

THE SARBANES-OXLEY ACT AND THE JAPANESE ACCOUNTING BIG BANG: NEW MOTIVATIONS FOR THE PROMOTION OF MULTIDISCIPLINARY PRACTICES

I. INTRODUCTION

In response to recent corporate scandals, the United States Congress hastily implemented the Corporate and Auditing Accountability, Responsibility, and Transparency Act, otherwise known as the Sarbanes-Oxley Act of 2002.¹ The Act implements many new reforms affecting auditing standards, corporate governance, and penalties for Security and Exchange Commission (“SEC”) violations. This Note focuses on the auditing provisions in these reforms.

The Sarbanes-Oxley Act’s effect on auditing is twofold. First, the Act establishes a “public oversight” board to monitor the accounting industry in the United States.² This board replaces the Financial Accounting Standards Board (“FASB”), which previously implemented Generally Accepted Accounting Practices (“GAAP”) standards under the SEC’s command. Second, for the first time, the Act includes an explicit provision outlawing the establishment or operation of multidisciplinary practices,³ or MDPs, in the United States.⁴

The United States’ current corporate scandals and the reformatory reaction to them can be analogized to scandals and reforms in Japan during the last few years. After questionable accounting practices caused many Japanese companies to go bankrupt, beginning in 1997, Japan’s Ministry of Finance implemented a series of reforms, known as the Japanese Big Bang.⁵ The Ministry intended to promote an auditing system similar to the deregulated system in the United States.⁶ Yet, despite the reforms, the Japanese economy has continued to decline.⁷

1. Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.) [hereinafter Sarbanes-Oxley Act].

2. Sarbanes-Oxley Act, § 101, 15 U.S.C.A. § 7211 (West Supp. 2003).

3. See *infra* note 73 and accompanying text.

4. Sarbanes-Oxley Act, § 201, 15 U.S.C.A. § 78j-1(g) (West Supp. 2003).

5. See *infra* pp. 940-41.

6. *METI to Examine Recent Accounting Reforms Given U.S. Scandals*, JAPAN ECON. NEWSWIRE, July 11, 2002, Westlaw, JAPANECON database. Japan has finished a three-year program to make its corporate governance style more like that of the United States, and the European Union is pressuring Japan to adopt International Accounting Standards. *Id.*

7. *Japan: Time for a Makeover*, THE ACCT., June 23, 2001, at 17. Financial reporters have

Perhaps the United States can learn from Japan's mistakes. The legislative quick fix of switching between policies of regulation and deregulation cannot effectively solve the recurring problem of corporate scandals.⁸ Instead, regulators must focus on a different kind of solution—the MDPs that the Sarbanes-Oxley Act currently prohibits.⁹

MDPs offering audit services, legal services, and tax services provide a solution that will prevent future economic disasters like those the United States and Japan have recently encountered.¹⁰ Combining all of these services into a cohesive unit will enhance the industries' effectiveness and discourage future unlawful practices. The MDP system would integrate all aspects of the financial consulting industry. While attorneys practicing in a MDP would provide legal advice on the potentially unlawful practices accountants should avoid, accountants would help attorneys better understand complicated accounting structures. This integration would create a system of checks and balances—one where the right hand would know what the left was doing. Involving more professionals in financial transactions will create more opportunities for employees to intervene and stop illegal practices before they start. There will also be more potential "whistleblowers" if the company engages in illegal practices. As a result, investors would learn about fraudulent practices before serious financial harm occurs.

The accounting industry already has many MDPs in place. The Big Five accounting firms currently employ a substantial number of attorneys in their taxation departments.¹¹ These lawyers are working effectively alongside accountants, providing legal advice so the accountants can structure effective legal transactions. Further, the integration of taxation and financial accounting will ensure that profits are accurately reported.

commented on Japan's poor economic recovery:

[t]he Japanese economy, which for the past decade has been in a state of stagnation, has shown no real signs of improvement over the past year or so. The Japanese yen continues to remain low against the major world currencies, and earlier in the year the stock market plummeted to a 27-month low. Analysts believe that any upturn in the economy would be dependent on an increase in consumer spending. At the moment, however, this seems unlikely due to economic insecurity and fear of job losses in the country.

Id.

8. See *infra* notes 51–62 and accompanying text.

9. See *infra* pp. 942–43 and note 90.

10. See *infra* pp. 938–40.

11. Lowell J. Noteboom, *Professions in Convergence: Taking the Next Step*, 84 MINN. L. REV. 1359, 1362 (2000) (noting that Big Five accounting firms employ more than 5,000 attorneys). The Big Five firms include: Arthur Andersen, Deloitte & Touche, Ernst & Young, KPMG, and PricewaterhouseCoopers. See also *infra* note 104 and accompanying text.

This will discourage the manipulation of financial statements that has led to recent scandals.¹²

MDPs are a global solution. The MDP system will work in Japan, the United States, and elsewhere. Many countries already recognize MDPs; others are integrating them into their accounting practices.¹³ The United States and Japan should follow the lead of more progressive countries in implementing these procedures. After analyzing the situations confronting the United States and Japan, it is obvious that the answer lies not in changing standards, but rather in changing mindsets to welcome MDPs.

II. HISTORICAL FACTS

A. *In 2002, Congress Passed the Sarbanes-Oxley Act to Address Concern Over Corporate and Accounting Scandals in the United States*

1. *Largely the Result of Unlawful Accounting Practices, Corporate Bankruptcies Caused Scandals Leading to Deep Depressions in the United States Economy in 2001 and 2002*

In the past few years, many events have caused the public to distrust the accounting industry and corporate America. The Enron Corporation declared one of the largest bankruptcies in United States history on December 2, 2001.¹⁴ In July of 2002, the SEC charged the WorldCom Corporation with corporate fraud after the company hid approximately \$3.9 billion in expenses.¹⁵ Other U.S. companies, such as Global Crossing, Qwest Communications, Xerox, Tyco, and ImClone, are facing similar problems.¹⁶

It seems that questionable accounting practices by corporate auditors caused most of these controversies. For example, Enron's public accounting firm, Arthur Andersen, admitted that its employees obstructed the investigation into the company's bankruptcy by destroying

12. *See infra* notes 14–19 and accompanying text.

13. *See infra* note 115 and accompanying text.

14. Noelle Knox, *Chapter 11 Latest Step for Enron*, USA TODAY, Dec. 3, 2001, at 1B. Enron declared bankruptcy in light of accounting fraud which led to a decline in its stock price and the termination of many corporate employees. *Id.* The stock price dropped from \$84.88 to \$0.26 in the year preceding the bankruptcy. *Id.*

15. Andrew Backover & Thor Valdmanis, *WorldCom Report Will Face Scrutiny*, USA TODAY MAG., July 1, 2002, at 1B (reporting that WorldCom was preparing for an SEC hearing to determine what laws the company violated).

16. *Id.*

documents.¹⁷ However, Andersen decided not to plead guilty to the charge of obstruction of justice, for which it was indicted on March 14, 2002.¹⁸ The firm was subsequently tried and convicted of that charge.¹⁹

2. *The Former GAAP Standards Were Too Stringent and Caused Accounting Firms to Find Loop-Holes*

The Enron example demonstrates how the Big Five accounting firms are deeply involved in the recent controversies. It is not as if the Enron executives were entirely without culpability,²⁰ as Andersen accountants audited and approved many of the accounting practices that formed the basis of the government's fraud charges. However, the accountants simply applied the standards set for their profession by the FASB.²¹

Until last year, public accountants in the United States adhered to accounting rules commonly referred to as GAAP rules. These rules functionally "govern[ed] audit methodology."²² In other words, they operated as guidelines for the accounting industry. The FASB was the administrative agency primarily responsible for the creation of the rules²³

17. Luisa Beltran, *Attorney: Andersen Will Admit Fault, Won't Plead Guilty*, CNN.com, Apr. 4, 2002, at <http://www.cnn.com/2002/LAW/04/04/anderson.justice.dept/index.html> (last visited Apr. 16, 2004). The accounting firm refused to accept responsibility for Enron's downfall. *Id.* However, Andersen had also insisted that any culpability is limited to its Houston office. *Id.*

18. *Id.* Stanley Brand, one of Andersen's attorneys said, "[w]e would consider something short of a guilty plea in court that would demonstrate an acceptance of responsibility." *Id.*

19. The jury relied on evidence that one employee had already pled guilty to charges. Andersen attorneys requested that the judge order a mistrial, but the motion was denied. Even after the motion was denied, Andersen partner C.E. Andrews said, "The purpose of this was for us to fight for our honor, our dignity. We did not think we committed a crime, we still do not think we committed a crime. We respect the process but the process is not over." Phil Magers, *Andersen Found Guilty of Obstruction*, WASH. TIMES, June 15, 2002, <http://www.washtimes.com/upi-breaking/15062002-112827-6571r.html> (last visited Nov. 11, 2002).

