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# **Avoiding Another Enron : The Role of the External Auditor in Financial Regulation and Supervision**

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# AVOIDING ANOTHER ENRON : THE ROLE OF THE EXTERNAL AUDITOR IN FINANCIAL REGULATION AND SUPERVISION.

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## ABSTRACT

*Following the collapse of Enron, many questions have been raised as to why the UK has avoided its Enron.<sup>ii</sup> Many commentators have considered whether this is due to the fact that the UK's system of financial regulation relies more on a principles based system, which promotes more fairness in its application as opposed to a rules based system.<sup>iii</sup> However, the crucial roles played by auditors in financial reporting and the system of financial regulation and supervision have been overlooked to an extent. In view of a spate of financial scandals such as those of Enron, Worldcom, Tyco etc, the US Congress acted swiftly by enacting the Sarbanes Oxley Act on July 30 2002 with the aim of protecting investors and restoring their confidence in the financial system.<sup>iv</sup> Amongst the provisions within the Sarbanes Oxley Act, the prohibition of non-audit services by auditors providing audits at that particular time, is a main feature of the Act.<sup>v</sup> This provision not only highlights the importance of the role of the external auditor, but also emphasizes the fact that safeguards are essential in order to prevent that role from being abused. Much as there are lessons which could be learned from the supervisory approaches adopted by various jurisdictions, there are also considerations on whether these jurisdictions could benefit from the measures implemented by US regulators and accounting bodies in the aftermath of Enron.*

## Introduction

The collapse of Enron raised consideration of the following points namely:<sup>vi</sup>

- i) **The regulation of auditors:** Enron highlighted the fact that self-regulation and peer review in the US were no longer enough. It was also suggested that the US Public Oversight Board should be turned from a self-regulatory body appointed and financed by accountants into a statutory one which was independent and which reported to the Securities and Exchange Commission (SEC). Additional powers to the Public Oversight Board to ban or fine auditors for wrong doing were also proposed ;
- ii) **Eliminating conflicts of interests in accounting firms;**
- iii) **Compulsory rotation of auditors** – as Andersen had audited Enron since its establishment in 1983; and
- iv) **Revisiting America's Generally Accepted Accounting Principles.**

The collapse of Enron also led to suggestions that the Securities and Exchange Commission (SEC), its standard-setting body – the Financial Accounting Standards Board may have to look to embracing international accounting standards.<sup>vii</sup>

This paper is organized as follows: The first section deals with systems of regulation and supervision operating in various jurisdictions namely the off-site and on-site systems of supervision. It also highlights the fact that the Basel Core Principles for effective Banking Supervision 1997 encourages greater use of external auditors within the supervisory process. Section two deals with the framework of financial institutions in the US and suggests a single regulator for US financial services operating at federal level. The move towards the adoption of a single regulator in certain jurisdictions, in particular the UK, and the need for continued involvement of the central bank is also discussed. Factors which could undermine the external auditor's role in the supervisory process,

namely factors which could compromise his integrity, objectivity and independence are considered in section three. This section also considers the safeguards in place to avoid the external auditor's role being compromised whilst section four deals exclusively with the Sarbanes Oxley Act. Section five then concludes with recommendations on various aspects of the paper.

### **Systems of supervision in various jurisdictions**

During his speech,<sup>viii</sup> the chairman of the Federal Reserve System acknowledged the fact that the U.S banking and financial system was becoming increasingly “interwoven” with that of the rest of the world. As a result of globalization, international cooperation and consistency, the need to work with the Basel Committee on Banking Supervision was also recognised.<sup>ix</sup> The risk-based approach to supervision which has been adopted in countries such as the United Kingdom and Switzerland, has also led to a realisation of the increasing importance in relying on external auditors. In Switzerland, the banks' external auditors are said to “act as eyes and ears of the Swiss Federal Banking Commission (SFBC) or at least provide extra eyes and ears”.<sup>x</sup> The Swiss supervisor depends a lot on the external auditor's supply of information and the external auditors carry out regular and direct supervisory functions.<sup>xi</sup> This approach is more in line with the requirements of the Basel Core Principles for effective Banking Supervision.

