Sarbanes-Oxley's Wake Up Call to Attorneys

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Abstract

This article addresses the different treatment of lawyers and accountants in the Sarbanes-Oxley Act of 2002. The article begins with an analysis of the SEC's authority to establish and regulate accounting standards. The article analyzes the SEC's historic oversight of auditors and its delegation of some of this oversight function to the accounting profession. It then provides a detailed analysis of the accounting profession's history of regulation under this delegation. This section also analyzes the role of SEC Rule 102(e) prior to the adoption of Sarbanes Oxley. The article then contrasts the treatment of lawyers and accountants in Sarbanes-Oxley and describes the effect of Sarbanes Oxley on multidisciplinary practices between lawyers and accountants. The article concludes that Congress' relatively light treatment of lawyers, in comparison to its micromanagement of the accounting profession, is attributable to the lack of effective self-regulation by the accounting profession in comparison to the many successful self-monitoring and discipline systems established by and within the legal profession. It also issues a cautionary note to the legal profession, suggesting that the reforms contained in the Sarbanes-Oxley legislation provide guidance to the legal profession to ensure that it remains a robust profession, able to protect and champion clients' rights.

In the wake of increasing revelations of corporate scandals, most

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notably the pervasive corruption and recklessness associated with the collapse of Enron, Congress acted with unusual dispatch in enacting corrective, prophylactic legislation to rein in what may be perceived as the demise of corporate responsibility. The end result was the passage of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley" or the "Act").[1] Among the most significant provisions of Sarbanes-Oxley are the extensive disciplinary and practice rules for the accounting profession, deemed necessary due to the abrogation of disciplinary responsibility by both the Securities and Exchange Commission (SEC), which was created in part to provide such oversight, and the accounting profession itself. In contrast, Sarbanes-Oxley imposes only minimal obligations upon attorneys. The law, however, should serve as a graphic reminder to the legal profession that it must be proactive in enforcing its own well-established ethical and disciplinary scheme so that it too is not forced to relinquish independent professional oversight.

Sarbanes-Oxley was enacted in July 2002, following extended and highly publicized Congressional hearings. Federal lawmakers concluded the self-regulatory efforts of the accounting profession to monitor accountant behavior in the corporate setting, as well as the SEC's system of accounting oversight, were ineffective and in need of a major overhaul necessitating government intervention.[2] The centerpiece of Sarbanes-Oxley, therefore, became a regulatory scheme directed at the accounting profession, which previously had been almost free from government

1. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15 U.S.C.), enacted July 30, 2002. *See also* President's Remarks on Signing the Sarbanes-Oxley Act of 2002, 31 WEEKLY COMP. PRES. DOC. 1283-1285 (Aug. 2, 2002) ("[T]oday I sign the most-far reaching reforms of American business practices since the time of Franklin Delano Roosevelt. This law sends very clear messages that all concerned must heed. This law says to every dishonest corporate leader: 'You will be exposed and punished. The era of low standards and false profits is over. No boardroom in America is above or beyond the law.' . . . This law says to corporate accountants: 'The high standards of your profession will be enforced without exception. The auditors will be audited. The accountants will be held to account.'").

2. *See, e.g.*, 148 CONG. REC. S6526 (daily ed. July 10, 2002) (comments of Sen. Sarbanes) ("it is very clear, as this issue has unfolded, that [Congress] needs to make structural changes. We need to change the system so that the so-called gatekeepers are doing the job they are supposed to be doing. That has not been happening."); 148 CONG. REC. S7351 (daily ed. July 25, 2002) (comments of Sen. Sarbanes to Senate Committee) (the "legislation establishes a carefully constructed statutory framework to deal with the numerous conflicts of interest that in recent years have undermined the integrity of our capital markets and betrayed the trust of millions of investors . . . [and] establishes a strong independent accounting oversight board, thereby bringing to an end the system of self-regulation in the accounting profession which, regrettably, has not only failed to protect investors, as we have seen in recent months, but which has in effect abused the confidence in the markets, whose integrity investors have taken almost as an article of faith").

regulation. The Act essentially created a new "watchdog" for accountants, the Public Company Accountant Oversight Board (hereinafter the "Board"),[3] and forbade accounting firms from offering consulting and other professional services, most notably legal advice, to public audit clients, derailing recent stepped-up efforts by the accounting profession to expand the role they played with clients.[4] Congress also increased regulation of the financial officers of public companies, created corporate governance standards, instituted a Code of Ethics for financial officers, and increased certification requirements for executive officers and boards of directors through Sarbanes-Oxley.[5]

By contrast, Congress imposed comparatively minimal regulations on attorneys practicing before the SEC.[6] In part, this may be attributed to the unique role played by attorneys charged with zealous advocacy on behalf of their clients, versus that played by accountants required to act as independent auditors who stand apart from their clients and scrutinize a corporation's financial records. The disparate nature of Sarbanes-Oxley's restrictions on the two professions also may be explained by the legal field's history of established, strong self-governing structures, such as state ethics boards and grievance committees operating through the courts.

