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How Consulting Services Could Kill Private-Sector Auditing

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By Dana R. Hermanson

On October 6, 2008, the Treasury Department's Advisory Committee on the Auditing Profession released its recommendations for enhancing "the sustainability of a strong and vibrant public company auditing profession" (www.treas.gov/offices/domestic-finance/acap/docs/final-report.pdf). The recommendations address a host of issues related to human capital, firm structure and finances, and market concentration and competition. I agree with most of the committee's recommendations. In fact, I served on an American Accounting Association-sponsored task force that commented on the draft recommendations and was quite supportive of the committee's efforts (www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Bedard060308.pdf).

Despite the appeal of the recommendations included in the committee's report, there are two critical areas that the recommendations do not address. First, the committee was unable to reach a consensus on any recommendations related to auditor liability. As discussed in the committee's report, there were very strong views on both sides of the auditor liability debate, and I understand how a committee with members from such diverse backgrounds could reach an impasse. I believe that the committee's discussion of the issues will lead to consideration of auditor liability reform in the future, especially consideration of how to strike the right balance. Auditing firms should be held accountable for audit failures, but the firms should not face potential losses so great that many good people choose to exit the auditing profession. If that happens, then audit quality surely will suffer.

Second—and I believe even more critical to "the sustainability of a strong and vibrant public company auditing profession"—the committee did not address the scope of services provided by auditing firms. Recent media coverage (discussed below) indicates that the large auditing firms are aggressively rebuilding their consulting practices, just a few short years after the major accounting scandals of 2001 and 2002. I fear that, even with the provisions of the Sarbanes-Oxley Act (SOX) in place (which essentially prevent firms from providing consulting services to audit clients), the reemergence of consulting poses a significant threat to long-term audit quality and to perceptions of audit firms' commitment to protecting the public interest. In fact, I would go so far as to say that consulting services might cause the public company auditing profession to cease to exist in the private sector, leaving us with government-run audits.

Consulting Services in Auditing Firms

As Arthur R. Wyatt so eloquently described, the nature of the large audit firms changed dramatically in the years leading up to the recent accounting scandals (see "Accounting Professionalism—They Just Don't Get It!" *Accounting Horizons*, March 2004 and two 2003 *Accounting Horizons* articles by Stephen A. Zeff). During the 1980s and 1990s, consulting services represented an ever-larger portion of the large audit firms' revenues. The firms' focus shifted from professionalism and technical accounting and auditing expertise to revenue generation and rewarding the "rainmakers." The scope of audits decreased markedly, as firms looked for ways to reduce costs, and many in public accounting viewed the audit as a com-

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