#### **The On-site and Off-site Systems of Supervision**

According to the Basel Core Principles for effective Banking Supervision 1997, an effective banking supervisory system should consist of a mix of both “on-site” and “off-site” supervision.<sup>xii</sup> Off-site supervision involves the regulator making use of external auditors. On-site work is usually done by the examination staff of the bank supervisory agency or commissioned by supervisors but may be undertaken by external auditors.

In the US, periodic on-site examinations are carried out and justified on the basis of the large number of small banks and on unit banking within particular states.<sup>xiii</sup> Unlike jurisdictions where authorities place reliance on outside experts, bank supervisors in the US must possess skills in order to evaluate asset quality and other areas governing a bank's activities.<sup>xiv</sup> The disadvantage in this is that it can be labour intensive and restricted by budgetary constraints.<sup>xv</sup> US supervisory authorities have responded to resource constraints in recent years by making greater use of off-site surveillance systems.<sup>xvi</sup> However the use of off-site surveillance systems can also be disadvantageous as computers cannot observe certain aspects of examinations namely the scrutiny of management practices.<sup>xvii</sup> For this reason, the use of external auditors is also encouraged.

The system of bank supervision in jurisdictions such as Germany and Switzerland is based on one which delegates on-site examination and inspection of banks and the verification of their records to external auditors.<sup>xviii</sup> In Switzerland, auditors are engaged by the Federal Banking Commission, subject to special statutory duties whilst in Germany, general auditors perform bank examinations and must inform the authorities should they discover facts warranting an audit qualification.<sup>xix</sup> In comparison to these two systems, the UK's system involves a reduced use of external auditors and mixed system of supervision whereby its regulator, the Financial Services Authority inspects banks (on-site) and utilises external auditors (off-site).

In addition to the importance of a cooperative relationship between the supervisor and external auditor, the structure of the system of regulation is also paramount. The dual banking system, a system that has been in existence in the US for over a century, has given rise to concerns over the past years. Challenges facing the US include how to overhaul a system that has been in existence for so long in order to adapt to the changes faced in a global based modern world. This is why the rationale for a more modern single regulator amongst other issues, needs to be considered.

## The Regulatory Framework of US Financial Services

In the US financial service sector, there are completely different rules governing whether banks, securities and insurance firms are regulated at the federal or state level or both.<sup>xx</sup> Under the banking sector, both the national government and the states charter regulate banks.<sup>xxi</sup> This dual system of banking refers to the parallel state and federal banking systems that exist in the US.<sup>xxii</sup> It has many strong supporters<sup>xxiii</sup> and benefits of having a dual banking system result from allowing each of the two components of the system to function in accordance with their particular characteristics.<sup>xxiv</sup> National banking allows for testing and evaluation of efficiencies and benefits that flow from national standards.<sup>xxv</sup> However this system faces problems of inconsistencies in the application of rules and regulations. Since the Supreme Court's decision in *McCulloch v Maryland* in 1819, the precedent was set that states cannot constitutionally control powers of entities created under federal law.<sup>xxvi</sup> In relation to national banks, the regulator of national banks, the Comptroller of the Currency (OCC)<sup>xxvii</sup> is allowed by federal law to preempt state law.<sup>xxviii</sup> Courts have now realised that federal policies and regulations under certain circumstances may preempt inconsistent state laws and regulations.<sup>xxix</sup> The problems caused as a result of federal preemption have been a major topic over the past years.<sup>xxx</sup>

The insurance sector is regulated wholly on state level and this system of state regulation also has its problems. These problems entail conflicting and overlapping state laws on product introduction and innovation.<sup>xxxi</sup> Legislation was introduced to create an optional federal charter hence paving way for implicit or explicit preemption of state laws.

**As a result of these loopholes for inconsistencies, why not have a single regulator operating on a federal level?** Even though the dual banking system has its benefits, its costs would seem to outweigh perceived benefits.<sup>xxxii</sup> Problems in the dual banking system are apparent but it is obviously not easy to replace a system that has been in operation for over 140 years – a gradual shift towards federal primacy is suggested whereby the banking and securities industry could gradually work towards operating on a federal and national level. The insurance sector could then also adopt a system of gradual change towards a federal based level.

With the advent of globalisation and many foreign banks in operation, it would make more sense to give federal banks more supremacy. Conglomeratisation would raise the case for insurance also to be carried out on national as opposed to state level. However it could take a while to successfully implement and adopt this where a system wholly on state level which has been in existence for so long were suddenly to be overhauled.