20. *See Fastow Charged with Enron Fraud*, CNN.com, Oct. 2, 2002, at <http://www.cnn.com/2002/BUSINESS/asia/10/02/us.fastow.biz/index.html> (last visited Apr. 16, 2004) (describing how former Enron CFO Andrew Fastow was indicted on federal charges of securities, mail, and wire fraud, money laundering, and conspiracy). *See also* Luisa Beltran, *Enron: Skilling Blames Others*, CNN.COM, Feb. 26, 2002, at <http://edition.cnn.com/2002/BUSINESS/02/26/enron.hearing/index.html> (last visited Apr. 16, 2004) (observing that former Enron CEO Jeffrey Skilling, who has an M.B.A. from Harvard, claimed he was ignorant of rules prohibiting the illegal accounting practices that Enron accountants used); *Ex-Enron Executive Pleads Guilty*, CNN.COM, Aug. 22, 2002, at <http://www.cnn.com/2002/BUSINESS/08/21/enron/index.html> (last visited Apr. 16, 2004) (covering the guilty plea of former Enron executive Michael Kopper, who agreed to cooperate with the investigation as part of a plea-bargain deal).

21. Manuel A. Rodriguez, *The Numbers Game: Manipulation of Financial Reporting by Corporations and Their Executives*, 10 U. MIAMI BUS. L. REV. 451, 452-53 (2002) (noting that the FASB issues "extensive and detailed accounting standards.").

22. *Id.* at 452.

23. *Id.* at 454-55. The FASB was created in 1973 to address "previous failed standard setting

while the American Institute of Certified Public Accountants (“AICPA”) had the supervisory power to oversee the regulation of the GAAP rules.²⁴

However, the GAAP system was subject to many flaws, including the self-regulation that led to massive abuses of the system. Since the requirements were so stringent, accounting firms found ways to circumvent the rules. In a 1996 review of the accounting profession, the General Accounting Office (“GAO”) identified five “major issues” that were seen as weaknesses in the self-regulatory nature of the accounting system including:

1. Auditor Independence;
2. Auditor’s Responsibilities for fraud and Internal Controls;
3. Audit Quality;
4. Accounting and Auditing Standard Setting Processes; and
5. The Role of the Auditor in the Further Enhancement of Financial Reporting.²⁵

Auditor independence is perhaps the most important of these concerns because it ensures that the auditor’s relationship with the client does not compromise the quality of the audit. Previous laws required accountants to maintain arm’s length relationships with their corporate audit clients.²⁶ The arm’s length requirement provides that a member of an accounting firm cannot audit a company in which he owns stock or serves as an officer.²⁷

attempts.” *Id.* at 454. The Board acts as the “primary private standard setter.” *Id.* Funded by the Financial Accounting Foundation (FAF), seven full-time members make up the Board. *Id.* The SEC “generally acquiesce[s]” to the GAAP standard adopted by the FASB. *Id.* The “principal pronouncement” of the FASB, releasing the GAAP standards, is known as the Statement of Financial Accounting Standards. *Id.* at 455. This pronouncement is “enacted only after extensive deliberation and regard for due process.” *Id.*

24. *Id.* (noting that the AICPA acts as the “national professional organization” for CPAs in the United States).

25. *Id.* at 457, citing United States Gen. Acct. Office, *The Accounting Profession, Major Issues: Progress and Concerns*, Sept. 1996, at 4, <http://www.gpoaccess.gov/gaoreports/index.html> (last visited Apr. 16, 2004). This report was requested by Representative John Dingell of Michigan, the Chairman of the Committee on Commerce of the U.S. House of Representatives. *Id.*

26. Tamar Frankel, *Accountants’ Independence: The Recent Dilemma*, 2000 COLUM. BUS. L. REV. 261, 262 (2000) (noting that in practice the arm’s length requirement meant that, “[i]ndependent accountants must be autonomous from the corporations that they audit.”).

27. *Id.*

3. *As the Big Five Accounting Firms Grew, They Provided Broader Services to Their Clients, Including Legal and Consulting Services*

As the Big Five accounting firms grew and offered more services,²⁸ they also compromised their independence.²⁹ When the responsibilities of the accounting firms increased, additional potential conflicts of interest arose.³⁰ The integration of accounting and consulting services led to a situation in which accounting firms audited transactions structured pursuant to their own consulting advice.³¹ As a result, in the late 1990s, many of the large accounting firms chose to separate their consulting practices from their public accounting practices in order to avoid conflicts of interest and government suspicions arising therefrom.³²

This was not the first time the accounting industry found itself in a situation it could not control through self-regulation. In the late 1980s, a practice of “opinion shopping” developed among the Big Five accounting firms.³³ Opinion shopping clients jumped from firm to firm in search of the most accommodating financial accounting standards.³⁴ As the SEC became more and more concerned with the industry’s practices, the accounting firms began to regulate their conduct, decreasing the prevalence of opinion shopping.³⁵

28. *Id.* The accounting firms had always offered audit services. However, they also began to offer legal services, tax services, management consulting, strategic planning, information technology, and mergers and acquisitions advice. *Id.* at 263. In short, the accounting firms sought to develop business strategies. *Id.* at 263.

29. *Id.*

30. *Id.*

31. *Id.*

32. Ken Brown, *Andersen Consulting Becomes Accenture*, WALL ST. J., Oct. 27, 2000, at B6. Arthur Andersen split with its consulting practice, Andersen Consulting. *Id.* After arbitration, Andersen Consulting was rebranded Accenture. *Id.* The consulting firm held its initial public offering of stock in July of 2001. Rachel Emma Silverman & Kate Kelly, *Accenture IPO Goes Forward in Cold Climate*, WALL ST. J., July 19, 2001, at C1. In order to “differentiate itself from its former parent, KPMG LLP,” KPMG Consulting changed its name to BearingPoint in October of 2002. Kemba J. Dunham, *KPMG Consulting Inc Picks BearingPoint for its New Name*, WALL ST. J., Oct. 3, 2002, at B10.

33. Dale R. Rietberg, *Auditor Changes and Opinion Shopping—A Proposed Solution*, 22 U. MICH. J.L. REF. 211, 215 (1988).

34. *Id.* at 216.

35. *Id.* at 227–28. In addition, the SEC developed regulations of their own to combat the problem. *Id.* The agency implemented several structural safeguards to “discourage opinion shopping.” *Id.*

4. *The Sarbanes-Oxley Act was Quickly Enacted by Congress as a Legislative “Solution” to Accounting and Securities Regulatory Incompetence*

In light of recent scandals involving Enron, WorldCom and other companies, Congress did not wait for the Big Five to regulate themselves and, instead, introduced the Sarbanes-Oxley Act on February 14, 2002.³⁶ The bill was introduced by Representative Michael Oxley of Ohio in order to “provid[e] enhancements necessary to support the Securities and Exchange Commission in its role to protect investors.”³⁷

The Sarbanes-Oxley Act modified accounting practices in several significant ways. First, it established a board to oversee the accounting industry.³⁸ Although the board is not an official agency of the federal government,³⁹ it nevertheless regulates the accounting industry. Second, Titles I and II of the Act set forth modifications to the governance of the accounting profession,⁴⁰ while Title II exclusively addresses auditing practices. Although the Sarbanes-Oxley Act focuses on corporate accountability and fraud penalties,⁴¹ the regulations governing accounting firm audits may be more problematic.

Title I establishes the oversight board⁴² and sets forth its powers and duties. These duties include: (1) the registration of all public accounting

36. Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002, Bill Tracking Report H.R. 3763, 107th Cong., § 2 (2002).

37. 148 CONG. REC. E657-E658 (daily ed. Apr. 29, 2002) (statement of Rep. Oxley).

38. Sarbanes-Oxley Act, § 101(a), 15 U.S.C.A. § 7211(a). The board is known as the “Public Company Accounting Oversight Board.”

39. Sarbanes-Oxley Act, § 101(b), 15 U.S.C.A. § 7211(b) (“The Board shall not be an agency or establishment of the United States Government”).