The history of the SEC's role in overseeing auditors for public companies and prior self-regulation within the accounting profession provides insight as to the reasons Sarbanes-Oxley reforms are directed mainly at the accounting profession. Moreover, the reforms contained in the Act provide guidance to the legal profession to ensure that it remains a robust profession that continues to be able to protect and champion clients' rights.

I. The Securities and Exchange Commission as Regulator

A. SEC Authority to Establish and Regulate Accounting Standards and its Delegation to the Accounting Profession

The Securities and Exchange Commission (SEC) was established in 1934 in response to the severe financial crises of the 1920s, most notably the stock market crash of October 1929. Prior to the SEC's establishment, the Securities Act of 1933 (the "Securities Act") had established a system requiring a public corporation to register its stock sales and distributions and to regulate its financial disclosures to the

3. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat 745 (codified as amended in scattered sections of 15 U.S.C.) at §§ 101-109.
4. *Id.* at §§ 201-209.
5. *Id.* at §§ 301-308, 401-409.
6. *Id.* at § 307.

public.[7] In the Securities Exchange Act of 1934 (the "Exchange Act"), Congress authorized the SEC to regulate this corporate activity, as well as the activity of financial exchanges and brokers.[8]

During debate on the passage of the Securities Act of 1933, several lawmakers proposed that a body of government auditors be created to audit public companies.[9] This proposal was rejected after members of the accounting profession urged Congress to rely instead on the private sector of accountants to regulate themselves.[10] The rationale for this decision was that accountants had the expertise and skills to conduct such audits and were better equipped to detect accounting problems at an earlier stage.[11] In lieu of establishing government auditors, and as an additional means of monitoring the profession, Congress required that all financial statements filed by a public company with the SEC be certified by public or independent accountants, allowing the SEC to prescribe the format in which such information should be put forward.[12] The SEC also was empowered to define "accounting, technical and trade terms" and to dictate the required methods to be used in preparation of accounts, earning statements, balance sheets and regulations concerning the preservation of records and books.[13] The SEC adopted Regulation S-X and other similar regulations to implement these provisions.[14]

The SEC, however, promptly delegated its oversight responsibilities to the accounting profession itself,[15] allowing the Committee on Accounting Procedure[16] to establish financial accounting and reporting

7. 15 U.S.C. 77a, *et. seq.*

8. 15 U.S.C. 78a, *et. seq.*

9. Roberta S. Karmel, *Securities Regulation—Enron and the Accounting Profession*, 2/21/2002 N.Y.L.J. 3, (col. 1) (referring to Hearings on S. 875 Before the Senate Comm. On Banking and Currency, 73d Cong., 1st Sess. 57 (remarks of Sen. Adams), 57-59 (remarks of Sen. Reynolds) (1933)).

10. *Id.*

11. *Id.* (referring to SEC Release No. 150, 1973 WL 149263 (October 20, 1973)); see also Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter, Commission Release Nos. 33-8221; 34-47743; IC-26028; FR-70 (available at http://www.sec.gov/rules/policy/33-8221.htm) (stating that Commission concluded that expertise and resources of private sector in the process of setting accounting standards would benefit investors).

12. *Id.* (referring to 15 U.S.C. 77aa (25)-(27) (schedule of information required in registration statement)).

13. *Id.* (citing 15 U.S.C. 77s(a) and 15 U.S.C. 78m(b)).

14. *Id.* (referring to 17 C.F.R. 210.2-01 (independence and good standing requirements); id. at 210.2-02 (requirements concerning audit representations and opinions); id. at 210.4 (general rules of form, content, and method of presentation of financial statements); id. at 256 (prescribing an accounting system to be used by certain types of companies); id. at 257 (regulations concerning the preservation of books and records)).

15. *Id.*

16. The Committee on Accounting Procedure is a committee of the American Institute of Certified Public Accountants (AICPA).

standards from 1938-1959. Pursuant to its mandate and during that timeframe, the AICPA issued fifty-one Accounting Research Bulletins that formed the basis of what came to be known as the generally accepted accounting principles (GAAP).[17] This committee was followed by the establishment of the Accounting Principles Board of the AICPA from 1959-1973, which issued thirty-one new principles during its tenure.[18]

By the early 1970s, the AICPA recognized that increasing complexities of the business world required the complete and full-time focus of an association to develop proper accounting standards. Accordingly, the task was moved from an AICPA committee to the Financial Accounting Standards Board (FASB), a private-sector organization financed by the Financial Accounting Foundation.[19] The FASB's mission is "to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors and users of financial information."[20] The SEC recognized the accounting standards promulgated by the FASB and stated that the "principles, standards and practices promulgated by the FASB . . . will be considered by the Commission as having substantial authoritative support, and those contrary to such FASB promulgations will be considered to have no such support."[21]

1. Oversight of Auditors

In addition to delegating the establishment of accounting standards, the SEC also abrogated its authority to oversee the activities of auditors, leaving the task of establishing auditing standards to the accounting profession.[22] As a result, the accounting profession has relied on internal checks within the profession to serve as its ethical barometer and issue discipline where appropriate. Until Sarbanes-Oxley, the profession itself, through the AICPA and its affiliated entities, had determined the proper role of an accountant in serving as auditor to a publicly held

17. *The Enron Crisis: The AICPA, The Profession & The Public Interest* (last modified Feb. 20, 2002), *available at* http://www.aicpa.org/info/regulation02.htm (providing a "brief history of self-regulation).