Factors such as the growth of financial conglomerates and the derivatives markets fuelled by the impact of information technology and increased competition have triggered a change in the way supervision is carried out around the globe. In addition, bank collapses have also contributed to a re-think in the structure of financial regulation, that is, the way in which financial regulation is carried out.

These developments make it virtually impossible to sustain some of the rules created for a different economic environment<sup>xxxiii</sup> and what is true of rules, also applies to regulatory structures. As mentioned in the previous paragraphs, financial regulation in the US is typified by the number of agencies involved both at state and federal level and this complicates any reform process towards a financial modernisation legislation.<sup>xxxiv</sup> During the course of 1997, the Federal Reserve Board had called for a consolidated “umbrella” supervision invested in itself as the central bank of the United

States.<sup>xxxv</sup>

In 1997, the UK government announced the adoption of a single regulator known as the Financial Services Authority, the **FSA**, to oversee the regulation and supervision of the financial system. The subsequent establishment of the Financial Services Authority and enactment of the Financial Services and Markets Act 2000 became fully operational in December 2001. The rationale for a single financial regulator includes *inter alia* the greater level of ease and efficiency with which a “single regulator” can regulate bank financial-conglomerates compared to a system where a multiple number of regulators exist.

The move towards a single regulator is not unique to the UK but is a trend that has gathered pace in the international capital markets. In Germany, the amalgamation of banks, securities and insurance supervisors, with the establishment of a single financial markets supervisory authority known as the Federal Agency for Financial Market Supervision, has taken place. In Italy, there has been a move towards deregulation with the so-called ‘de-specialization’ of the banking system, which is the first step towards a possible single financial regulator being set up.

From the Treasury Committee's First Report on Barings Bank and International Regulation, it was highlighted that the Bank of England, the FSA's predecessor, could not perform its main objective of protecting the financial system without assessment of the functionings of the firms in the market. Same applies to the FSA. In order to achieve its objectives to the financial system, public, market and consumers, the FSA must get closer to the market and consumers.

This need to get closer to the market requires early warning indicators – indicators which the FSA's predecessor, the Bank of England could easily detect. So who could provide the answer to the gap left as a result of the Bank of England's reduced involvement in the banking supervisory process? The FSA in its proximity to the market and consumers would also need to be mindful of not getting 'captured' by those it is supposed to be regulating. The external auditor would seem to have a role in the banking regulatory process by

- i) Acting as an intermediary in getting close to the market and consumers
- ii) Helping the regulator avoid regulatory capture

Other issues

Central bank's involvement upon adoption of a single regulator.

One controversial issue following the adoption of a single financial services regulator in the UK has been the role left to the Bank of England – particularly regarding the safekeeping of the soundness of the financial system.<sup>xxxvi</sup> According to the Memorandum of Understanding between the Treasury, the Bank of England and the Financial Services Authority which was in circulation from October 28 1997,<sup>xxxvii</sup> the Bank of England has continued responsibility for financial stability, comprising the lender of last resort (LOLR) function.<sup>xxxviii</sup> However, the Bank of England no longer has the authority to gather information related to the well being of each individual bank and the system as a whole through direct supervision.<sup>xxxix</sup> This was so vital to determining whether or not to execute its discretion as LOLR in a particular case.<sup>xl</sup>

Perceived advantage of the German system over the UK system of financial supervision – Germany's central bank, the Bundesbank still retains supervisory functions (naturally as well as monetary policy setting functions) whilst benefiting from attributes of a single regulator (one of such attributes being the ability of a single regulator to manage cross sector services' risks more effectively). In contrast the UK system of financial services supervision comprises a system whereby banking supervisory functions of the central bank have been transferred to its single

regulator.

With a separate agency such as that of the Financial Services Authority dealing with bank supervision, the Bank of England could avoid damage to its reputation and also avoid conflicts of interest as lender of last resort in the event of bank failures. However it may still be important for the central bank to be involved in the supervision of the banking system. The single regulator for Germany, BaFin, is responsible for the supervision of credit institutions, financial services institutions, insurance companies and securities trading. **However, Germany's central bank the Bundesbank, still performs key banking supervisory functions in Germany**, helping to ensure the functional viability of the German credit and financial services institutions and the stability of the financial system. BaFin and the Deutsche Bundesbank share responsibilities for banking supervision and this division of responsibilities is aided through a Memorandum of Understanding (MoU).

