The PCAOB Meets the Constitution: The Supreme Court to Decide on the PCAOB’s Conformity with the Separation of Powers Doctrine and Appointments Clause

Ronald R. King

SYNOPSIS: This commentary provides an overview of the case currently before the U.S. Supreme Court that alleges constitutional problems with the Public Company Accounting Oversight Board (PCAOB). The PCAOB, a Board designed to oversee auditing for publicly traded firms, was created by Congress when it passed the Sarbanes-Oxley Act of 2002 (hereafter, SOX). To enhance PCAOB’s independence from political pressures, Congress established it as a private-sector, non-profit organization, and gave oversight powers to the Securities and Exchange Commission (hereafter, SEC), an independent agency. The plaintiffs in this case allege that Congress empowered the PCAOB with broad executive powers, yet limited the President’s ability to appoint Board members (thus violating the appointments clause of the Constitution) and to control and/or remove Board members (thus violating the separation of powers doctrine of the Constitution). The Supreme Court’s decision about the constitutionality of the PCAOB is important because of its potential impact on (1) the future of auditing oversight; (2) the validity of SOX; and (3) the future of independent agencies in general. From a policy point of view, the case highlights the importance of the combination of independence and accountability for auditing and accounting standard setting and practice.
INTRODUCTION

Politics have long been recognized as having the potential to play a dysfunctional role when intersecting with standard setting in accounting and auditing. Recognizing this, Congress worked to establish a system with minimal political influence when crafting the PCAOB. After considering various approaches, Congress made the PCAOB a private-sector non-profit organization, with oversight by the SEC (Nagy 2005; Nagy 2009; Pildes 2009). In addition to being insulated from political pressures, the Board was to have far-reaching powers as summarized in the statement by Senator Gramm below:

Anybody who thinks this board is just going to slap around a few accountants does not understand this bill. This board is going to have massive power, unchecked power, by design … I mean, that is the nature of what we are trying to do here … We are setting up a board with massive power that is going to make decisions that affect all accountants and everybody they work for, which directly or indirectly is every breathing person in the country. They are going to have massive unchecked powers.

Congress, however, in its attempt to augment political independence, may have violated the Constitution, as alleged in the Free Enterprise Fund and Beckstead & Watts, LLP, v. Public Company Accounting Oversight Board et al. case (FEF/BW 2009). The plaintiffs contend that the PCAOB violates three constitutional tenets: the appointments clause, the separation of powers doctrine, and the nondelegation doctrine. The appointments clause was established by the framers of the Constitution to enhance Presidential accountability. It does this by establishing the protocol for appointing principal officers and inferior officers, both groups being officers of the United States. The Constitution requires that principal officers be appointed by the President, with the advice and consent of the Senate. Inferior officers, on the other hand, can be appointed by the President alone, heads of departments, or courts of law (Nagy 2009).

The FEF/BW plaintiffs contend that SOX violates the appointments clause because the PCAOB members are principal officers and therefore must be appointed by the President with advice and consent of the Senate. Because Congress gave appointment powers to SEC commissioners, the process is constitutionally impermissible. The plaintiffs argue further that even if PCAOB members are considered inferior officers, the SEC is not a department, and therefore does not merit appointment powers. Further, the plaintiffs argue that even if the SEC is ruled a department, the five commissioners collectively are not a department head, again making the process for appointing PCAOB members unconstitutional.

In ruling on this issue, the District Court and a three-judge panel of the U.S. Court of Appeals for the District of Columbia Circuit (hereafter, the D.C. Circuit), in a two-to-one decision, dis-

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1 The literature is too expansive to summarize here, but discussions of the potential for the distorting effects of politicizing accounting/auditing standard setting include Beresford (1993), Dopuch and Birnberg (1963), Dye and Sunder (2001), Leuz et al. (2005), Walker (2007), Watts and Zimmerman (1986), and Zeff (2009). Specific examples include accounting for stock options (Farber et al. 2007), inventory valuation (Pincus 1989), oil and gas accounting (Deakin 1989), GAAP versus tax differences (Murray 2002; Scholes et al. 2009), fair value accounting (Pulliam and McGinty 2009), IASB (Zeff 2002), and investment tax credits (Sunder and Haribhatti 1984).
2 The Supreme Court granted writ of certiorari to the plaintiffs in the Free Enterprise Fund and Beckstead & Watts, LLP, Petitioners v. Public Company Accounting Oversight Board et al. on May 19, 2009, and the case will be argued and a decision rendered during the 2009–2010 term.
3 Commentators have found it challenging to categorize the PCAOB. For example, Strauss (2009, 52) writes “While all the parties agree that the PCAOB is to be considered a ‘government entity,’ it is … an odd duck.” In general, most agree that the PCAOB is a federal entity for constitutional purposes (Nagy 2009).
5 The non-delegation argument is that the PCAOB is unconstitutional because it has legislative power that should be reserved for Congress. The plaintiffs did not raise this issue on appeal, the D.C. District Court did not address it, and, thus, I will not discuss it further here.