40. Sarbanes-Oxley Act, §§ 101-209, 15 U.S.C.A. 7211.

41. See Sarbanes-Oxley Act, §§ 101-1107. For example, Title VIII provides that all accountants shall maintain any records containing audit information for a period of five years. Sarbanes-Oxley Act, § 802, 18 U.S.C.A. § 1520(a)(1). Also, the Act, provides “whistleblower protection” for the employees of publicly traded companies. Employees who report company violations cannot be discharged, demoted, suspended, threatened, or otherwise. Sarbanes-Oxley Act, § 806, 18 U.S.C.A. § 1514A(a). In addition, penalties are increased for wrongdoers in Title VIII. Under the Act, an individual who commits securities fraud may be punished with fines and up to twenty years in prison. Sarbanes-Oxley Act, § 906, 18 U.S.C.A. § 1350(c). The penalties for mail and wire fraud are also increased under Title IX. Sarbanes-Oxley Act, § 903, 18 U.S.C.A. § 1341, 18 U.S.C.A. § 1343. Finally, Title XI provides that the SEC can freeze the assets of those who violate securities fraud rules. Sarbanes-Oxley Act, § 1103(a)(3), 18 U.S.C.A. § 78u-3(a)(3).

42. Sarbanes-Oxley Act, § 101(a), 15 U.S.C.A. § 7211(a). This section of the Act also enumerates the board’s powers:

The members of the Board shall take such action (including the hiring of staff, proposal of rules, and adoption of initial and transitional auditing and other professional standards) as may be necessary or appropriate to enable the Commission to determine, not later than 270 days after the date of enactment of this Act, that the Board is so organized and has the

firms preparing audit reports; (2) the establishment of auditing standards; (3) the inspection of public accounting firms; (4) the investigation and discipline of firm violations; (5) the performance of necessary, non-designated functions; (6) the enforcement of compliance with the Act and related law; and (7) the management of the board.⁴³

Title II addresses current problems perceived to be related to auditor independence.⁴⁴ One facet of Title II prohibits accounting firms from becoming the one-stop shops, commonly known as MDPs.⁴⁵ The Act explicitly provides that it shall be unlawful for a public accounting firm performing auditory functions for a company to also carry out any of the following functions for the company: (1) bookkeeping, including services related to the preparation of financial statements; (2) financial information system services; (3) appraisal services; (4) actuarial services; (5) audit outsourcing services; (6) management or human resources functions; (7) investment banking services; (8) legal services unrelated to the audit; or (9) other services as the oversight board determines.⁴⁶

The Act contains additional provisions designed to insure auditor independence. For example, the Act prohibits an audit partner in a public accounting firm from overseeing the audit of a company for more than five consecutive fiscal years.⁴⁷ In addition, the Auditor Independence provisions require the Office of the Comptroller General to conduct a study of the effects of the mandatory rotation of public accounting firms.⁴⁸ If adopted, mandatory rotation would require the entire firm be rotated, while the current law requires only the rotation of partners within a firm.⁴⁹

capacity to carry out the requirements of this title, and to enforce compliance with this title by registered public accounting firms and associated persons thereof.

Sarbanes-Oxley Act, § 101(d), 15 U.S.C.A. § 7211(d).

43. Sarbanes-Oxley Act, § 101(c), 15 U.S.C.A. § 7211(c).

44. Sarbanes-Oxley Act, §§ 201-209, 15 U.S.C.A. §§ 7231, 7232, 78j-1 et seq.

45. Sarbanes-Oxley Act, § 201, 15 U.S.C.A. § 7231 (explicitly addressing “services outside the scope of practice of auditors.”).

46. Sarbanes-Oxley Act, § 201(g), 15 U.S.C.A. § 78j-1.

47. Sarbanes-Oxley Act, § 203(j), 15 U.S.C.A. § 78j-1. This section provides:

It shall be unlawful for a registered public accounting firm to provide audit services to an issuer if the lead (or coordinating) audit partner (having primary responsibility for the audit), or the auditor partner responsible for reviewing the audit, has performed audit services for that issuer in each of the 5 previous fiscal years of that issuer.

Id.

48. Sarbanes-Oxley Act, § 207(a), 15 U.S.C.A. § 7232(a).

49. MODEL RULES OF PROF'L CONDUCT R. 1.7 (1983). Firm rotation is similar to the imputed disqualification rule of legal ethics. *Id.*

Congress believed that the provisions of the Sarbanes-Oxley Act would be effective in preventing future disasters like Enron.⁵⁰ The bill was passed by the House on April 24, 2002, two months after it was introduced.⁵¹ The Senate passed the bill on July 25, 2002.⁵² Under the pressure created by corporate scandal, the members of Congress had enacted a legislative quick fix to distance themselves from responsibility relating to the economic downturn in the United States.

B. Before the United States Experienced the Problems of the 1990s and Early 2000s, Japan Faced Similar Struggles and Answered with Similar Legislative "Solutions"

1. As Commercial Code Reforms Were Passed by the Japanese Ministry of Finance Over a Period of Two Decades, the Japanese Economy Found Itself in a Perpetual State of Decline

The Japanese Ministry of Finance ("MOF") controls nearly all aspects of finance in Japan. It regulates the securities markets, the accounting standards, and taxation accounting practices.⁵³ For accounting

50. Representative Oxley introduced the bill by claiming that the "enhancements [were] necessary to support the Securities and Exchange Commission in its role to protect investors of public companies[.]" See *supra* note 37.

51. Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002, Bill Tracking Report H.R. 3763, 107th Cong. § 2 (2002).

52. *Id.*

53. Bill Gordon, A Critical Evaluation of Japanese Accounting Changes Since 1997 (1999) (unpublished M.A.A.J.S. dissertation), <http://wgordon.web.wesleyan.edu/papers/jaaccont.htm> (last visited Apr. 16, 2004). The Japanese operate within a "triangular legal system." *Id.* at 2. "There are three laws which prescribe financial accounting and reporting in Japan; the Commercial Code, Securities and Exchange Law, and Corporate Income Tax Law." Japanese Institute of Certified Public Accountants, *Accounting and Disclosure System in Japan*, at http://jicpa.or.jp/n_eng/e-account.html (last visited Apr. 16, 2004) (describing the integration of the legal system in Japan). Regarding the individual laws, the Institute states:

The Commercial Code requires a joint-stock corporation . . . to prepare an annual report basically on an individual basis. The annual report submitted to the general meeting of shareholders has to include the balance sheet, the income statement, the business report, the profit appropriation/loss disposition proposal, and supporting schedules. The Code also requires certain "large corporations" (as defined by the Code) to include designated consolidated financial statements . . . in the reports of the business years ending in or after April 2004.

Under the Securities and Exchange Law, each "issuer" of designated securities is required to file annual and semi-annual reports with the Prime Minister and copies of those with the stock exchange(s) where its securities are listed. The financial statements prepared for the purpose of securities registration and periodic reporting under the law have to include the balance sheet, the income statement, the statement of profit appropriation/loss disposal, supporting schedules thereto; the consolidated income statement, the consolidated statement of retained earnings, the consolidated statement of cash flows, and supporting schedules thereto.

standardization and regulation, the MOF works mainly through the Business Accounting Council (“BAC”), an entity much like the SEC’s FASB.⁵⁴ In response to the manipulation of profits through subsidiaries by several corporations,⁵⁵ the MOF instituted Commercial Code Reforms in 1974.⁵⁶ These reforms first introduced an independent audit requirement in

The financial statements prepared under the Commercial Code and the Securities and Exchange Law are, for the most part, compatible with each other.

The Corporate Income Tax Law provides methods for calculating taxable income and requires that revenues and expenses be recorded in the books of account in order to be qualified under the Law. This requirement sometimes affects enterprise accounting in Japan.

Id.

54. See Gordon, *supra* note 53, at 6. The Council was originally established in 1948 and became the BADC in 1952, after a series of name and structure changes. *Id.* The BADC has undergone a recent name change and is now known as the Business Accounting Council (“BAC”). The JICPA states:

Business Accounting Principles issued by the Business Accounting Council (BAC), Accounting Standards issued by the Accounting Standards Board of Japan (ASBJ), and Practical Guidelines issued by the JICPA are deemed to be the generally accepted accounting principles (GAAP) in Japan . . . The standard setters have been successful in narrowing the gap between Japanese standards and International Accounting Standards in recent years. The financial statements according to the regulations . . . contain few differences with IAS or USGAAP.