The FSA, HM Treasury and the Bank of England also cooperate through a Memorandum of Understanding. A more direct involvement between the Bank of England and the FSA would have been preferable – especially through greater involvement of the Bank of England in the supervisory process – as is the case in Germany. The FSA could benefit more through an involvement of the Bank of England in the supervisory process and not just through the Memorandum of Understanding's allocation of their responsibilities. The MoU clearly aids **accountability** in the supervisory process – however, the **quality and efficiency** of the supervisory process could be greatly enhanced through the Bank of England's immense potential to contribute its wealth of knowledge to the banking supervisory process.

From the above-mentioned points, it would be vital to address the roles to be played by the central bank in the supervisory process, if the US were to consider adopting a single regulator. In a situation whereby supervisory functions result to acquisition of information which aids the execution of central bank functions, or where central bank functions yield information which cannot be obtained easily by assigning all supervisory functions to a single agency, then a division of supervisory responsibilities between the central bank and the single agency would not be a bad idea<sup>xli</sup>. However, if such economies of scope are superseded by the benefits of specialization, then the separation of supervision from central banking may provide better efficiency.<sup>xlii</sup> According to Huepkes, Quintyn and Taylor,<sup>xliii</sup> granting independence to financial sector supervisors is a more controversial issue than that of central bank independence. More importantly and as stated by Llewellyn, any country setting up the structure of a regulatory system, should consider such factors as the necessary number of agencies, the appropriate structure of those agencies, how the objectives for each agency should be defined, the degree of coordination and information haring between different agencies, the independence and accountability of the regulatory agencies and other factors.<sup>xliv</sup>

Plans to create an integrated financial regulator will most likely influence the structure of the supervisory framework for financial supervision and regulation in the US. It is also likely to impact the role of auditors. Since the introduction of a single financial services regulator, the Financial Services Authority in the United Kingdom, the FSA is said to have taken a more restrictive approach to its use of external auditors than its predecessor, the Bank of England<sup>xlv</sup>

In view of this restrictive approach adopted by the FSA, it is worth mentioning that the role of external auditors in financial regulation and supervision would also depend upon a particular jurisdiction. Employing an external auditor to perform bank inspections has many advantages. Audit firms may avoid resource and salary constraints which often prevent supervisory authorities from employing and retaining highly qualified staff.<sup>xlvi</sup> In addition auditors are able to combine

prudential inspection with general accounting audits. However there are also issues which could affect the external auditor's ability to effectively carry out his role in the supervisory process. These issues could arise in situations where the external auditor finds himself faced with conflicting roles.

The primary aim of the audit today is the verification of financial statements. The auditor provides **independent** verification on the financial statements of a company and as a result, the audit loses its value when such independence which gives credibility to the financial statements, is undermined. The external auditor's role in financial regulation and supervision requires such factors as integrity, objectivity and independence to be met.

### **Threats to objectivity and independence**

#### Non audit services

Non-audit services may be defined as any services other than audit provided to an audit client by an auditor.<sup>xlvii</sup> There are three categories of non-audit services namely<sup>xlviii</sup>: Services required by legislation or contract to be performed by auditors of the business; services that will be better performed by auditors because of their knowledge of the business and services which could be provided by a number of firms.

#### Self interest threat

This arises when auditors have financial or other interests which might result to them being reluctant to take actions that would be adverse to the interests of the audit firm.<sup>xlix</sup>

#### Self review threat

This arises when the results of a non audit service performed by the auditors or by others within the audit firm are included in the figures disclosed in the financial statements.<sup>1</sup> As a result of providing non audit service, the audit firm is associated with aspects of the preparation of the financial statements and may be unable to give an objective view of relevant aspects of those financial statements.<sup>li</sup>

Other threats to objectivity and independence include<sup>lii</sup>: Management threat, advocacy threat, familiarity threat and intimidation threat.