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agreed with the plaintiffs. Both courts ruled that the PCAOB does not violate the Constitution. Specifically the Court found that PCAOB members are inferior officers who need not be appointed by the President. In addition, the Court ruled that the SEC is considered a department for purposes of the Constitution, and that its commissioners constitute a department head.

The second issue is the separation of powers doctrine, also referred to as removal-powers (Helisek 2009). This doctrine is designed to facilitate the system of checks-and-balances at the federal level. The plaintiffs contend that SOX violates the separation of powers doctrine because SOX allows the Legislative Branch to encroach on the powers of the Executive Branch by giving the PCAOB broad executive powers, yet constraining the President’s influence over the Board by restricting his/her power to remove PCAOB members. Specifically, SOX requires that PCAOB members may be removed only by the SEC commissioners, and then only for-cause reasons, rather than at-will. Thus, the President can only bring about a change in the PCAOB members indirectly by inducing SEC commissioners to take action. However, this is a muted power because the President can only remove SEC commissioners based on for-cause justifications. Thus, SOX creates a double-for-cause removal architecture for the PCAOB members. That is, the President has for-cause removal powers over the SEC commissioners and in turn the SEC commissioners have for-cause removal power over PCAOB members. This double-for-cause architecture (which does not have precedent in other agencies) is argued by the plaintiffs to limit the President’s influence over the PCAOB because of the limited power to remove members.

On the separation of powers matter, the District Court and the three-judge panel of the D.C. Circuit ruled that there is no constitutional violation because, although the President does face this double-for-cause limitation, the SEC has broad oversight and enforcement authority over the PCAOB (including the power to modify the PCAOB’s rules, block its sanctions, and limit its activities, functions, and operations), which provides a constitutionally acceptable measure of oversight. Thus, the architecture of double-for-cause removal of PCAOB members does not impermissibly restrict the President’s power.

The FEF/BW plaintiffs appealed these rulings, and the Supreme Court agreed to review the case during its 2009–2010 term. As Judge Kavanaugh’s quote below indicates, the FEF/BW case is considered to address important constitutional issues:

Judge Kavanaugh in his dissenting opinion in the FEF/BW case. Judge Kavanaugh argued that the Constitution was violated based on both the appointments clause and the separation of powers doctrine.

6 This latest chapter involving the Public Company Accounting Oversight Board is the most important separation-of-powers case regarding the President’s appointment and removal powers to reach the courts in the last 20 years.

The motivation for this commentary is to provide a synopsis of the FEF/BW case so accounting academics can more fully appreciate the debate and the issues behind it. This case is an important chapter in the intersection of accounting, politics, and law. Congress’s attempt to provide for independence of the PCAOB may turn out to violate the accountability of the Executive Branch of the federal government that is required by the Constitution. The Supreme Court’s decision, which is expected in the Spring of 2010, has the potential to affect not only the PCAOB, but more broadly, SOX, and the oversight architecture of all federal government agencies. Either way, this case raises questions about independence and accountability for the future of auditing oversight.

The four sections of this commentary include (1) a brief summary of the PCAOB and the oversight mechanisms of the SEC; (2) an overview of the players and the timeline of the FEF/BW case; (3) an outline of the constitutional issues involved in the case, including a high-level overview of the appointments clause and the separation of powers doctrine; and (4) a summary section...
with a discussion about the potential implications of the Supreme Court’s possible rulings and suggestions for future research possibilities.

THE PCAOB AND OVERSIGHT MECHANISMS OF THE SEC

Congress passed SOX on July 25, 2002, with the Senate voting 99 to 0 and the House voting 423 to 3 for its passage. President Bush signed it into law on July 30, 2002. SOX was passed in the midst of high-profile accounting and corporate scandals and was characterized by William Donaldson, the Chairman of the SEC (Donaldson 2003), as having its central purpose “to restore confidence in the accounting profession.” Title I of SOX established the PCAOB as a five-person Board, with members appointed by the SEC commissioners with consultation from both the Secretary of the Treasury and the Chairman of the Board of Governors of the Federal Reserve. SOX vests the Board with the responsibilities “to oversee the audit of public companies that are subject to the securities laws … in order to protect the interests of investors …” (Section 101(a) of U.S. House of Representatives 2002).

PCAOB Members and Duties

I begin by providing an overview of the individuals who served or are serving on the PCAOB. SOX (Section 101(e)(1)) provides that Board members be:

appointed from among prominent individuals of integrity and reputation who have a demonstrated commitment to the interests 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 disclosures.

This description gives SEC commissioners great flexibility in terms of Board members’ expertise, but SOX does limit the PCAOB to no more than two CPAs. PCAOB membership for the period of January 2003 to October 2009 is shown in Exhibit 1. William McDonough, the first chair, served from June 2003 through November 2005. Prior to his service on the PCAOB, he was President of the Federal Reserve Bank of New York. Mark Olson, the second chair, served from July 2006 to July 2009. Prior to his appointment to the Board, Olson was a member of the Board of Governors of the Federal Reserve Board and prior to that was a partner for Ernst & Young (working as national director of the firms’ regulatory consulting practice for the financial service industries). As of September 2009, the chair position was open.

