned auditing professionals the PCAOB’s ability to inspect registered accounting firms’ operations is largely symbolic and is not likely to yield any meaningful reduction in the likelihood of audit failure. Therefore, the quality control aspect of the PCAOB’s power may be limited to contributing to refining the state-of-the-art of auditing, without significantly impacting the incidences of audit failure.

The PCAOB’s ability to impose sanctions does not reduce the likelihood of audit failure. The SEC has always had the same authority. This authority is limited to prohibiting individuals or firms from performing audits on SEC filers for a proscribed period of time. There is no evidence to date which indicates that the PCAOB will impose sanctions any differently from the SEC.

New rules for audit committees
Prior to the SOX, it was legal for auditors to report to their client’s management. The SOX requires that auditors report to and be overseen by a company’s audit committee. This audit committee must approve all audit and non-audit services, must receive all new accounting and auditing information from the auditor, and must serve as the official line of communication between the auditor and the client company. Members of the audit committee are independent members of the board of directors of the company being audited, and at least one board member must be a “financial expert”. Before the SOX only companies listed on the New York Stock Exchange were required to have audit committees. The SOX requirement that all SEC filers employ audit committees using the above rules represents a significant change in the auditing environment of corporate America.

The required use of audit committees by SEC filers could produce a significant reduction in the likelihood of audit failure. There are several reasons for this. First, requiring the audit committee to make all decisions about hiring or firing the auditor removes from management the ability to threaten or coerce the auditor with dismissal
if the auditor fails to perform in a manner acceptable to management. Second, requiring the audit committee to approve all payments made to the auditor for auditing and nonauditing services makes it difficult for management to purchase unneeded consulting services from the auditor with the intent of paying a “legal bribe” in the hope of getting more favorable treatment from the auditor. Third, requiring the audit committee to deal with disagreements between the auditor and management about accounting matters makes it difficult for management to prevail on questionable accounting practices. This effect is further enhanced by the requirement that at least one member of the audit committee be a financial expert. Finally, requiring audit committee members to receive no compensation beyond their normal payment for being a member of the Board of Directors of the auditee preserves a clear separation from management, thereby increasing the independence of the audit committee and the audit.

However, the SOX fails to address a major loophole associated with the reality of audit committees. Although, audit committees represent the interests of stockholders, current procedures make it difficult for an individual stockholder to become a candidate for the Board of Directors without the blessings of corporate management. Under normal circumstances board candidates are nominated by senior management or other directors. The CEO is often the chairperson of the board. Management fully recognizes the power implications of selecting board candidates who will be sympathetic to the needs of management. Accordingly, close friends and business associates of senior management often wind up on the ballot for the Board of Directors. CEOs typically have the power to block any board candidates at their own discretion. There are procedures for external board candidates to be elected without the blessings of senior management, but these procedures are expensive and cumbersome. The result is often a Board of Directors composition that is biased toward the interests of management instead of the stockholders.

**Criminal penalties and protection for whistle-blowers**

The SOX increases the criminal penalties for securities, mail and wire fraud from five to ten years imprisonment. The statute of limitations for such offences is extended to the earlier of five years from the fraud, or two years after the fraud is discovered (previously three years and one year respectively). In the wake of Arthur Andersen’s shredding of documents related to the Enron audit, auditors are required to retain all audit working papers for seven years. Employees of both the auditor and auditee are granted “whistle-blower protection” which prohibits their employer from retaliating against them for disclosing fraudulent activities. The financial statements of SEC filers must be personally certified by the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) with knowing violators facing a fine of up to $5 million and/or imprisonment for up to 20 years. Similarly, a prison term of up to 20 years awaits those persons who conceal or tamper with any documentation related to any official proceeding pursuant to the audit investigation of SEC filers. The sharp increase in fines and prison time available under the SOX for fraudulent activities in financial reporting should create an environment that reduces the likelihood of audit failure. Especially effective are the personal certification requirements of the CEO and CFO. Most major audit failures in the USA involved either fraudulent conduct or the exhibition of a reckless disregard for the truth by the associated CEO or CFO. Facing
20 years imprisonment for knowingly violating their certification should make both of these senior managers think twice before releasing questionable financial statements.

CPA firms will take note of the criminal prosecution of Arthur Andersen for obstruction of justice along with the severe price that firm paid for their misconduct in the Enron audit. Moreover, the SEC has announced a “new enforcement paradigm” intending to take a tougher stance against CPA firms involved in future auditing failures. This new paradigm will hold the CPA firm responsible for the actions of its partners and will cause these firms to act with increased caution when auditing SEC filers. The result will be a decrease in the likelihood of audit failure.