#### The reporting accountant (skilled persons)

Section 166 of the Financial Services and Markets Act 2000 deals with the powers of the FSA to obtain a report by a skilled person (reporting accountant) to assist the FSA in performing its functions under FSMA 2000. Under sections 167 and 168 of the Financial Services and Markets Act 2000, the FSA also has the powers to appoint competent persons to carry out investigations. The differences between the roles of reporting accountants (now known as skilled persons) and competent persons are demonstrated by the bearer of the costs for work carried out by these persons. For work undertaken by skilled persons, the bank bears the cost directly whilst for work undertaken by competent persons, the FSA bears the cost.<sup>liii</sup> The role of the reporting accountant has become so important that it will be incorporated into the entire regulated sector.<sup>liv</sup> Even though skilled persons are usually approved by the FSA, the role is usually performed by auditors of the regulated firm.<sup>lv</sup> This raises the question of independence since both roles of auditor and reporting accountant are distinct roles which still overlap occasionally.<sup>lvi</sup> Measures have however been adopted by the FSA to safeguard against possibilities of a conflict of interest. Chapter 5 of the FSA

Supervision Manual provides examples of circumstances where the FSA may use skilled persons. The FSA may nominate or approve the appointment of the auditor of a bank as a skilled person if it is cost effective to do so but also takes into account any conflicts the auditor may have in relation to the matter to be reported on. There are also defined and limited circumstances in which a firm can use skilled persons.<sup>lvii</sup>

From 1 April 2003 to 31 March 2004, the FSA exercised its power under section 166 of the Financial Services and Markets Act 2000 to require firms to produce a skilled person's report in 28 situations.<sup>lviii</sup> This is a considerable reduction in investigations from the number of reporting accountants commissioned under its predecessor's regime where section 39 Banking Act 1987 frequently exceeded 600 reports annually.<sup>lix</sup>

### Mandatory rotation of audit firms

The risk of having an auditor becoming too familiar with a particular business, hence becoming too close to a company and compromising his independence is the main reason why mandatory rotation of audit firms has been proposed. Whilst supporters of mandatory rotation believe that the auditor's independence would be strengthened as a result of making companies change their auditor after a fixed period of years, many have opposed the idea of mandatory rotation, arguing that it is a costly exercise.

Having considered these points, reasons for using external auditors in more capacities than others may be justified across different jurisdictions. The reason for Britain's FSA's reduced use of external auditors within the banking supervisory process may well be as a result of greater potential for conflicts of interest. According to research on how European arrangements differ from the UK, the dual role of auditors and reporting accountants/skilled persons directly comparable to that of the UK does not exist at European level.<sup>lx</sup> One significant difference between the auditing professions in Germany and Britain is the existence of auditing as a distinct profession in Germany.<sup>lxi</sup> The *Wirtschaftspruefer* is a qualified auditor and in contrast to Britain, an accounting profession does not exist in Germany.<sup>lxii</sup> In Britain, auditors grew more dependent on the expertise of accountants over the years until the audit function became dominated by the accounting profession.<sup>lxiii</sup> The concepts of "auditing" and "accounting" are often used interchangeably in Britain.<sup>lxiv</sup>

Where there is potential for conflicts of interest to arise, it may be well worth reducing the use of external auditors in such circumstances. As stated by Polizatto,<sup>lxv</sup> the appropriateness of delegating on-site inspections to external auditors would very much depend on an assessment of whether it is best able to perform the on-site verification function. This requires consideration of factors such as skills, competence, experience and independence from political or other influence.<sup>lxvi</sup>

However, weighing the immense benefits which external auditors contribute to the supervisory process, it could be worthwhile implementing a law like that of Sarbanes Oxley in Britain. The Sarbanes Oxley Act would discourage the dual role of auditors and reporting accountants/skilled persons thereby encouraging greater use of external auditors within the financial supervisory process.