18. *Id.*

19. *Id.; see also* Karmel, *supra* note 10; *Facts about FASB* (2003-2004) http://www.fasb.org/facts/index.shtml. The Financial Accounting Foundation is a group representing corporate interests from 1973 to the present.

20. *Facts about FASB* (2003-2004) http://www.fasb.org/facts/index.shtml (setting forth mission of the FASB).

21. *See* Karmel, *supra* note 10 (referring to SEC Release No. 150, 1973 WL 149263 (October 20, 1973)).

22. The Enron Crisis, *supra* note 18.

company.[23] For example, the AICPA is currently the main self-regulating organization for accountants, responsible for setting professional rules and ethical guidelines, issuing disciplinary decisions, and posting the same on their website.[24] Curiously, the AICPA assumes this responsibility despite the fact that a large portion of its funding comes from the very individuals and firms it seeks to regulate. The AICPA also does not have the authority to suspend licenses or stop unethical accountants from practicing. Rather, the AICPA only can impose limited sanctions upon its members, related primarily to membership in the organization.[25] Although the AICPA may refer the disciplinary matter to the state societies regulating the accounting profession,[26] such referrals are extremely rare and thus do little to deter.[27]

It is unfortunate that state regulation systems are not included in the review of accountant behavior more often because as state regulatory agencies are the entities that issue practice licenses to accountants, and, therefore, may also act to suspend those licenses or impose penalties for disciplinary violations by accountants.[28] In New York, for instance, the Office of the Professions, part of the New York State Education Department, is tasked with regulating accountants.[29] The Board of Regents of the New York State Education Department has issued Rules of Professional Conduct that apply to public accountants,[30] and the Office of Professional Discipline investigates and prosecutes complaints of professional misconduct.[31] The Board of Regents handles the most serious of these cases and may impose mandatory continuing education, fines or suspensions, or revoke one's license.[32] These sanctions certainly

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23. *Id.*

24. *See* http://www.aicpa.org/pubs/cpaltr/disciplil.htm. The AICPA recently has begun to publish ethics decisions in the *Wall Street Journal*, a publication read by leaders of the corporate world, as a means of making public their decisions about unethical behavior on the part of accountants. *See* Lisa A. Snyder, *Streamlining Ethics Enforcement: It's Time the Profession Sped Up the Ethics Enforcement Process and Let the Public See How it Works*, 8/1/03 J. Acct. 51, 2003 WL 122003659.

25. *See* http://www.aicpa.org/members/div/ethics/defin_sanction.asp (AICPA Definitions of Ethics Sanctions/Disposition, including the issuance of letters requiring corrective action, such as directing a member to complete CPE courses, admonishment by the AICPA Joint Trial Board or expulsion or suspension of membership within AICPA).

26. *See* http://www.aicpa.org/members/div/ethics/defin_sanction.asp.

27. Of the 253 cases completed from January 1 to December 1, 2002, only two were referred to state societies. *See* http://www.aicpa.org/members/div/ ethics/staterpt.htm (Annual Report of AICPA Disciplinary Action).

28. *See* http://www.aicpa.org/about/faq012.htm.

29. *See* http://www.op.nysed.gov.

30. Rules of Board of Regents, 29.10, Special Provisions for the Profession of Public Accountantcy, *available at* http://www.op.nysed.gov/part29.htm.

31. *See* http://www.op.nysed.gov/opd.htm.

32. *Id.*

have more teeth than those imposed by the self-regulating organization of the profession.

In 1989, the AICPA enacted by-laws mandating that members who audited publicly held companies must work for a firm belonging to the AICPA SEC Practice Section,[33] and that such firms must undergo a "peer review" every three years by another accounting firm of similar size, as a means to ensure that auditors and accountants were complying with generally accepted auditing practices and standards.[34] Results of these reviews are made available to the public on the AICPA website.[35] Originally, these peer reviews and quality control methods were overseen by the Public Oversight Board of the AICPA, a group considered to be "quasi-independent" although it was actually financed by the AICPA and its membership.[36] Recent events establish that such "peer reviews" were unsuccessful in assuring "quality control" in a number of the larger accounting firms.[37]

The major ethical focus by accounting self-regulating organizations prior to Sarbanes-Oxley was auditing standards and the regulation of auditing practices, with the primary focus being placed upon the issue of "independence." As noted earlier, the federal securities laws require that financial information filed with the SEC be certified and audited by an "independent" public accountant.[38] Although the definition of "independence" has been a complicated issue for the accounting profession, the term generally refers to those auditing activities that do not create a potential conflict of interest or otherwise compromise an accountant's objectivity.[39]

A sampling of those activities deemed by the AICPA to compromise an accountant's independence include: acquiring financial interest in the client, acting as trustee of trust or executor or administrator of any estate for client, grandfathered employment relationships, considering employment with client, having custody of client's assets, or serving as a client's stock transfer or escrow agent, registrar. These activities indicate that the provision of multiple services to a client may

33. *See* http://www.aicpa.org/centerprp/full_reg.htm.