Restrictions on auditor consulting
The SOX prohibits auditor-client consulting in the areas of bookkeeping, financial information systems, valuation services, actuarial services, internal auditing, managerial functions, investment services, legal services unrelated to the audit, and any other service prohibited by the PCAOB. Only the prohibition against bookkeeping was in effect prior to the SOX. This restriction on the scope of non-audit services that are delivered contemporaneously with the audit is obviously unpopular with CPA firms. They argue that synergistic efficiencies will be lost if CPA firms performing audits are prohibited from performing certain types of consulting. There is some truth to this, especially in the areas of financial information systems and internal auditing. One could easily envision increased economies in an audit from the consulting side of the firm working with and answering questions from the auditing side regarding accounting information system design, internal control, etc. However, these economies are offset by the perception of a conflict of interest between the CPA firm functioning as an auditor and that same firm serving as a consultant to the auditee. How can a CPA firm be objective in evaluating the financial information of a client when that same firm helped to create the information system that they are judging? Moreover, the revenues generated from consulting may be sufficiently large to influence the auditor’s judgment regarding questionable accounting policies.

The increased restrictions on auditor-client consulting contained in the SOX should reduce the likelihood of audit failure. CPA firms recognize that significant disagreements with the client regarding accounting matters could result in the firm being discharged for future audits. The economic harm of losing a client in which significant consulting fees have been earned in addition to the normal audit fee is obviously greater than losing an audit client with no related consulting fees. Accordingly, from an economic perspective, CPA firms are more likely to exercise a proper degree of professional skepticism with “audit only” clients than with “audit and consulting” clients.

New financial reporting and auditing procedures
The SOX requires a thorough second partner review and approval of every audit report for SEC filers. This type of review, however, has been a requirement for CPA firms belonging to the SEC practice section for a number of years. Membership in the SEC practice section is required of all CPA firms auditing SEC filers. Whether the required second partner review under SOX will be more rigorous and effective than the current SEC practice section standards is difficult to assess even on an a priori basis. There is little specific information on any difference as of this writing. The SOX also requires
that management make representations about the effectiveness of its internal control structure. Moreover, the auditor will be required to do a complete and separate audit of the internal control representations made by management. Any significant weaknesses in management’s internal control structure must be noted in this separate report on internal control.

The impact of the above changes on the likelihood of audit failure appears to be minimal. An examination of the classic audit failures that have occurred in the past indicates that second partner reviews were required and considered routine auditing procedures for companies required to file with the SEC. Yet, there is no indication that these second partner reviews provided any assistance in preventing audit failure. Similarly, the classic auditing failures of the past cannot be tied to deficiencies in internal control. The best internal control system can easily be rendered ineffective by senior management fraud and collusion. The underlying causes of auditing failure are more correctly tied to gross violations of auditing procedures rather than to deficiencies in management’s internal control structure.

**Improving the Sarbanes-Oxley Act**
The practical impact of the SOX appears to be primarily focused on issues relating to the appearance of auditor independence rather than actual auditor independence. As was previously stated, increasing the mere appearance of auditor independence cannot result in a real decrease in the probability of audit failure. Also, the SOX does nothing to address the issue of unintentional blunders committed by the auditor. The question arises as to whether there are practical, cost-effective methods and procedures to significantly enhance the ability of the SOX to make meaningful reductions in the probability of audit failure.