### **Sarbanes Oxley Act**

Sarbanes Oxley was designed to tackle corporate malpractices and restore investor confidence in the aftermath of the Enron scandal but it has been made unpopular particularly amongst European companies, as a result of its provisions which some say is costly and burdensome.<sup>lxvii</sup> The objectives of Sarbanes Oxley are as follows: To improve the quality and accuracy of financial reporting; to reduce fraud and false accounting; to raise awareness of internal controls; to increase executive



responsibility for reported numbers and to strengthen the independence of audit firms.<sup>lxviii</sup>

Section 404 of the Act places a requirement on directors to document and confirm the effectiveness of internal controls on spending and usage of company assets and also to report on any discovered weaknesses. A representative of the European Employers' Federation, Jerome Chauvin, stated that European companies felt that costs of Sarbanes Oxley were disproportionate and that there was need for reform so that objectives of Sarbanes Oxley were met at a reasonable cost.<sup>lxix</sup> Other criticisms directed at the Sarbanes Oxley Act include:<sup>lxx</sup> The fact that disclosure has proven to be a more efficient means of regulating markets and reduces the need for substantive regulation; that increasing substantive regulation would prevent issuers from coming to the markets; that substantive regulation is likely to increase costs and that markets can regulate themselves. Espinosa<sup>lxxi</sup> (2004) counters these arguments by concluding amongst other things that disclosure does not reduce the need for substantive regulation and that strong regulation does not prevent access to the markets.<sup>lxxii</sup> He also concludes that the US Congress, in adopting Sarbanes Oxley, considered that though disclosure was still vital in ensuring transparency within the financial markets, reforms were still necessary to ensure that the source of such disclosure was free from conflicts of interests and thereby obtain correct and accurate disclosure.<sup>lxxiii</sup>

## CONCLUSION

The role of the external auditor in financial services regulation and supervision is one which could be harnessed in such a way as to prevent further corporate scandals such as Enron. This is possible where necessary safeguards are in place to ensure that the external auditor's integrity, objectivity and independence are not compromised. The Sarbanes Oxley Act has gone a long way to ensure this.

A post Enron consequence is the decline in auditors' undertaking consultancy or non-audit services and an increased perception of auditor independence.<sup>lxxiv</sup> Post Enron developments, in particular the US Sarbanes – Oxley Act meant that financial services firms with a US listing were not allowed to have their auditors undertaking consultancy work.<sup>lxxv</sup> Section 166 skilled persons' reports being commissioned by Britain's Financial Services Authority and if undertaken by auditors, arguably should not be classified as “consultancy”.<sup>lxxvi</sup> However if the FSA perceived a conflict of interest, it had the power to require others to be appointed.<sup>lxxvii</sup>

Following the collapse of Enron, a lot of comparisons were drawn between the principles based approach which exists in the UK and the US rules-based approach. Under David Tweedie's guidance during the 1990s, the UK Accounting Standards Board developed accounting standards which relied heavily on rules but still looked at the substance of the transactions, and if the rules did not produce the right answer, then one would have to look to the substance to produce the answer.<sup>lxxviii</sup> One of the major problems with Enron was the off balance-sheet debt which resulted from direct following of rules without being able because the accounting standards did not permit, to consider the substance of the transaction.<sup>lxxix</sup> Many of the differences between the UK and US accounting practices resulted from changes driven by corporate collapses of the 80s and early 1990s and such differences need to be considered when deciding whether to adopt certain post Enron reforms which have been adopted in the US.

In contrast to the US, the European Union's reaction to financial scandals has been less stringent.<sup>lxxx</sup> Whilst the US has enacted rules on corporate governance to ensure full and accurate disclosure, the EU issued codes of ethics for public companies.<sup>lxxxi</sup> In view of all that has already been mentioned in this paper, although the US would need to embrace international trends – including the possibility of adopting a single regulator operating on a federal level, Europe could also well benefit from considering a move towards Sarbanes Oxley. Historical developments, differences between

the regulatory and accounting practices existing between the different jurisdictions involved would need to be considered. Conglomeratisation and globalisation are however factors peculiar to both the EU and the US and which justify a need for change. One of the greatest benefits of having a single regulator for financial services is the ability of a single regulator to manage cross sector services' risks more effectively.

Debates about whether the UK has its principles-based regulatory tool to thank for avoiding another major corporate scandal are sure to continue. The impact of the adoption of a single regulator of financial services in the UK is a significant move which cannot be ignored. The crucial role that can be played by external auditors within this framework governed by the single financial services regulator is one which should be exploited.