34. *See* http://www.aicpa.org/centerprp/peer_review.htm.

35. *See* http://www.aicpa.org (peer review reports).

36. *See* http://www.aicpa.org./info/regulation02/htm. That Board was dissolved in March of 2002, however, in anticipation of SEC mandated changes in the self-regulation of the accounting profession.

37. *See id.*

38. Revision of the Commission's Auditor Independence Requirements, Securities Act Release No. 7870, (June 30, 2000).

39. *See* http://www.aicpa.org/about/code/et101.htm (setting forth Rule 101-Independence). The AICPA website contains twenty-five pages interpreting the meaning of independence as set forth in its Rule 101, detailing activities that are considered to impair independence.

compromise an accountant's independence or create a conflict of interest. Indeed, the matter of providing multiple services to clients has presented something of a dilemma for the accounting profession, especially in the context of auditors serving as consultants for the very firms they audit. Despite what appears to be an obvious conflict of interest in such an event, the AICPA specifically has stated that even if one of its members provides extensive advisory services for a client, including attendance at board meetings, analyzing financial statements, offering advice on potential expansion plans and serving in a banking relationship, the member would not be considered compromised for auditing purposes because such a role was "advisory."[40] In hindsight, accountants who looked to the AICPA for guidance on this issue of independence and conflicts of interest were led astray, as these "advisory" behaviors are thought to have been a substantial cause of the recent downfall of major corporations and accounting firms.

Prior to Sarbanes-Oxley, although the SEC was empowered to define "independence" insofar as independence related to the filing and certification of financial statements, the SEC was never able to prevent these conflicts because Congress never gave the SEC authority to regulate auditing standards.[41] The SEC did issue new auditor independence rules in 2000,[42] but contentious arguments between the Big Five accounting firms[43] and the SEC ultimately prevented the SEC from prohibiting accounting firms from providing consulting services to audit clients.

Despite the AICPA's efforts to regulate accountants and maintain independence within the profession, these self-regulatory attempts failed miserably. Indeed, in the fiscal year 2002, a mere 253 disciplinary cases were completed under the auspices of the AICPA, representing all disciplinary action taken by the organization within the fifty states; certainly not a measure of the unethical behavior occurring at that time. Reliance on peer review and reports of accounting misbehavior similarly were ineffective, particularly within the context of larger accounting firms where unethical (and illegal) behaviors were not the result of improper behavior by an individual CPA, but the combined efforts of

40. *See Ethics Rulings on Independence, Integrity and Objectivity*, ET Section 191, No. 8, *available at* http://www.aicpa.org/about/code/et191.htm.

41. *See* 15 U.S.C. 77aa (25-26); 15 U.S.C. 78q *et. seq.*, 17 C.F.R. Part 210.3-01.

42. *See* Revision of the Commission's Auditor Independence Requirements, Securities Act Release No. 7919 (Nov. 21, 2000).

43. Although the recent demise of Arthur Anderson may have changed this grouping to the "Big Four," the Big Five Accounting Firms in 2000 were: 1) Deloitte & Touche; 2) KPMG; 3) Arthur Anderson; 4) Price Waterhouse Cooperative; and 5) Ernst & Young. *See* Geanne Rosenberg, *Big Four Auditors' Legal Services Hit by Sarbanes-Oxley*, NEW YORK L.J., *available at* www.nylawyer.com/news/04/01/ 010504b.html.

numerous actors. A focus on the individual CPA was no longer good enough. As one commentator, a long time professor of accounting, said when expressing his "disappointment" in the accounting profession in comments made to the SEC in 2000,

> the accounting profession and the AICPA appear to have regressed from having a primary commitment to the public interest and professionalism to having a major concern for the private interest and the business of public accounting. The AICPA's many attempts at self-regulation appear to have failed, and the profession appears increasingly to deny that anything seriously is wrong . . . (as evidenced by the fact that) the AICPA and three of the five major accounting firms are vigorously attempting to prevent the adoption of this proposed revision of rules on auditor independence.[44]

B. Rule 102(e)—The SEC Tool of Enforcement

Prior to the enactment of Sarbanes-Oxley, the primary tool available to the SEC to oversee behavior by those professionals who practiced before it was Rule 102(e).[45] Theoretically, Rule 102(e) could be used to sanction *any* professional practicing before the SEC, but since the 1970s, SEC Rule 102(e) proceedings have been instituted principally against CPAs.[46] The rule allows sanction when, after opportunity for notice and hearing, a finding is made that a professional: (i) does not possess the requisite qualifications to represent others; (ii) is lacking in character or integrity or has engaged in unethical or improper professional conduct; or (iii) willfully violated, or aided or abetted the violation of Federal Securities laws or the rules or regulations pertaining to those laws.[47]

The use of Rule 102(e) has proven controversial, especially as applied to accountants.[48] The term "improper professional conduct" was not clearly defined in the legislation and the lack of clarity led to problems for the SEC with respect to a matter involving a proceeding against two auditors.[49] In *Checkosky v. SEC*, two auditors appealed the SEC's judgment that they had engaged in improper professional conduct

44. Commentary of Harvey Hendrickson on proposed SEC rule No. S7-1300, *available at* http://www.sec.gov/rules/proposed/s71300/hendric2.htm.