Japanese Institute of Certified Public Accountants, *Accounting and Disclosure System in Japan*, *supra* note 53. The BAC is responsible for all three laws of the Triangular Legal System. “The Auditing Standards codified by the BAC together with audit guidelines issued by the JICPA are deemed to be the generally accepted auditing standards (GAAS).” Japanese Institute of Certified Public Accountants, *Auditing System in Japan*, at http://www.jicpa.or.jp/n_english-audit.html (last visited Apr. 16, 2004). The GAAS provide guidance for statutory and non-statutory audits under the Commercial Code, Securities and Exchange Law, and other related laws. *Id.*

55. See Gordon, *supra* note 53, at 8. Because subsidiaries were not subject to CPA firms’ audits, the parent companies could use subsidiaries to “disguise losses” or “inflate profits.” *Id.* Gordon notes:

Before 1974, the CC did not require company financial statements to be audited by a CPA firm. Although the SEL [Securities and Exchange Law] required audits of parent-only financial statements for listed companies, the subsidiaries and affiliates generally did not have audits since they were not listed on a stock exchange. The CC and SEL require that a corporation’s statutory auditors examine the financial statements to ensure fraud does not take place and that directors have complied with the law and articles of incorporation. The statutory auditors, with their qualifications not clearly defined in the law, sometimes had no independence or lacked sufficient knowledge of accounting and auditing, which resulted in several cases in the 1960s of financial statement window-dressing not being detected or reported. Even for the companies that had audits by independent CPAs under the provisions of the SEL, the CPAs for several of the companies that went bankrupt failed to disclose to the MOF, through their audit reports, financial statement window-dressing used by the companies to manipulate profits and disguise their true financial position.

Id. Some have compared the Japanese era where “big companies went bankrupt revealing their fraudulent accounting” to the United States’s recent corporate scandals. Zenichi Shishido, *Reform in Japanese Corporate Law and Corporate Governance: Current Changes in Historical Perspective*, 49 AM. J. COMP. L. 653, 666 (2001).

56. See Gordon, *supra* note 53, at 8. The reforms applied to companies with capital greater than 500 million yen or liabilities greater than 20 billion yen. *Id.* The reforms required that an auditor be either a CPA or an “auditing corporation of CPAs.” *Id.* Perhaps these auditors’ ineffectiveness can be

Japan.⁵⁷ The MOF intended the independent audits to expand the auditor's function beyond accounting to include monitoring illegality.⁵⁸ In 1981, the MOF felt that the Commercial Code governing Japanese companies needed further reform. The MOF instituted new reforms, including the creation of additional auditing standards that required companies "to have more than two auditors, one of which was full-time."⁵⁹

These reforms were widely criticized, largely due to the ineffectiveness of auditor monitoring.⁶⁰ Ineffective monitoring led to questionable accounting practices, which inflated financial data and created an economic boom in Japan during the 1980s.⁶¹ During this time, the Nikkei Dow almost tripled.⁶² However, the bubble eventually burst and the Japanese economy slipped into a lengthy recession.⁶³

2. *Japan Implemented a Significant Series of Reforms in the Mid-1990s Known as the "Japanese Big Bang"*

Thus, in the early 1990s, the Japanese MOF once again found itself in a position where it needed to make auditing reforms. The MOF identified three areas in need of reform: (1) the "business and regulatory environment"; (2) the "loopholes and weaknesses in the accounting rules";

linked to their lack of education and experience. In Japan, the procedure for becoming a CPA is a simple, three-stage process. Japanese Institute of Certified Public Accountants, *Becoming a CPA in Japan*, at http://www.jicpa.or.jp/n_eng/e-cpaexam.html (last visited Jan. 30, 2004). The first stage has "no educational requirements." In fact, this stage simply ensures that a potential candidate has "general literacy" skills. *Id.* A candidate with at least two years of college education does not even have to sit for this stage. *Id.* Candidates who passed the first stage are eligible for the second stage. *Id.* This stage includes multiple choice tests, which are a prerequisite to an essay exam covering basic accounting principles, the commercial code, and other topics. *Id.* Candidates for the third stage must merely complete a two-year training course (much like an associate's degree program in the United States) and then pass written and oral examinations. *Id.*

57. Gordon, *supra* note 53, at 9. These measures were intended to "improve the quality of CPA audits" and "strengthen the financial reporting of companies." *Id.*

58. Shishido, *supra* note 55, at 666. This restored a previously possessed power to the auditors. *Id.*

59. *Id.*

60. *Id.* At the time of the reforms, the legislature was looking for a quick response to recent scandals involving large companies. *Id.* The legislature implemented the reforms because they were acceptable to the companies' executives. *Id.*

61. *Id.* at 668.

62. *Id.* "Japanese management enjoyed free cash flow for the first time in history and they wasted it. Japanese corporate governance was good at encouraging the growth of the company but had never experienced the need to monitor for efficient use of free cash flow." *Id.*

63. *Id.* The recession created a need for a change in the corporate governance system, which came about in the 1990s. *Id.* The following changes occurred during the Japanese transition: (1) shift from loan financing to equity financing via bonds; (2) significantly decreased rates of return to shareholders; and (3) elimination of lifetime employment. *Id.* at 669-71.

(3) and the “weak auditing practices” of the Japanese accounting system.⁶⁴ In response, the Prime Minister ordered the BADC to bring Japanese accounting in line with international standards.⁶⁵ The BADC’s response became known as the “Japanese Accounting Big Bang.”

The goal of this plan was to make the Japanese markets “free, fair, and global.”⁶⁶ In effect, the plan was to deregulate several elements of the business markets in Japan.⁶⁷ Just like the Sarbanes-Oxley Act, the Big Bang affected both securities and accounting regulations.⁶⁸ The intended effect of the reforms was to make the Japanese marketplace more like that of the United States.⁶⁹ The plan was to “promote competition by lowering, or even eliminating, the barriers separating different sectors of the financial industry.”⁷⁰

III. ANALYSIS AND PROPOSED SOLUTION

A. *The Japanese System of Regulation Has Not Performed as Well as Those Who Proposed the Reforms Thought As It Resulted in a Lack of Auditor Independence*

The “Big Bang” reforms have not had a positive impact on the Japanese economy. The Nikkei 225 Stock Index, also known as the Nikkei

64. Gordon, *supra* note 53, at 36. “The BADC pointed out the need for reform of Japan’s financial reporting system in order to enable investors to make better informed decisions based on more accurate representation of a company’s financial condition and operating results.” *Id.*

65. *Id.* Explicit objectives of the system were “promoting the participation of foreign and domestic investors in Japan’s securities markets and [establishing] a disclosure system on par with international standards and based on consolidated financial statements.” *Id.* In fact, many organizations in addition to the government indicated an interest in keeping Japan in line with other international accounting organizations. The JICPA is a founding member of the International Federation of Accountants (“IFAC”), the International Accounting Standards Committee (“IASC”), and the Confederation of Asian and Pacific Accountants (“CAPA”). The JICPA also retains a leadership role in many of these organizations. Japanese Institute of Certified Public Accountants, *Contribution to International Organizations*, at http://www.jicpa.or.jp/n_eng/e-cpa.html (last visited Apr. 16, 2004).

66. Sheryl WuDunn, *Japan Announces New Plan to Deregulate Financial Markets*, N.Y. TIMES, Nov. 12, 1996, at D9.

67. *Id.* “[T]he government intended to ease nearly all major regulations” including “the tax, accounting and legal systems.” *Id.* “The plain conclusion is that Japan’s rigid regulation of its domestic financial markets made it uncompetitive with the world’s other major financial centers and created financial institutions that depend more on official protection than the ability to succeed amidst free competition.” Jessica J. Wiley, *Will the “Bang” Mean “Big” Changes to Japanese Financial Laws*, 22 HAMLINE INT’L & COMP. L. REV. 379, 386 (1999).

68. *Id.*

69. Ernest T. Patrikis, *Japan’s Big Bang Financial Reforms*, 24 BROOKLYN J. INT’L L. 577, 577 (1998). “Once the Big Bang reforms are fully implemented, Japan’s cloistered financial system may come to resemble the open, competitive system [in] the United States.” *Id.*

70. *Id.* at 584.

Dow, was at 22,041 in April of 1996 before the reforms were announced; by August of 2002, the index was down to 9,619.30.⁷¹ This economic downturn may have been caused by the exceptions the MOF made to its new reform rules, demonstrating its reluctance to change.⁷² The downturn could also have been due to differences between Japanese accounting standards and international standards.⁷³ However, it is more likely that the downturn was caused by the government's continued control of the accounting industry in Japan.⁷⁴ In summary, "[t]he current process of having MOF dictate the issues on the agenda to the BADC does not allow for an independent, comprehensive, and proactive examination of accounting issues that will remain after implementation of the changes announced since."⁷⁵

B. The Sarbanes-Oxley Act Did Little to Change the Disastrous Situation in the United States Because the Regulations Failed to Address the Correct Issues

The Sarbanes-Oxley Act reflects many of the same weaknesses found in Japan's Big Bang Reforms, although its effect is not yet as evident.⁷⁶

71. Japan Nikkei 225 Stock Index Monthly Values, at <http://www.forecasts.org/data/data/nik225M.htm> (last visited Apr. 16, 2004).

72. Gordon, *supra* note 53, at 47 (pointing out, "[t]he government continues to manipulate financial reporting rules for political purposes."). Gordon, *supra* note 53.