- i School of Social Sciences and Law. Usual disclaimers apply
- ii See D Kershaw 'Evading Enron: Taking Principles Too Seriously In Accounting Regulation' *Modern Law Review* (2005) 594
- iii See also AM Whittaker 'Better Regulation – Principles vs Rules' *Journal of International Banking Law and Regulation* (2006) Issue 5
- iv ML de Espinosa Abarca 'The Need for Substantive Regulation on Investor Protection and Corporate Governance in Europe : Does Europe Need a Sarbanes-Oxley?' *Journal of International Banking Law and Regulation* (2004) 419
- v Section 201 Sarbanes Oxley
- vi “ Enron : The real scandal” *The Economist* Jan 17<sup>th</sup> 2002  
<[http://www.economist.com/displaystory.cfm?story\\_id=940091](http://www.economist.com/displaystory.cfm?story_id=940091)>
- vii “Enron : The real scandal” *The Economist* Jan 17<sup>th</sup> 2002
- viii Remarks by Ben S Bernanke, Chairman , Board of Governors of the Federal Reserve System before the Federal Reserve Bank of Chicago's 42<sup>nd</sup> Annual Conference on Bank Structure and Competition, Chicago, May 18, 2006
- ix *ibid*
- x E Huepkes, M Quintyn and M Taylor “The Accountability of Financial Sector Supervisors : Principles and Practice” IMF Working Paper at pg 11
- xi *Ibid* at pg 2
- xii See The Relationship between Bank Supervisors and External Auditors”, Basel Committee Publications No. 87 January 2002. Also see Basel Core Principles for effective Banking Supervision 1997, Basel Committee Publications No. 30 (September 1997); <http://www.bis.org/publ/bcbs30a.htm>
- xiii V Polizatto 'Prudential Regulation and Banking Supervision : Building an Institutional Framework for Banks' World Bank Working Paper January 1990 at p 17
- xiv *ibid*
- xv *ibid*
- xvi *ibid*
- xvii See 'Off-site Surveillance Systems' < <http://www.fdic.gov/bank/historical/history/vol2/panel2.pdf>> last visited 17 November 2006. Also see advantages and disadvantages of Off site Monitoring on pp 479,480
- xviii *Supra* note xiii p 15
- xix *ibid*
- xx H S Scott , P J Wallison “ Statement of the Shadow Financial Regulatory Committee on **Federal Preemption for Financial Services Firms** , Paper presented at the 42<sup>nd</sup> Annual Conference on Bank Structure and Competition, Federal Reserve Bank of Chicago, May 18-19 2006
- xxi *ibid*
- xxii “National Banks and the Dual Banking System” September 2003 Comptroller of the Currency pg 3 < <http://www.occ.treas.gov/DualBanking.pdf>>
- xxiii Remarks by Alan Greenspan “Our banking history”  
<<http://www.federalreserve.gov/Boarddocs/speeches/1998/19980502.htm>>
- xxiv *Supra* note xxii pg 13
- xxv *Ibid* at pg 12
- xxvi “National Banks and the Dual Banking System” September 2003 Comptroller of the Currency pg 7 < <http://www.occ.treas.gov/DualBanking.pdf>>
- xxvii On state level, state member banks are supervised by the Federal Reserve whilst state non member banks and insured branches of foreign banks are supervised by the Federal Deposit Insurance Corporation (FDIC)
- xxviii *Supra* note xx
- xxix *ibid*
- xxx See A Wilmarth Jr “The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System and Consumer Protection” *Annual Review of Banking and Financial Law, Volume 23 pp 225-364 2004*. Also see “Public Hearing on Preemption Petition : Public Debate on the Health of the Dual Banking System is essential “ <[http://www.fdic.gov/news/conferences/agency/public\\_allison\\_summ.html](http://www.fdic.gov/news/conferences/agency/public_allison_summ.html)> last visited 19<sup>th</sup> June 2006
- xxxi *Supra* note xx
- xxxii *ibid*
- xxxiii Testimony of Alan Greenspan of the Federal Reserve Board before the Committee on Banking and Financial Services, US House of Representatives, May 22 1997.
- xxxiv W Blair 'The Reform of Financial Regulation in the UK' *Journal of International Banking Law Issue 2 1998* p 43
- xxxv *ibid*
- xxxvi RM Lastra 'Banking Regulation in the 1990s' *Journal of International Banking Law* (1999) Issue 2 at p 45
- xxxvii Paragraphs 11 to 13
- xxxviii *Supra* note xxxvi
- xxxix *ibid*
- xl *ibid*
- xli See Remarks by Chairman Ben S Bernanke, at the Allied Social Science Association Annual Meeting, Chicago,