45. 17 C.F.R. Part 201.102(e).

46. Leo Orenstein and Marc Dorfman, *A Rule Gone Bad - SEC No Longer Needs to Rely on Rule 102(e), But Can't Seem to Let Go*, LEGAL TIMES, Vol. 23, No. 46 (November 20, 2000).

47. 17 C.F.R. Part 201.102(e)(1)(i-iii).

48. *See* Orenstein, *supra* note 47.

49. Checkosky v. SEC, 139 F. 3d 221 (D.C. Cir. 1998) (D.C. Cir. found SEC had achieved "impressive feats of ambiguity" in defining "improper professional conduct," criticizing Agency for not articulating a "clearly delineated standard").

under Rule 102(e).[50] After calling upon the SEC to explain the applicable standard for its review, the D.C. Circuit Court found that the SEC was incapable of doing so and had no clear and coherent definition of the prohibited conduct.[51] The Court, therefore, remanded the case to the SEC to dismiss.[52]

Following the remand, the SEC amended Rule 102(e), with the intent of providing a clear articulation of its standard. This new definition of "improper professional conduct" applied only to accountants and required intentional or knowing conduct, which included reckless conduct and two types of negligent conduct described as "highly unreasonable conduct," resulting in the violation of professional standards.[53] Some find even this new standard "convoluted and incomprehensible."[54] The SEC's lack of clarity on this issue exemplifies their failure to monitor adequately the accounting profession's ethical behavior.

C. Sarbanes-Oxley's Widespread Effect on the Accounting Profession

Following the disasters in 2002 involving major corporations such as Enron, it became apparent that neither the AICPA self-regulation nor SEC oversight were effective in regulating the accounting profession and thus the Sarbanes-Oxley Act was enacted. As previously noted, the Act's central means of reforming the practices of the accounting industry is the creation of a new "watchdog," the Public Company Accounting Oversight Board (the "Board"), which co-exists with current self-regulating organizations.[55] The Board regulates accountant behavior, which removes the significant level of autonomy accountants enjoyed pre-Enron. The Board also promulgates rules and regulations, governs accountant conduct, carries out investigations, and institutes disciplinary and enforcement actions.[56] Public accounting firms are required to register with the Board and may not prepare audit reports for registered issuers without being registered with the Board.[57]

The Board is funded primarily by publicly traded companies and consists of five members who are appointed by the SEC after consultation with the chair of the Federal Reserve Board and the

50. *Id.* at 222.
51. *Id.* at 225.
52. *Id.* at 227.
53. 17 C.F.R. Part 201.102(e)(iv)(A)(1).
54. *See* Orenstein, *supra* note 47 (citing SEC Commissioner Norman Johnson).
55. Pub. L. 107-204, 116 Stat 745 (codified as amended in scattered sections of 15 U.S.C.) at § 101(a).
56. *Id.* at § 101(c).
57. *Id.* at § 102(a).

Secretary of the Treasury.[58] Of these five members, only two may be CPAs and, if the chairperson is a CPA, s/he must have been absent from practicing for five or more years.[59] The Board also was charged with creating auditing standards, quality control standards, and ethics standards to be used by registered public accounting firms.[60] The Board is required to conduct a continuing program of inspections to monitor compliance of each registered public accounting firm and also must establish rules and procedures for the investigation and disciplining of registered public accounting firms.[61] Although the SEC has oversight and enforcement powers over the Board, the Board itself has the power to sanction and audit firms, and discipline registered public accounting firms and associated persons by revoking registrations and impacting their ability to audit public companies.[62]

Through Sarbanes-Oxley, the SEC also adopted new rules that expand the requirements of auditor independence, including a mandatory "cooling off" period of one year after an accountant terminates an employment relationship.[63] Section 201(a) also provides that it is unlawful for a registered public accounting firm to serve as auditor of a company while contemporaneously providing certain non-auditing services. These services include: bookkeeping or other services dealing with financial statements and accounting records; valuation services; actuarial services; and legal services.[64] These provisions apply to foreign accounting firms of both U.S. based reporting companies operating overseas and non-U.S. companies.[65]

The provisions enacted by Sarbanes-Oxley are extensive and detailed. For instance, the rules spell out prohibited activity for auditors with respect to certain non-audit services, require pre-approval for audit and permitted non-audit services, mandate rotation of audit partners such that no audit partner can serve more than five years and must then be

58. *Id.* at § 101(e).
59. *Id.* at § 101(e)(2).
60. *Id.* at § 103(a)(1).
61. *Id.* at § 104.
62. *Id.* at § 105.
63. *Id.* at § 106.
64. *See* R. Max Crane and Jeffrey Fessler, *Just When You Thought it Was Safe to Go Back Into the Water: More SEC Rules and Regulations for Counsel to Implement—Sarbanes-Oxley Act of 2002—Part II*, Metropolitan Corporate Counsel, Vol. 11, No. 5 (May 2003) (noting that "[t]he standards for auditor independence are significant in that one of the major reasons for enacting Sarbanes-Oxley, in addition to the desire to have more oversight by the Board and particularly its independent members, was the concern that the company/auditor relationship was too cozy and convenient for there to be genuine auditor objectivity.").
65. Pub. L. 107-204, 116 Stat 745 (codified as amended in scattered sections of 15 U.S.C.) at § 106 (noting applicability to foreign accounting firms operating in US).

subject to a five-year waiting period.[66] All told, a total of eighteen sections of the Act are directed at the accounting profession, which is a direct indictment of the inability of the accounting profession to self-regulate.