73. *Id.* at 48–50. Gordon pointed out several key differences. These were:

- (1) the fact that the Japanese accounting standards lacked a recognition element for a capital loss on a long-term asset;
- (2) the relevance of the inventory valuation method. While international systems use a valuation method of lower-of-cost-or-market, the Japanese accounting standards allow a company to value inventory by whatever method it chooses; and
- (3) the lack of a standard to recognize a change in a company's internal accounting methods.

Id.

74. *Id.* at 50. There is still doubt whether "CPAs will perform objective, thorough audits and will challenge company management on questionable accounting treatments." *Id.*

75. *Id.* at 52.

76. Although the implementation of the Act has not had direct effects on the accounting industry yet, the federal government is already in chaos. First, Harvey Pitt, the chairman of the SEC, resigned on November 5, 2002 after the SEC failed to effectively carry out the important task of appointing members to the oversight board created by the Sarbanes-Oxley Act. David S. Hilzenrath & Mike Allen, *Besieged Pitt Quits as SEC Chairman*, WASH. POST, Nov. 6, 2002, at A01. Following Pitt's resignation, the SEC's head accountant, Robert K. Herdman, resigned as well for his role in the appointment of William Webster as Head of the Public Company Accounting Oversight Board. Kathleen Day, *SEC's Head Accountant Resigns, Role in Audit-Board Choice Spurred Herdman's Move*, WASH. POST, Nov. 9, 2002, at E01. Then, on November 12, 2002, William Webster resigned as head of the oversight board. Stephen Labaton, *Webster Resigns as Head of Board to Oversee Audits*, N.Y. TIMES, Nov. 13, 2002, at A1; *see also Webster Resignation; SEC Gets a Chance to Recover From Chaos*, DALLAS MORNING NEWS, Nov. 14, 2002, at 26A. Although Webster was a former judge,

There are provisions which can be readily criticized. How is the new oversight board different from the previously existing FASB? How is the new board going to be as effective as legislators hope? Can government regulation fix the problems created by ineffective accounting standards?

First, according to the language of the act, the five members of the oversight board shall “be appointed from among prominent individuals of integrity and reputation.”⁷⁷ This is a very weak and subjective standard that places the decision in the hands of those who may not be able to provide unbiased, independent judgment. Until recently, legislators certainly would have trusted corporate executives of highly successful companies, such as Andrew Fastow⁷⁸ and Jeffrey Skilling.⁷⁹

Second, the provisions of Title I limit the number of members of the oversight board who can be CPAs.⁸⁰ Would the legislators rather have as board members corporate executives who merely have a finance background? Should the members of the board not be those who understand the principles of accounting? CPAs understand the principles of accounting and can analyze the policy behind these standards better than others. Why limit the number of CPAs on the board?

Third, how are the functions of the board different from the functions of the former FASB? The accounting oversight board has the responsibility of developing audit, quality control, and ethics standards.⁸¹

director of the FBI, and director of the CIA, he also had been the head of the audit committee at U.S. Technologies, a company that had been accused of fraud. *Id.*

77. Sarbanes-Oxley Act, § 101(e)(1), 15 U.S.C.A. § 7211(e)(1). The requirements state that the members should be individuals:

who have a demonstrated commitment to the interest of investors and the public, and an understanding of the responsibilities for and nature of the financial disclosures required of issuers under the securities laws and the obligations of accountants with respect to the preparation and issuance of audit reports with respect to such disclosure.

Id.

78. *See* Fastow, *supra* note 20 (reporting how Andrew Fastow, former Enron CFO, is suspected to be the “mastermind” behind the Enron mess).

79. *See* Beltran, *supra* note 20 (citing the fact that Skilling would admit no fault of his own in relation to the Enron debacle, but instead pointed fingers at others).

80. Sarbanes-Oxley Act, § 101(e)(2), 15 U.S.C.A. § 7211(e)(2). The statute provides:

Two members, and only 2 members, of the Board shall be or have been certified public accountants pursuant to the laws of 1 or more States, provided that, if 1 of those 2 members is the chairperson, he or she may not have been a practicing certified public accountant for at least 5 years prior to his or her appointment to the Board.

Id.

81. The Act provides:

The Board shall, by rule, establish, including, to the extent it determines appropriate, through adoption of standards proposed by 1 or more professional groups of accountants, amend or otherwise modify or alter, such auditing and related attestation standards, such quality control standards, and such ethics standards to be used by registered public accounting firms in the

As previously noted, the FASB was responsible for the creation, implementation, and enforcement of these same standards,⁸² leading to the conclusion that this is just a further regulation of the rule-making and enforcement body.

Title II's provisions create further problems. In order to address auditor independence, the provisions prohibit accounting firms from offering any services other than auditing and tax accounting.⁸³ The firms are not allowed to provide consulting, legal, or other services that the oversight board deems inappropriate.⁸⁴ This prohibition, in effect, prohibits MDPs.⁸⁵ Why would the government want to forbid these practices when, in fact, a major cause of the Enron debacle was that the right hand did not know what the left hand was doing?⁸⁶

C. Both the American and Japanese Reforms Fail to Address Necessary Issues; Both Systems Get Lost in a Mess of Regulation and Deregulation

In comparing the two countries' reforms, it is easy to identify the many similarities between the Japanese Big Bang reforms and the American reforms of the Sarbanes-Oxley Act. Both utilize a board to oversee the creation, implementation, and enforcement of accounting standards. The Japanese BAC and the American Public Company Accounting Oversight Board are controlled by their respective federal government. The BAC is controlled by the MOF and the Oversight Board is an indirect extension of the SEC.⁸⁷ However, the fact that the accounting industries are controlled

preparation and issuance of audit reports . . .

Sarbanes-Oxley Act, § 103(a)(1), 15 U.S.C.A. § 7213(a)(2)(A)(i).

82. See *supra* note 23.

83. Sarbanes-Oxley Act, § 201(g), 15 U.S.C.A. § 78j (listing activities that accounting firms are prohibited from performing).

84. *Id.*

85. Rodriguez, *supra* note 21. Rodriguez notes:

[r]ecently, the SEC has aggressively encroached on traditional accounting enforcement and self-regulatory schemes in slowing the growth of the multi-disciplinary practice (MDP) and significantly strengthening auditor independence rules. This flawed oversight of the financial reporting and regulatory model in the United States has helped usher in a period of standards overload and increased investor confusion over the comparability and credibility of financial statements[.]

Id.

86. Naftali Bendavid, *Enron's Law Firm Begins to Draw Fire*, CHI. TRIB., Mar. 14, 2002, at 17 (noting that Vinson & Elkins, Enron's law firm, seemed to not know that Arthur Andersen accountants were structuring these illegal accounting transactions).

87. The Oversight Board is an indirect extension of the SEC. The Public Company Accounting Oversight Board is not explicitly a governmental organization according to the words of the Sarbanes-

by governmental entities merely exacerbates the central problem—that federal governments turn to regulation as a solution.

Essentially, both the Japanese and American reforms are a confusing web of regulation and deregulation. The auditing standards get lost in the system. In a mass of legislation, it becomes difficult to interpret which reforms are applicable at any given time. The regulation, deregulation, re-regulation, and re-deregulation can be analogized to the recently-adopted airport security system in the United States. Many have criticized the regulation of the airport security system because it federalizes the pre-existing services, when it is widely recognized that competition in industry usually results in higher quality.⁸⁸ The solutions of both the United States government and the Japanese government do not solve the problems that their legislation was designed to address.⁸⁹

These governments should refrain from falling into their old traps. Each time a problem has surfaced within the accounting industry, there has been a default response of regulative control from legislatures. In contrast, more innovative and progressive solutions are needed. By consulting with members of the industry and taking time to develop effective solutions, accounting scandals can be avoided in the future.

D. A Proposed Alternative Solution in Response to Accounting Controversies: Encouraging MDPs

Although both the Japanese and American systems have weaknesses, the American system fails to an even greater degree. The Sarbanes-Oxley Act sets a goal of eliminating MDPs,⁹⁰ when in reality these practices are

Oxley Act. The Act states that, “[t]he Board shall not be an agency or establishment of the United States Government” and “[n]o member of person employed by, or agent for, the Board shall be deemed to be an officer or employee of or agent for the Federal Government by reason of such service.” Sarbanes-Oxley Act, § 101(b), 15 U.S.C.A. § 7211(b). However, many provisions in the Act refer to powers conferred under the Securities and Exchange Act of 1934. See Sarbanes-Oxley Act, § 2(a), 15 U.S.C.A. § 7210(a)(b).

88. See, e.g., Daniel John Sobieski, *Best Airport Security Includes Private Companies*, CHI. TRIB., Nov. 13, 2001, at 18.