**Auditor fatigue**
One of the more remarkable results of examining prior audit failures is the consistent use of apparently poor judgment by the auditor. In the overwhelming majority of cases, auditors have made blunders in the application of Generally Accepted Auditing Standards that should be easily recognizable to any student taking their first auditing class in college. Some examples include: failure to use basic analytical procedures; allowing the client to improperly restrict the scope of the audit; failure to follow up obvious red flags with respect to deficiencies of audit evidence; and failure to plan the audit in an organized manner. Even more puzzling is the observation that these elementary auditing errors were committed by virtually all of the large, international public accounting firms. Even senior partners with many years of public accounting experience have made gross blunders in what should have been a routine auditing situation. What is the explanation for this paradox? The authors hypothesize that a contributing factor in unexplained gross auditor blunders is mental fatigue owing to the long hours that auditors are forced to work during the busy season. Approximately 70 percent of companies registering with the Securities and Exchange Commission have a calendar year end. Accordingly, approximately 70 percent of the substantive auditing procedures must be performed in the first quarter of the new year. This peak auditing workload coincides with the tax season to create severe workload demands on members of the public accounting profession. Many auditing professionals are forced to work 55 to 70 hours per week from the beginning of January to April 15.
There is very little information in the professional literature regarding the effect of auditor mental fatigue on audit quality. This is no doubt owing to the difficulty of objectively measuring the effects of mental fatigue in an auditing environment. However, there is evidence that mental fatigue has a derogatory effect on human decision-making processes (Meijman, 1997). The current evidence seems to indicate that humans can perform simple memory tasks under fatigue, but higher cognitive processes such as planning and decision-making suffer sub-optimal performance (Van der Linden, 2003). This would explain why even honest and hard-working auditors could make very serious auditing errors, which result in audit failure. Additionally, common sense seems to indicate that audit quality must suffer when the audit staff are tired and overworked. Is there a practical solution to the issue of auditor mental fatigue induced by the demands of the busy season?

The authors advocate the elimination of the busy season by requiring the PCAOB (or SEC) to assign the fiscal year-end for all companies filing with the SEC. The Board would study the timing of the current demand for auditing services and begin reassigning fiscal year ends for SEC filers in such a matter that the demand for auditing services would be approximately uniform throughout the year. The Board would also take into account the income tax preparation season in this reassignment to further level the auditor’s workload throughout a calendar year. Thus, there would actually be fewer audits of SEC filers performed in the first quarter of a typical year than in any of the remaining three quarters.

The only significant cost of the above reassignment of fiscal year-ends would involve the initial study and set up cost in making the initial reassignment. The benefits include a more uniform workload for the auditor throughout the year, and the associated secondary benefits that would be derived therefrom. These secondary benefits include less mental fatigue for the auditor, less stress in the auditor’s personal life associated with working long hours, and a smoothing of the demand for auditing professionals throughout the year. Also, if our hypothesis is correct regarding auditor fatigue being a factor in causing auditor blunders, fewer auditor blunders would be committed and the likelihood of audit failure would be reduced. The authors are of the opinion that the benefits of mandatory reassignment of fiscal year-ends outweigh the associated costs.

Auditor independence
A clear majority of the provisions of the SOX concern the appearance of auditor independence. Chief among these provisions is that the independent auditor is hired by, and serves at the pleasure of, the audit committee rather than management. There is significant value in maintaining this requirement. However, as was previously indicated, audit committees are not independent of management or management’s interests. Ultimately, management still has a significant influence over the choice of independent auditors. If those independent auditors provoke management by disagreeing with management’s accounting procedures, there is the clear possibility that these auditors will be replaced via the audit committee. This is a serious, fundamental problem with the current structure of all independent audits. How can the auditor be independent of an entity when the entity has the right to fire the auditor and thereby damage the auditor’s financial position?
The authors propose that all SEC filers be required to seek independent auditor bids for a time period of exactly four years. When an auditing firm has completed its four-year term as independent auditor, that firm must be replaced by a different public accounting firm and cannot return as the independent auditor for at least four additional years. Thus, the auditor will serve as the independent auditor for four years regardless of the wishes of management, the audit committee, or the Board of Directors. If for some reason the audit committee wishes to replace the independent auditor prior to the expiration of the four-year term, it may appeal to the PCAOB/SEC. The PCAOB/SEC would make the final decision regarding replacement based on the merits of the appeal.

There is clear evidence in the auditing literature supporting the value of mandatory auditor rotation. In a sample of 776 UK Finance Directors (also known as Chief Financial Officers) there was strong support for the banning of non-audit work and the mandatory rotation of auditors (Hussey, 2001). This result holds true even among Finance Directors with good relationships with their external auditors. In another study experimental analysis involving auditor rotation requirements indicate that mandatory rotation decreased the auditor-subjects’ willingness to issue audit reports biased in favor of management (Dopuch, 2001). Another study used game theory to find that a laissez-faire approach to auditor opinion shopping is significantly related to the frequency of independent auditor rotation (Cushing, 1997). Another game theoretic analysis constructs a multi-period model which demonstrates that mandatory rotation of auditors is costly, but the improved incentives for auditor independence outweigh the associated costs (Gietzman, 2002). On the negative side of auditor rotation, one analysis indicates that mandatory auditor rotation significantly increases audit cost owing to the distortion of competition and increased investment in learning a new client’s accounting system (Arrunada, 1997). This analysis also indicates a potential negative impact on quality owing to an assumed lower technical competence of the audit staff. However, the analysis does not consider the mitigating factors of auditor rotation with a four-year contract audit period as discussed below.