D. Attorneys Before and After Sarbanes-Oxley

Only one section of Sarbanes-Oxley, Section 307, entitled Rules of Professional Responsibility for Attorneys, is directed at attorneys. This section applies to attorneys who appear and practice before the SEC and creates minimum standards of professional conduct for such attorneys. One important component of the rules enacted by the SEC in compliance with Section 307[67] is a non-revolutionary definition of who the "client" is when attorneys represent companies before the SEC. The "client" is the company as an organization, not the company officers, directors, or employees.[68] If they were not before, attorneys now clearly are on notice that ethical obligations are owed to the company as an organization even if advising individual employees or officers.[69]

Consistent with its definition of the corporate client, the rules promulgated by the SEC further establish an obligation for attorneys to report material violations of federal and state securities laws and breaches of fiduciary duty "up the ladder" to chief legal counsel or the chief executive officer.[70] If the attorney does not receive an appropriate response, the attorney is obligated to take the matter to the audit committee or the full board of directors.[71] Alternatively, an attorney practicing before the SEC in representing a company may report evidence of material violations to the company's qualified legal compliance committee if a company has established such a committee.[72] By making this report to the committee, an attorney has satisfied the reporting requirements and is not asked to determine if the response is adequate.[73]

After the enactment of Sarbanes-Oxley, the SEC voted to extend the

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66. *Id.* at §§ 202-203.
67. 17 C.F.R. Part 205.1, *et. seq.*
68. 17 C.F.R. Part 205.3(a).
69. This obligation is also reflected in the Model Rule of Professional Conduct regarding the client-lawyer relationship, entitled "Organization as Client." MODEL RULES OF PROF'L CONDUCT, R. 1.13 (1983).
70. 17 C.F.R. Part 205.3(b)(3).
71. 17 C.F.R. Part 205.3(b)(3).
72. 17 C.F.R. Part 205.3(c).
73. *Id.* Attorneys are excused from these reporting requirements altogether when they have been retained or directed by the company's chief legal officer or when the attorney is retained by the qualified legal compliance committee itself to investigate evidence or undertake an investigation on behalf of the company or applicable officer, director or agent. 17 C.F.R. Part 205.3(b)(7).

comment period for a proposal originally included in the Act known as the "noisy withdrawal" provision.[74] This provision would require attorneys to notify the SEC of their withdrawal from representation of a company for "professional considerations." This withdrawal would be based on the attorney's belief that the company has failed to respond appropriately and is breaking the law, even after reports of such illegality have been submitted pursuant to the Act.[75] The SEC also is considering an alternative provision to the "noisy withdrawal" proposal, which would require the company itself to notify the SEC of the attorney's withdrawal, when such withdrawal results from the company's failure to adequately respond to the attorney's initial reports of wrongdoing.[76] To date, neither of these proposals have been enacted.

In contrast to the virtual micromanagement of accountants outlined in Sarbanes-Oxley, attorneys are neither heavily targeted nor regulated by the Act because very little government regulation of the profession exists. This may reflect a recognition that, contrary to some public perception, lawyers have succeeded in regulating themselves and have made a successful commitment to establish ethical standards for the profession and to create mechanisms to enforce those standards.

Attorneys long have recognized the need for controls over professional behavior and the profession has exercised strong self-discipline for quite some time. The first professional standards for the legal profession were adopted in 1887 in the state of Alabama and were soon adopted by several other states.[77] Later, in 1908, following a three-year study, the American Bar Association (ABA) promulgated the Canons of Professional Ethics.[78] These canons were in effect until 1964, when a special committee of the ABA began work on a new set of ethical provisions, which were adopted in 1969 and are known as the Model Code of Professional Responsibility (the "Model Code").[79] The Model Code provided, for the first time, mandatory standards of acceptable

74. *See* SEC Release 2003-13, *available at* http://www.sec.gov/news/press/2003-13.htm.

75. *Id.* (stating that "the significance and complexity of the issues involved, including the implications of a reporting our requirement on the relationship between issuers and their counsel," the Commission would take additional time to seek comment and thoughtfully consider the provision).

76. *See id.; see also* Bart Schwartz, *Corporate Governance, The Rules Are Different Now*, 10/23/2003 N.Y.L.J. 5 (col. 1) (detailing both "noisy withdrawal" provision and alternate proposal).

77. *See* Bernard Ingold, *An Overview and Analysis of the New Rules of Professional Conduct for Army Lawyers*, 124 MIL. L. REV. 1 (Spring 1989) (citing Armstrong, *A Century of Legal Ethics*, 64 A.B.A. J. 1063 (1978) (canons were based on work by legal scholars George Sharswood and David Hoffman)).

