

## Sarbanes-Oxley Act of 2002

In an article published in *The Australian Financial Review* (Buffini & Tingle, 5 August 2002), a detailed analysis is made of the provisions of the Sarbanes-Oxley Act, comparing these provisions with the present position in Australia. The main provisions of the Act are summarised in July's edition of *Current Affairs in Auditing*.

One of the issues discussed in the above article is whether rules-based or principle-based regulations provide better standards. (Rules-based systems have also been termed 'black letter law'.) The type of regulation contained in the Sabanes-Oxley Act is said to be different from those contained in *Professional Statement FI: Professional Independence*, which is the independence standard issued by the Australian accounting profession. The following comment by Rob Ward, the audit chief of PricewaterhouseCoopers, suggests principle-based standards contained in *FI* are superior to the rules-based standards used in the Sarbanes-Oxley Act.

The US is going to a rules-based system, which has been some of the cause of issues they've been facing. Too heavy-handed a touch in terms of rules does not in fact correct poor behaviour. (p. 8)

*Professional Statement FI: Professional Independence* adopts a 'principle approach that allows discretion for case-by-case approach' (p. 8). Similar arguments have been made about the superiority of a principle-based approach in relation to accounting standards.

Proponents of the superiority of the principle-based approach over the rules-based approach have a poor memory of the history of Australian accounting regulation. Australia used to have a true and fair override, whereby an accounting treatment not allowed in the accounting standards could be adopted if this treatment presented a true and fair view. The requirement to show a true and fair view took precedence over following the accounting standards. It was argued that companies were abusing this rule by adopting an accounting treatment that resulted in favourable results; they claimed that following the standards did not result in a true and fair view. Corporations Law was changed to make it mandatory to follow the standards and add extra information that resulted in a true and fair view. (For a discussion of the value of the true and fair override, see Gearin & Khandelwal 1995.)

Both principle-based and rules-based standards have weaknesses. Specific transactions or events can be designed to defeat the intention of a rules-based regulation. The discretion in principle-based standards allows various parties to interpret the principle for their own benefit. Perhaps the best approach would be to use a combination of the two approaches. However, it is feared that the business world contains sufficient parties willing to search out loopholes in the standards that would give preparers of reports an advantage. It is generally suggested that lawyers would be among the first professionals to take on such a task. In this sense, defeating accounting or auditing standards is like committing any other fraud, with rule or standard setters battling constantly with fraudsters as the regulators try to devise rules that are effective in the modern environment.

Whether or not it is accepted that the rules-based approach adopted in the Sarbanes-Oxley Act is superior to the principle-based approach, the Act will still have relevance for Australian auditors. This is because any Australian auditor that ‘audits a US registrant, audits a subsidiary of a US registrant or provides substantial assistance in the audit of a US registrant’ is subject to the terms of the Act. It is estimated that 20 to 30 per cent of the Australian audit market is affected (Buffini 2002, p. 9).

## References

Buffini, Fiona, and Tingle, Laura 2002, ‘US shake-up pressures corporates’. *The Australian Financial Review*, 5 August, pp. 1 and 8.

Buffini, Fiona 2002, ‘US reforms hit local auditors’. *The Australian Financial Review*, 15 August, p. 9.

Institute of Chartered Accountants and CPA Australia, *Professional Statement F1: Professional Independence*, [www.icaa.org.au](http://www.icaa.org.au)

Gearin, M, and Khandelwal, S 1995, ‘A true and fair view or mandatory standards’. *Australian Accountant*, June, pp. 12–16.