89. Shishido, *supra* note 55, at 676. “The actual effect of legal reform on the practice depends on the coordination of practical demands, which is the creature of the background economic market and social norms.” *Id.*

90. Sarbanes-Oxley Act, § 201(g), 15 U.S.C.A. § 78j-1(g). These provisions have caused one commentator to note:

After a phase-in period, public companies will be prohibited from using their auditors for designated non-audit services, and other services will require audit committee approval and public disclosure. Non-audit services are broadly and ambiguously defined as any professional services other than in connection with an audit or review of financial statements, and specifically include tax services, bookkeeping, systems design and implementation,

the solution to each country's predicaments.⁹¹ Instead of regulation and deregulation, a self-help measure of integration is the solution. A multidisciplinary practice integrating auditing services, tax services, and legal services would result in the kind of accountability and integrity both sets of reforms were intended to accomplish. "This proposed solution takes into account the interests of the members of the legal and accounting professions and the clients they serve."⁹²

The American Bar Association ("ABA") defines an MDP as:

a partnership, professional corporation, or other association or entity that includes lawyers and nonlawyers and has as one, but not all, of its purposes the delivery of legal services to a client other than the MDP itself or that holds itself out to the public as providing non-legal, as well as legal, services[.]⁹³

MDPs include an arrangement by which a law firm joins with other professional firms to provide services with direct or indirect sharing of profits as part of the arrangement.⁹⁴ Currently in the United States, MDPs

appraisals, actuarial services, management or human resources services, investment banking, or legal or expert services unrelated to the audit.

Brian P. Kane, *The Sarbanes-Oxley Act of 2002: Something for Everyone to Worry About*, 45-OCT ADVOC. (IDAHO) 16, 17 (2002).

91. There are many factors causing the push towards MDPs:

1. Globalization
2. Consumers
3. The Big Five Accounting Firms
4. Banks
5. Other Financial Institutions

Bourland, *infra* note 93, at 531 (listing the factors causing the "MDP Initiative").

92. Jon Coffin, *Multidisciplinary Practices: A Proposed Solution to Effectuate the Inevitable*, 3 *Transactions*, TENN. J. BUS. L. 35, 35 (2002).

93. *See supra* note 90. *See also* Haddon, *infra* note 110, at 395. The Commission went on to say that an MDP "includes an arrangement by which a law firm joins with one or more other professional firms to provide services, and there is a direct or indirect sharing of profits as part of the arrangement." Michael Bourland & W. Marc. McDonald, *Multidisciplinary Practice: Challenges and Opportunities—Alternative Models and Client Service Opportunities*, SG020 ALI-ABA 523, 530 (2001). Although MDPs with accounting services are not permitted, under legal ethics rules, there are some multidisciplinary practices which are permitted:

- A. An organization fully or partly owned by non-lawyers in which lawyers are engaged in the provision of legal services to clients for fees.
- B. Independent law firms working in close cooperation with non-lawyer owned businesses, usually under management services contracts.
- C. The Commission recognized that MDPs could include lawyers working with social workers, medical personnel, psychologists, and other professionals.

Phoebe A. Haddon, *Multidisciplinary Practice: Recent Developments and Effects of the Continuing Debate*, SF58 ALI-ABA 373, 375 (2001).

94. ABA COMMISSION ON MULTIDISCIPLINARY PRACTICES, MDP FINAL REPORT APP. A, at

are not lawful.⁹⁵ Accountants would like to see the practice legalized so that their firms can offer full-scale services.⁹⁶ In contrast, the ABA and most lawyers oppose the legalization of MDPs;⁹⁷ however, the ABA holds this position without reference to the findings of its commission appointed to investigate MDPs.⁹⁸ Although hesitant to implement the practices, even

<http://www.abanet.org/cpr/mdpappendixa.html> (last visited Apr. 16, 2004).

95. Coffin, *supra* note 92, at 36. "The pure form of the MDP is not currently sanctioned in the United States. Specifically, legal rules of professional conduct prohibit the unauthorized practice of law and prevent fee-sharing between licensed attorneys and non-lawyers." *Id.*

96. *Id.* at 38 (noting that a survey of 1,000 AICPA members "demonstrated that accounting firms already provide legal services in the United States and desire to provide additional services if MDPs are allowed.").

97. The ABA holds many concerns about "accounting firms' incursion into the legal market." *Id.* at 37. If the ABA took the time to look at the situation objectively, it would recognize that more legal jobs would be created if accounting firms were allowed to provide legal services. "MDPs can achieve for traditional law firms the results that occurred when accounting firms developed into professional services firms." Kathryn Lolita Yarbrough, *Multidisciplinary Practices: Are They Already Among Us*, 53 ALA. L. REV. 639, 651 (2002).

98. Hadden, *supra* note 93, at 375. "President Phil Anderson appointed a Commission to determine whether changes in the Model Rules to permit lawyers to share fees with non-lawyers were in the public's interest." *Id.* The Commission concluded, after a year of research, that "it was in the public interest to relax the rules." *Id.* at 375. In 1999, when the Commission recommended that "MDPs (including 'fully integrated' MDPs) be permitted, subject to special regulations," the ABA House of Delegates rejected the proposal. *Id.* The Commission, a year later, proposed another solution which "permitted [lawyers] to share fees provided that the lawyers have the control and authority necessary to assure lawyer independence in the rendering of legal services." *Id.* at 376. *See also* Bourland, *supra* note 93, at 529-30; Stuart S. Prince, *The Bar Strikes Back: The ABA's Misguided Quash of the MDP Rebellion*, 50 AM. U.L. REV. 245, 246-47 (2000).

In addition to the different solutions proposed by the Commission, there are many varieties of MDP alternative implementations: (1) the "Loose Alliance Model," which allows for a "lawyer to form a loose alliance with the nonlawyers."; (2) the "Captive Law Firm Model," in which a law firm practices on the premises of an accounting firm, while having no ownership or managerial interest in the new law firm; and (3) the "Highly-Integrated MDP Model," which would involve a law firm operating as a fully-integrated division of an accounting firm. Charles W. Wolfram, *Comparative Multi-Disciplinary Practice of Law: Paths Taken and Not Taken*, 52 CASE W. RES. 961, 966-69 (2002). These models are often referred to, respectively, as the "Contract or Association Model", the "Washington, D.C. Model", and the "Fully Integrated Model". *See* Breakley, *infra* note 104, at 279-83. *See also* Prince at 262-65 (describing five practice models including "(1) the Cooperative Model, (2) the Command and Control Model, (3) the Law-Related Services/Ancillary Business Model, (4) the Contract Model, and (5) the Fully Integrated Model.").

Among the "barriers to the MDPs" are the legal ethics rules, particularly Rules 5.4, 1.6, and 1.0 of the ABA Model Rules of Professional Conduct. *See* Bourland *supra* note 87, at 531. Rule 5.4 prohibits "fee sharing with non-lawyers." *Id.* Rule 1.6 provides for "confidentiality of information." *Id.* Finally, Rule 1.10 is the "imputed disqualification rule." *Id.* The comments following Rule 5.4 provide that:

the provisions of this Rule express traditional limitations on sharing fees. These limitations are to protect the lawyer's professional independence of judgment. Where someone other than the client pays the lawyer's fees or salary, or recommends employment of the lawyer, that arrangement does not modify the lawyer's obligation to the client. [S]uch arrangements should not interfere with the lawyer's professional judgment.

MODEL RULES OF PROF'L CONDUCT R. 5.4 (Discussion Draft 1999). This comment demonstrates that the ABA's real concern is about the lawyer's judgment. However, adding an accountant to the

the legal profession has recognized that MDPs are effective as a tool for businesses.⁹⁹

It is not surprising that many of the lawmakers who formulated the Sarbanes-Oxley Act, which outlaws MDPs, are themselves attorneys. Thus, the question becomes whether attorneys are trying to give the best representation and services to their clients, or whether these professionals are concerned with setting up potential defenses for themselves if accounting scandals give rise to legal issues. Consider the Enron situation, where Vinson & Elkins, the former corporation's law firm, escaped responsibility for any wrongdoing.¹⁰⁰ Meanwhile, Arthur Andersen, the oil giant's accounting firm, faced many charges.¹⁰¹

If the situation were different, and all of the services were integrated, many people would know about the transactions and could confer about their potential illegality in order to avoid wrongdoing.¹⁰² While the provisions of the Act include requirements for lawyers to report any violations of SEC regulations they discover, the Act also outlaws MDPs.¹⁰³ It is evident that the Sarbanes-Oxley Act can never accomplish

decision-making process will not impede the attorney's judgment; rather it will further the client's best interests. In fact, this provision has been widely criticized because it "establishes a flat ban where less drastic means would suffice" and "constitutes a barrier to competition in the delivery of legal services." *Id.*

99. See *supra* note 98. See also Haddon, *infra* note 111, at 396 (recognizing that "the ABA House of Delegates recommended that every state revisit and revise rules governing relationships between lawyers and nonlegal professionals."). See generally Susan B. Schwab, *Bringing Down the Bar: Accountants Challenge Meaning of Unauthorized Practice*, 21 CARDOZO L. REV. 1425 (2000).