There are numerous advantages to the above auditor rotation system. First, the free-market process of providing auditing services is preserved without any government intervention. The only real difference concerns contracting for a four-year period rather than the traditional one year. Second, auditor independence is significantly increased because the audit client no longer has the tactical threat of changing auditors in circumstances when they disagree with the auditor’s professional judgment. Auditors will be freed from the burden of simultaneously keeping client management happy and executing their attestation responsibilities. Third, audit planning will be significantly improved because the auditor now has a four-year time horizon instead of only contracting from year to year. Auditing strategy would be modified to take into account the advantages that a four-year time horizon provides. Finally, the price of auditing services should decline slightly owing to the increased economies of scale available in the longer four-year time period.

The disadvantages of the above rotation system are modest. First, the four-year time period is semi-arbitrary. The authors believe that a shorter time period will make significant sacrifices with respect to increasing auditor independence. A longer time period will make significant sacrifices with respect to free-market flexibility and changing environmental circumstances. Second, there is additional administrative cost
to the PCAOB/SEC of handling appeals if the audit committee wishes to terminate an
auditor prematurely. Third, there may be some resistance on the part of public
accounting firms who have audit clients that have been with them for many years.
However, this resistance is mitigated by the advantages to the auditor of having the
client locked into a four-year audit contract as discussed above. All things considered,
it appears that the advantages of mandatory auditor rotation far outweigh the
disadvantages.

A final recommendation concerns the previously discussed loophole regarding
senior management’s strong influence over the composition of the Board of Directors.
The use of audit committees is a key provision of SOX. However, its effectiveness is
diminished by senior management’s capacity to block candidates for the Board of
Directors. If senior management can control the composition of the Board of Directors,
then they also control the composition of the audit committee. The authors recommend
that all SEC filers be required to follow a process whereby the stockholders have
complete and absolute power to elect members of the Board of Directors without
interference from senior management.

The specifics of this process are debatable, and could take various forms. However,
the end result should be the creation of a process that grants significant independence
to stockholders with respect to selecting members of the Board of Directors. One
possible scenario would involve granting administrative control for electing Board
members to the audit committee instead of senior management. Such an arrangement
would clearly increase the independence of the electoral process because all audit
committee members are required to be outside members of the Board of Directors and
cannot simultaneously serve as a member of management. A variation of this theme
could be assigning a specific individual from the audit committee to serve as an
ombudsman on behalf of stockholders for board electoral issues. Regardless of the
specifics, a final safeguard would include a process for stockholder appeal directly to
the SEC for perceived violations of independence or due process in the electoral
process. When management no longer has significant power over who sits on the
Board of Directors, audit committees will be more independent and the likelihood of
audit failure will decrease.

Summary and conclusions
The SOX is an attempt to restore investor confidence in the financial statements of
public corporations by sharply reducing the incidence of major audit failures such as
Enron. Some provisions of SOX such as restrictions on auditor-client consulting and
increased criminal penalties for financial statement fraud are likely to make
substantive reductions in the likelihood of major audit failure. Other provisions such as
the establishment of the PCAOB and the mandatory use of audit committees have
significant potential, but are handicapped by operational shortcomings or hidden bias
to the point that they are unlikely to make significant reductions in the likelihood of
audit failure. The approach of the SOX is uni-dimensional in that it only considers
deliberate misconduct by auditors as the causal factor in the incidence of audit failure.
However, environmental factors including the auditor’s working environment and the
difficulties associated with auditing someone who has the right to fire you probably
account for a significant portion of contemporary audit failures. Yet, the SOX fails to
address these environmental causes of audit failure.
The authors advocate amending the SOX regulations by requiring governmental authority to identify the fiscal year-end of SEC filers with the intent of eliminating the auditor’s busy season. If auditing work is performed at a uniform pace throughout the year, auditor fatigue is eliminated along with the auditing errors associated with that fatigue. The authors also advocate mandatory auditor rotation at the end of every required four-year audit contract period. Finally, the authors advocate the creation of an independent process for electing members of the Board of Directors of public corporations which will prevent senior management from “stacking” the Board of Directors with sympathetic friends and associates.

References