- Illinois Jan 5, 2007 <<http://www.federalreserve.gov/BoardDocs/Speeches/2007/20070105/default.htm>>
- xlii *ibid*
- xliii *Supra* note x at pg 3
- xliv See D Llewellyn 'The Creation of a Single Financial Regulatory Agency in Estonia : The Global Context' Paper Presented at Conference Organised by the World Bank and the Ministry of Finance of Estonia, 2001 at p 4
- xliv See D Singh "The Use of External Auditors by the Financial Services Authority : A Legal Analysis" at pg 13
- xlvi *Supra* note xiii p 15
- xlvii V Beattie, S Fearnley 'Auditor Independence and Non audit services' pg 1.( See <<http://www.icaew.co.uk/publicassets/00/00/03/64/0000036464.PDF>>)
- xlviii House of Commons , Select Committee on Treasury, Minutes of Evidence at pp 18 and 19 . Also see [www.publications.parliament.uk/cgi-bin/](http://www.publications.parliament.uk/cgi-bin/) Services required by law or contract include regulatory returns eg to the FSA, legal requirements in many countries including the UK, for auditors to report on matters such as share issues for non-cash consideration; contractual requirements, for example to report to lenders or vendors on net assets, covenant requirements etc. Services that are most efficient for the auditors to provide because of their existing knowledge of the business include those services listed in category (1) above but where the information derives mainly from the audited financial records and such include : tax compliance, where much of the information results from the audited financial records and "short form" or other reports in acquisition or reorganisation situations where completion is necessary in a very short time. The third category namely services which could be provided by a number of firms, include management consultancy, tax advice and human resources consultancy.
- xlix Ethical Statement 1 Integrity, objectivity and independence paragraph 28 <<http://www.asb.co.uk/apb/publications/index.cfm>>
- l *ibid*
- li *ibid*
- lii *ibid*
- liii See J Hitchens, M.Hogg and D.Mallett 'Banking : A Regulatory Accounting and Auditing Guide' PricewaterhouseCoopers at p 295
- liiv D Singh 'The role of third parties in banking regulation and supervision' *Journal of International Banking Regulation* Volume 4 No 3 , 2003, at pg 9
- lv *ibid*
- lvi *ibid*
- lvii According to chapter 5 of the Supervision Manual, the FSA stated that firms are to appoint skilled persons only for specific purposes; not to use them as a matter of routine;to use skilled persons only after having considered alternatives; to use skilled persons because of the added value to be gained due to their expertise or knowledge and not because of resource restraints; to take into account cost implications and to use the tool in a focused and proportionate way.
- lviii P Dewing and P O Russell *The Role of Auditors, Reporting Accountants and Skilled Persons in UK Finewinancial Services Supervision* Institute of Chartered Accountants of Scotland p 107
- lix *ibid*
- lx *Ibid* p 114
- lxi HR Vieten *Banking Regulation in Britain and Germany Compared : Capital Ratios, External Audit and Internal Controls* p 146
- lxii *ibid*
- lxiii *ibid*
- lxiv *ibid*
- lxv *Supra* note xiii p 15
- lxvi *ibid*
- lxvii See B Jopson 'Accounting Standards : Deadline on Sarbanes Oxley Closing ' *Financial Times*, July 10 2006
- lxviii *ibid*
- lxix *ibid*
- lxx *Supra* note iv p 425
- lxxi *Supra* note iv p 431
- lxxii *Ibid* p 431
- lxxiii *ibid*
- lxxiv *Supra* note lviii p 116
- lxxv *Ibid* p 116
- lxxvi *ibid*
- lxxvii *ibid*
- lxxviii House of Commons Select Committee on Treasury; Examination of Witnesses : Mr Michael Groom, Mr Peter Wyman, Mr David Bishop, Mr Roger Adams, Mr Bruce Epsley and Mr Richard Mallett, 10 April 2002 pg 1
- lxxix *Ibid* p 2
- lxxx *Supra* note iv p 422
- lxxxi *ibid*