78. *Id.*

79. *Id.*

ethical behavior that subsequently were adopted in some form by most states.[80] Revisions of these provisions were ongoing, culminating in the enactment of the ABA Model Rules in the 1980s,[81] as well as the tailoring and revision of state disciplinary rules of professional responsibility in the individual states.[82]

To date, lawyers practicing in any state are subject to the disciplinary code and rules of professional responsibility adopted by that state. These rules are interpreted by State Bar Associations, which are attorney membership organizations that, among other functions, issue ethics opinions and help interpret the ethical rules of the given state. Many states have established such bar associations at the county and the city level as well. Although these bar associations are not disciplinary bodies insofar as they have no authority to enact disciplinary mechanisms, other than negative opinions, or to specify penalties for violations, great weight is given to the ethical opinions issued by these bodies and most attorneys are motivated to avoid referral to bar association disciplinary committees. These decisions are published to the profession as a whole and great importance is placed upon attorneys by their own peers to abide by the disciplinary rules and codes of professional responsibility.[83]

Despite the fact that attorney peer pressure to abide by the rules is so pronounced and effective, members of the profession have recognized that the rules themselves, as administered through the various bar associations, had very little "teeth" to truly discipline those whose misconduct seriously violated the state codes of professional responsibility. Twenty years ago, New York State addressed this issue and established formal grievance committees through the court system. Most states also have established similar grievance committees, which have the power to make recommendations to the state Supreme Courts which have the power to suspend the license of an attorney and to otherwise discipline attorneys who have violated the ethical rules of the

80. *Id.*

81. *Id.*, (noting that the ABA Model Rules of Professional Conduct were adopted in August, 1983 by the ABA House of Delegates, citing HAZARD, G. AND HODES, W., THE LAW OF LAWYERING: A HANDBOOK ON THE MODEL RULES OF PROFESSIONAL CONDUCT at xxxi (1985)).

82. *Id.*

83. For example, New York State requires attorneys sitting for the bar exam to take a separate "ethics" exam testing knowledge of the Rules of Professional Responsibility; this exam, the Multistate Professional Responsibility Exam, must be passed to receive admission to the New York State Bar. *See* http://www.nybarexam.org/mpre.htm. In addition, New York requires a minimum level of CLE credits be obtained as part of its state CLE requirement. *See* N.Y. Ct. Rules, Part 1500 (setting forth New York's mandatory CLE requirements) *see also* http://www.courts.state.ny.us/attorneys/cle/index.shtml.

state.[84]

Often, grievance committees are run through the court system. In New York, the conduct of attorneys is governed by the Appellate Divisions of the State Supreme Court and the disciplinary and grievance committees appointed by that court.[85] The grievance committees are comprised of both attorneys and non-attorneys, working with a court-appointed, state-financed professional staff.[86] Each committee investigates the complaints it receives against various attorneys.[87] Various levels of sanction are available against attorneys ranging from a letter of caution not made public to disbarment. In cases of serious misconduct, possibly resulting in disbarment and/or monetary fines, the committee refers the matter to the court for formal disciplinary proceedings.[88]

Despite the somewhat unsavory portrayal of lawyers and the proliferation of anti-lawyer jokes, the legal profession has been very successful in establishing a code of ethics, living by it, and enforcing it. For instance, the New York State courts' Grievance Committee system hears and decides a large volume of grievance cases—in a one-year period from January 1, 2002 to December 31, 2002, the four Appellate

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84. In each state and the District of Columbia, the court of highest appellate jurisdiction has the inherent and/or constitutional authority to regulate the practice of law. *See, e.g.*, In re Shannon, 876 P. 2d 548, 570 (Ariz. 1994) (noting that the state judiciary's authority to regulate the practice of law is universally accepted and dates back to the thirteenth century); Hunt v. Maricopa County Employees Merit Sys. Comm'n, 619 P. 2d 1036 (Ariz. 1980) (listing cases from numerous states recognizing the authority of the state supreme courts to regulate the practice of law); In re Attorney Discipline System, 967 P. 2d 49 (Cal. 1998) (noting that in every state the court has the power to admit and discipline lawyers).

Judicial regulation of the legal profession in the United States has evolved into an effective, complex, professionally-staffed enterprise. The entity responsible for investigating, prosecuting and adjudicating allegations of misconduct (violations of the rules/codes of professional conduct) at the behest of the court varies in each state. In some states the court has delegated that job to the state bar association. For example, in California the State Bar of California is considered an arm of the court for this purpose. In re Attorney Discipline System, 19 Cal. 4th 582 (1998). In other states, the supreme court has created an agency of the court separate from the state bar association. For example, the Attorney Registration and Disciplinary Commission of the Supreme Court of Illinois was created by the Supreme Court of Illinois in 1973 and is empowered to investigate, prosecute and adjudicate allegations of misconduct by lawyers. 103 Ill.2d, Rs. 751 through 771.

85. A GUIDE TO ATTORNEY DISCIPLINARY PROCEDURE IN NEW YORK STATE, prepared by NYSBA Committee on Professional Discipline, *available at* http://www.nysba.org/Content/NavigationMenu/Public_Resouces/Attorney_Grievance_Procedures.htm; *see also* http://www.courts.state.ny.us/ip/attorneygrievance/complaints_attorney.shtml.