100. Mark Curriden, *Enron Casts Pall Over Legal Firm; But Vinson & Elkins Doesn't Appear to Have Done Wrong, Experts Say*, THE DALLAS MORNING NEWS, Jan. 30, 2002, at 1D. "The good news for [Vinson & Elkins] is that there's no evidence so far that it violated any laws or did anything improper, some legal ethicists say." *Id.* In the view of some legal ethicists, Vinson & Elkins was not liable for any violations. "In my view, the criticism of V&E has been unfairly harsh," said Stephen Gillers, a legal ethics expert at New York University, "because there is no evidence the firm violated ethics rules." Bendavid, *supra* note 86, at 17. In addition, the firm defended its own conduct. "Vinson & Elkins spokesman defended the law firm's work yesterday, saying it should not be held responsible for failing to uncover complex accounting problems that Wall Street analysts and others repeatedly missed." Carrie Johnson, *House Panel to Question Enron's Attorneys*, WASH. POST, Mar. 14, 2002, at E01.

101. The SEC filed charges against Andersen partners, alleging they "signed off on fraudulent accounting practices." Phil McCarty, *SEC Alleges Andersen Partner Approved Fraudulent Accounting*, WALL ST. J., Dec. 24, 2002, at C12. In June, a federal jury convicted Arthur Andersen LLP of criminal obstruction of justice in connection with investigation of its Enron Corp audits. Jonathan Weil, *Andersen Win Lifts US Enron Case*, WALL ST. J., June 17, 2002, at A1. Andersen was subjected to a \$500,000 fine and a 5-year probation period following its conviction on obstruction of justice charges. *Andersen Sentenced to 5 Years Probation*, WALL ST. J., Oct. 17, 2002, at C3.

102. MDPs are a way "to improve the perception of the legal profession" and the accounting profession. Yarbrough, *supra* note 97, at 649.

103. Sarbanes-Oxley Act, § 201, 15 U.S.C.A. § 78j-1. Regarding this provision, one commentator has stated:

its intended goals without the integration of the legal and accounting duties within corporations.¹⁰⁴

Having access to the knowledge of each profession will help the firms better serve their clients. Accountants bring accounting expertise to the table and lawyers meld that knowledge with accepted legal theories.¹⁰⁵ This is especially true for tax practitioners.¹⁰⁶ Attorneys need to understand complex accounting theory and accountants need to understand the law as it relates to their field of practice.¹⁰⁷

By January 26, 2003, the SEC must issue final rules setting forth minimum standards of professional conduct for attorneys appearing and practicing before the SEC in the representation of issuers. Included within this rule, must be provisions requiring attorneys to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation to the CEO or Chief Legal Counsel, and absent appropriate response, report the same to the issuer's audit committee. It appears that this reporting requirement will apply to both in-house and outside legal counsel. Attorneys will not be required to report violations to the SEC or any other third party. A related provision seems to strike at the heart of multidisciplinary practice.

Kane, *supra* note 71, at 17.

104. Yarbrough, *supra* note 97, at 648. "[T]he public will be best served by utilizing the combined skills of both professions" in order to "offer clients competent, effective, and cost-effective one stop solutions to global business problems," solutions that are within the limits of the law. *Id.* One author has analyzed the efficiency, expertise, and cost-effectiveness offered by such practices. In terms of efficiency, "[t]here has been an increasing demand for 'one-stop shopping.' This trend can be seen not only in the accounting and consulting fields, but also in the legal services field." Tia Breakley, *Multidisciplinary Practices: Lawyers & Accountants Under One Roof?*, 2000 COLUM. BUS. L. REV. 275, 298 (2000) (quoting Irwin L. Trieger & William J. Lipton, Written Remarks to the ABA Commission on Multidisciplinary Practice (Mar. 11, 1999), available at <http://www.abanet.org/cpr/trieger1.html> (last visited Aug. 15, 2003)). Further, "[t]he Big Five are clearly well-positioned to offer clients a wide array of services from management consulting to tax planning." *Id.* The accounting firms can also offer needed expertise. *Id.* "[A]ccounting firms have already begun to recruit attorneys directly from top law schools and have been successful in luring associates from many of the country's top law firms." *Id.* at 299. In terms of cost-effectiveness, "most significant cost savings to the client would come from the sharing of resources." *Id.* "[The firms] have a client base that already uses those services and a wealth of individuals within their ranks who have the expertise to provide the services. From a human resources standpoint, these firms could implement a virtually seamless expansion of services." *Id.* at 300.

105. Robert A. Prentice, *The Case for Educating Legally-Aware Accountants*, 38 AM. BUS. L.J. 597, 617-18 (2001).

106. *Id.* at 618. Prentice observes:

Tax practice is law, and rather complex and confusing law at that. There can be no doubt that knowledge of important legal concepts, such as rules of statutory construction and the role of precedent in our court system are vital matters for all tax professionals to know. Inaccurate legal research is often the basis for accountant malpractice liability. Indeed, given the intertwining of accountants' tax work and law, accountants also must know enough law to avoid illicitly engaging in its practice.

Id.

107. *Id.* at 616. "A basic understanding of business law is essential to the auditor in his task of categorizing transactions for accounting purposes." *Id.* (quoting Harris J. Amhowitz, *The Accounting Professor and the Law: The Misunderstood Victim*, J. ACCT., May 1987, at 356). "The point is that the CPA must have sufficient knowledge of various areas of law in order to perform the audit. Adequate

MDPs would also reduce costs for the consumer.¹⁰⁸ Researchers have found that MDPs would cause reduced consumption-related and reduced production-related costs for the average consumer.¹⁰⁹ This further exemplifies why integration is the best solution for providing the best service to clients,¹¹⁰ and why many have referred to MDPs as the wave of the future.¹¹¹

understanding is necessary both to recognize the legal problem and to realize that some help is probably needed.” *Id.* at 617.

108. Micheal Trebilcock and Lilla Csorgo, *Multi-Disciplinary Professional Practices: A Consumer Welfare Perspective*, at <http://www.abanet.org/cpr/canada.html> (last visited Apr. 16, 2004).

109. The consumption-related cost-savings stem from the fact that the firm is “able to offer a number of services and specialists in one location.” *Id.* at 6. The different types of consumption-related costs are search costs, contracting costs, and coordination costs. *Id.* at 7–8. “[A] consumer may wish to reduce search costs by engaging an MDP that is able to provide all these services in many or all geographic locations. The MDP could offer such a consumer the additional benefit of a signal of quality.” *Id.* at 8.

If a consumer chooses to complete the merger process using the services of a variety of professional firms, she will have to contract with each one If an MDP were to be available, the consumer may choose not to incur costs of contracting with a large number of firms and only choose to contract with one.

Id. There are also coordination costs to consider.

Once having entered into . . . contracts with separate firms to perform various parts of the merger process, the consumer must coordinate these tasks If an MDP were available to a consumer, the consumer would be able to weigh the benefits of these reduced transaction costs against the cost she may incur from conducting the transaction through an MDP.

Id. at 9. Reduced production-related costs are the product of “moving a function in-house . . . rather than purchasing it . . . on the open market or leaving it to his customer to purchase elsewhere[.]” *Id.*

The benefits associated with “the technology of production” are classified as economies of scale and economies of scope. *Id.* “Economies of scope arise when the total cost of producing a group of products or services is less when these products are produced by a single firm than when the same volume of those products or services are produced by a set of independent firms.” *Id.* at 10. “Economies of scale arise when the average cost of producing a good decreases with increased production of the good.” *Id.*

110. Some have defined the ways in which MDPs will be in the client’s interest: (1) the client’s needs do not need to be “narrowly defined as legal”; (2) the client benefits from a “collaboration in problem solving”; (3) there are “savings in resources (one-stop shopping)”; (4) serving clients who are “[dissatisfied] with traditional model of lawyering”; (5) serving the “special needs of some clients with health issues” who “may be better served by [a] team approach”; and (6) greater “client autonomy/choice.” Phoebe Haddon, *Some Ethical Considerations of Emerging Forms of Practice: Multidisciplinary Practice and Multijurisdictional Practice*, SG095 ALI-ABA 393, 398 (2002). The article went on to define several ways in which attorneys will benefit, including: (1) Creation of “new opportunities to form creative relationships with other professionals such as doctors, nurses, psychologists, and social workers”; (2) “Recognition that client problems are not strictly legal”; (3) Creation of a means to address “client intimidation”; (4) Revision of the “definition of the practice of law (e.g. non-adversarial approaches to controversies)”; and (5) Elimination of the “barriers on fee-sharing and practice with other professionals at odds with recognized practice models.” *Id.* The article also discussed benefits to other service professionals and law students. *Id.*

111. Diane L. Karpman, *Multidisciplinary Practice: ‘Rampant’ Conflicts in a New Economy*, 669 PLI/LIT 345, 347 (2000). These “partnerships, strategic alliances, and entrepreneurial unions between lawyers and other professionals, giv[e] clients ‘one-stop shopping.’” *Id.*

MDPs are essentially already in place in the United States, with many lawyers working at public accounting firms.¹¹² The large accounting firms seem to be more progressive than Congress or the legal industry in this respect. The Big Five firms consider tax accounting to be a reasonable measure for financial statements. In integrating these services, there is less of a likelihood that questionable accounting practices could be utilized in financial reporting. The measure of profits for tax accounting purposes creates a reasonable benchmark for comparison to the financial accounting.