86. A GUIDE TO ATTORNEY DISCIPLINARY PROCEDURE IN NEW YORK STATE, *supra* note 85.

87. *Id.*

88. *Id.*

Divisions of the New York State Court System received 14,044 new matters and had 5,932 matters pending from the previous year. Of these, 14,300 were disposed of in one year's time.[89] Altogether, 1785 attorneys were disciplined by letters of caution, letters of admonition or reprimand and referral to court.[90] Of the 691 referred to court for trial, 448 cases closed, resulting in 84 disbarments, 75 suspensions, 26 resignations and 23 public censures.[91] This is significant when contrasted with the AICPA's national record of 253 decisions in a full year. Lawyers must continue along this path of strong self-discipline, revising the various codes as necessary, always keeping in mind the need to be zealous advocates for their clients. Failure to do so may result in government interference with the role of self-governance, similar to that seen within the accounting field.

E. Multi-Disciplinary Practice

Sarbanes-Oxley's limits on multi-disciplinary practice abroad is another example of how the accounting profession is further limited by the Act. Indeed, Congress has dealt a fatal blow to multi-disciplinary practice abroad and, thus, to the marketing of accounting firms as a place for "one-stop shopping" for their clients, including audits and legal services. During the late 1990s, America's largest accounting firms, the Big Five, were hiring lawyers, acquiring law firms overseas, establishing overseas branches of U.S. companies, and providing legal services to audit clients.[92] By 2001, the Big Five accounting firms together had more lawyers on staff than the largest five law firms in the world.[93] Anderson Legal, the legal branch of Arthur Andersen Global, led the pack with 2,880 lawyers on staff, the second largest number of attorneys in any law firm. Andersen Legal was dissolved during the Enron meltdown, however, and many of those attorneys moved on to other accounting firms' global law practices, such as Ernst & Young.[94]

In the United States, local bar association rules have prevented accounting firms from engaging in law practice, as did attorney fee-

89. *See* New York Bar Association Annual Report of Committee of Professional Discipline, NYSBA Annual Meeting Jan. 26-31, 2004, Reports by Committee Sections—Committee on Professional Discipline, *available at* http://www.nysba.org.

90. *See id.* at Table 1. The other matters were rejected for failing to state a claim, referred to other agencies, dismissed or withdrawn. *Id.*

91. *Id.*

92. *See Big Six Count on Legal Work, Large Accounting Firms are Moving into Areas that Were Once the Exclusive Domain of Lawyers*, 2/9/1998 LEGAL TIMES S44 (detailing US accounting firms' expansion into legal arena).

93. Rosenberg, Geanne, *Big Changes in Offing for Big Four, Sarbanes-Oxley Triggers Restructuring in Global Law Networks*, NAT'L. L.J. 8, Col. 4, 12/12/03.

94. *Id.*

splitting restrictions. The SEC also prohibited auditors of public companies from providing legal service to audit clients in the United States.[95] Nonetheless, the SEC was aware that accounting firms engaged in overseas expansion were in the business of providing legal services to their overseas clients. The SEC chose not crack down on this development prior to the enactment of Sarbanes-Oxley, however.[96]

Section 201(a) of the Sarbanes-Oxley Act addresses auditor independence and clearly prohibits the provision of legal services by accounting firms to auditing clients either in the United States or abroad.[97] The SEC took this provision to heart and enacted a rule prohibiting the provision of legal services in foreign jurisdictions.[98] As a result, the accounting world's global law networks are either on hold while awaiting the effects of the new law or, in some cases, these networks have been disassembled and attorneys have moved elsewhere.[99]

II. Conclusion

The passage of the Sarbanes-Oxley Act of 2002 and the rules subsequently established by the SEC resulted in a wide-spread regulatory scheme directed at the accounting profession and the executive and financial officers of public companies. Accounting firms were further restricted by the Act's prohibition against the multi-disciplinary practices that had been cultivated by the Big Five accounting firms. These restrictions were the result of a long-history of poor self-regulation and discipline within the accounting profession and lack of oversight of accounting practices by the SEC.

Attorneys, on the other hand, were the subject of only one provision of Sarbanes-Oxley, which created a reporting obligation for attorneys practicing before the SEC who become aware of corporate wrongdoing. This comparatively light treatment of attorneys by Congress was the result of the many successful self-monitoring and discipline systems established by and within the legal profession. Those engaging in the practice of law would do well to maintain and continually update these systems in order to ensure they are not the next profession facing government intervention and regulation.

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95. *Id.*

96. *Id.*

97. Pub. L. 107-204, 116 Stat 745 (codified as amended in scattered sections of 15 U.S.C.) at § 201(a) (amending Section 10A of the Exchange Act to include "legal services and expert services unrelated to the audit" among the prohibited activities).

98. *See* Final Rule: Strengthening the Commission's Requirements Regarding Auditor Independence, *available at* http://www.sec.gov/rules/final33-8183.htm.

99. Rosenberg, *supra* note 93 (quoting Joseph Petito, a partner at Pricewaterhousecoopers, Saba Ashraf, a tax partner at Alston & Bird and Gerald A. Kafka, a tax lawyer who left a large firm).