Not only are the Big Five ahead of U.S. lawmakers, but other countries seem to be as well. MDPs have been springing up throughout the world.¹¹³ In Europe, Canada, and Australia, lawyers are not prohibited from working alongside CPAs.¹¹⁴ In fact, in other countries, “the Big Five are dominating the legal market.”¹¹⁵ “The effect is that the international accounting firms are providing legal services, including litigation, in ways that are fundamentally indistinct from law firms.”¹¹⁶

112. Coffin, *supra* note 92, at 40 (observing that CPA firms are the largest employers of attorneys in the United States). *See also* Tanina Rostain, *Pockets of Professionalism*, 54 STAN. L. REV. 1475, 1482 (2002) (reporting that many tax partners have left law firms to practice with Big Five firms); Yarbrough, *supra* note 97, at 659 (observing that many lawyers work in accounting firms to provide tax services). Also, BDO Seidman, another large firm that provides accounting as well as other professional services, heads a network of law firms and other professional firms around the globe. *See* Univer, *supra* note 93, at 465. BDO lists the “benefits to their member firms” as:

- (1) Resource Sharing; (2) Access to Member Expertise; (3) Access to BDO Resources; (4) Access to BDO Affiliations; (5) Increased Profitability; (6) Structure and Organization; and (7) Conflict Avoidance through Independence.

Id. at 465–66. These member benefits assist in areas of tax, auditing, and consulting. *Id.*

113. *See* Prince, *supra* note 98, at 266 (noting that a different MDPs model has developed in Canada and that Swiss rules allow for fully integrated MDPs).

114. Micheal W. Loudenslager, *Cover Me: The Effects of Attorney-Accountant Multidisciplinary Practice on the Protection of the Attorney-Client Privilege*, 53 BAYLOR L. REV. 33, 39 (2001).

The nineties saw the Big Five grow into some of the largest providers of legal services in several European countries . . . [T]he legal work of the Big Five in Europe now includes not only tax work but also work on commercial agreements, mergers and acquisitions, business restructurings, corporate law, intellectual property law, and finance issues.

Id. “PricewaterhouseCoopers employs 1,600 attorneys in 42 countries around the world and Arthur Andersen acquired a law firm in Australia.” Coffin, *supra* note 92, at 40.

115. Yarbrough, *supra* note 97, at 659. Yarbrough notes:

Currently, only Switzerland allows a fully integrated MDP, but Germany, the Netherlands, New South Wales, Australia, and . . . Canada expressly allow forms of MDPs. Similarly, some countries such as France permit a variation of MDPs by allowing captive law firm arrangements. For example, PricewaterhouseCoopers in Paris has entered one of these arrangements—the firms are separate but they share clients, office space, supplies, telephones, and computers . . . Moreover, other countries are considering permitting MDPs on some level.

Id.

116. *Id.*

In fact, this approach would work in Japan as well. Japan, like the United States, suffered an economic downturn that was caused by questionable accounting practices, which lawmakers attempted to fix through a confusing web of regulation and deregulation. MDPs would have been a more productive solution.

Of course, “some countries have voiced opinions against the establishment of MDPs,”¹¹⁷ and there are criticisms related to the implementation of MDPs in the United States as well. Many note that the “inconsistent role of auditor and advocate” will lead to breaches of confidentiality and a decrease in competence.¹¹⁸ But, the accounting industry is sensitive to the client’s need for confidentiality. In the standards governing CPAs, there are provisions requiring accountants to consult their clients when the disclosure of information is needed.¹¹⁹ In addition, the mere fact that an attorney works in an accounting firm does not relieve the attorney from the burden of the rules of legal ethics.¹²⁰ Involving more professions and individuals in the audit practice reduces the possibility of illegal accounting practices. This is not to say that some regulation of MDPs would not be needed,¹²¹ but that, ultimately, the solution will work.

117. Coffin, *supra* note 92, at 39 (reporting that Dutch leaders argued that MDPs would violate anti-trust laws).

118. See Coffin, *supra* note 92, at 39–40 (observing that possible disadvantages of MDPs include “increased conflicts of interest and loss of confidentiality”); Yarbrough, *supra* note 97, at 653–55.

119. *Id.* at 657. “[A] CPA must obtain client consent before disclosing information or he or she will be subject to discipline by the AICPA and a potential damages award.” *Id.*

120. *Id.* at 658. “[A]n attorney working in an MDP would still be required to keep client information confidential and would still be protected by the attorney client privilege.” *Id.*

121. Prince *supra* note 98, at 275. The regulatory solution would be to put all lawyers, no matter where they practice, on the same playing field. “Lawyers in non-lawyer controlled MDPs should be treated the same as lawyers practicing in lawyer-controlled MDPs.” *Id.* “The Commission erred when it created different regulatory schemes for non-lawyer controlled and lawyer-controlled MDPs. The Commission should not impose a burden on attorneys practicing in an MDP setting when it fails to impose the same burden on lawyers in all other settings.” *Id.* at 276.

New York State has already adopted legal ethics rules that deal with MDPs. Manuel del Valle, *New York Adopts Multi-Disciplinary Practice Rules*, 314 PLI/EST 641, 665 (2002). “The new rules . . . allow for limited, strictly business alliances between attorneys and non-attorneys and are constructed around two basic precepts: preservation of core values of the legal profession and the best interests of the client.” *Id.* The rule

makes clear that non-lawyers cannot direct or regulate the professional judgment of lawyers in rendering legal services or take any action that would compromise an attorney’s ability to protect client confidences. It explains the circumstances under which the Code of Professional Responsibility applies to a lawyer or law firms providing nonlegal services.

Id. at 666. New York attorneys have taken the bold step that all attorneys need to take in recognizing their clients’ needs, recognizing that “strategic ventures are here to stay[.]” *Id.* With these progressive steps and favorable laws, it is possible that New York will be the breeding ground for MDPs in the 21st century just as Delaware has been the preferred state of incorporation for the past century. See

IV. CONCLUSION

Japan and the United States are in similar predicaments. MDPs are the global answer to controversies created by questionable accounting practices. Legislators must stop falling into the same traps of rotating between eras of regulation and deregulation and find a way to effectuate positive change. Multidisciplinary practices represent the type of alternative solution to which lawmakers should be looking.

MDPs offer the benefits of integration, which include greater accountability, more comprehensive services for customers, and a new job market for both lawyers and accountants. Although some may criticize these practices, the arguments upon which they typically rely are flawed. First, both the legal and accounting profession have ethics rules that address confidentiality issues. Accountants have a duty to obtain client consent similar to the attorney-client privilege of legal ethics before any information can be disclosed. Second, an attorney's competency could only increase as a result of involvement in MDPs. Involving both professions in transactions will help the professionals to better understand the transactions they are administering. Each profession possesses knowledge that is beneficial to the other.

This proposed solution does not include integration for all business practices. Conflicts of interest still exist when an accounting firm offers consulting advice to an audit client. Therefore, the accounting firms have taken the proactive step of withdrawing from the consulting market or separating any consulting practice from their accounting practices.

MDPs are the wave of the future and the United States and Japan should rush to implement them. MDPs are new and progressive practices, and it is only with forward-thinking that the law can improve. The legislatures of both the United States and Japan need to abandon the default regulatory practices that have proven ineffective in the past and devise new strategies to create positive economic effects. This change is necessary not only for both countries' domestic economies but for the global economy as well.

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Haddon *supra* note 110, at 397 (summarizing the decision of the New York State Bar Association to allow a "limited form of lawyer-controlled MDPs").

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