Charles Niemeier was an inaugural Board member appointed in 2002. His term expired in 2008, but members are allowed to continue to serve until a replacement is named. Prior to joining the Board he served as Chief Accountant in the SEC’s Division of Enforcement. Daniel Goelzer, also an inaugural Board member, is currently acting chair. He held various positions prior to his appointment, including a position as SEC’s General Counsel and as a partner with Baker & Mckenzie. Bill Gradison is also an inaugural Board member. His term expired in October 2009, and he continues to serve (as of November 2009). His positions, prior to Board appointment, include being a former nine-term Congressman from Ohio, a senior public policy counselor with Patton Boggs, and president of a health care industry group. Kayla Gillan, an inaugural Board

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7 I do not include William Webster, who was appointed as chair during 2002. During Webster’s appointment process, allegations were made that SEC Chair Harvey Pitt withheld information from other SEC commissioners concerning Webster’s involvement with U.S. Technologies (a failing company). Webster resigned shortly after his appointment. In an effort to determine the issues behind this controversy, Congress requested an investigation by the GAO. The GAO report (GAO 2003) found that the SEC omitted some important steps that could have resulted in a more efficient selection process. The report also made various recommendations, including that the “Commission develop agreed-upon selection criteria for PCAOB members and chairman that embrace the intent of the act” (GAO 2003, 5).

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member, served from 2002 to 2008. Prior to her appointment she served as chief legal advisor to California Public Employees’ Retirement System (CalPERS). Steve Harris was appointed in 2008 to fill Gillan’s seat. He had been the Staff Director and Chief Counsel of the U.S. Senate Banking, Housing and Urban Affairs Committee (serving under Chair Paul Sarbanes during the passage of SOX). It is evident that individuals appointed to the PCAOB are high-profile individuals, many with regulatory and/or legislative experience.

The PCAOB’s primary duties are summarized below, followed by an overview of the SEC’s oversight and enforcement authority over the Board.

1. Registration: The PCAOB is required to register public accounting firms that issue, or play a substantial role in issuing, audit reports for issuers. As of December 31, 2008, 1,874 accounting firms were registered with the PCAOB. 1,131 of these firms (60.4 percent) had zero issuer-clients during 2008 and, on the other extreme, 11 firms (0.6 percent) had over 100 issuers. Of the 1,874 audit firms, 983 were domestic firms (52.5 percent) and 891 were non-U.S. firms (47.5 percent). Registered firms came from 88 different countries (PCAOB’s 2008 Annual Report, page 8).

2. Standard Setting: The PCAOB is required to establish rules for auditing, quality control, independence, and other standards related to the preparation and issuance of audit reports by registered firms. Glover et al. (2009) provide an extensive assessment of the PCAOB’s audit standard-setting activities. The authors makes recommendations for the PCAOB to

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8 For purposes here, issuers include companies whose securities are registered in the United States or who have particular financial reporting obligations under U.S. law.
change its approach for both audit standard setting and inspections and suggests that there may be a need for a quasi-governmental body to oversee the PCAOB separate from the SEC (based on reasons not related to the constitutionality of its structure).

(3) Inspections: The PCAOB is required to inspect registered public accounting firms and associated persons in an effort to assess their compliance with the promulgated rules and standards. Annual inspections are required for firms that audit more than 100 issuers. Inspections for registered firms that audit 100 or fewer issuers are required at least once every three years. Those registered accounting firms that do not have issuers are not subject to regular inspection by the Board. In 2008, the PCAOB inspected 255 registered accounting firms, including 12 firms that audited more than 100 public companies. The other firms audit 100 or fewer public companies and include 194 U.S. firms, with the remainder as non-U.S. firms located in 19 countries (PCAOB’s 2008 Annual Report).

(4) Investigation and Discipline: The PCAOB is required to conduct investigations and disciplinary proceedings and, where justified, impose sanctions upon registered public accounting firms and associated persons. Sanctions can differ depending on the severity of the infraction and can include civil money penalties, the revocation of a firm’s PCAOB registration, and the barring of an associated person from auditing any public company.\textsuperscript{9} The Board imposed its first civil money penalty in 2008 against an audit partner of a registered public accounting firm and assessed the first monetary penalty against a firm in 2007. The PCAOB also announced four settled disciplinary proceedings during 2008 (see Appendix 2 of PCAOB’s Annual Report for a list of violations of their rules and standards).

(5) Budgeting: The PCAOB is required to set its budget, subject to SEC approval. SOX legislated that the primary funding for PCAOB activities was to come from an annual fee assessed on public companies in proportion to their market capitalizations. The 2008 calendar-year budget was $144.6 million (see PCAOB’s Annual Report for details on its budget).

The duties listed above indicate that the Board’s activities have a broad scope and deep impact because the standards promulgated by the PCAOB affect an array of accounting firms, and this in turn affects the financial reporting of all publicly traded companies in the U.S. (Glover et al. 2009; PwC 2005; SEC 2005).

\textbf{SEC Oversight of the PCAOB}

Section 107 of SOX describes the SEC’s oversight and enforcement authority that it has over the PCAOB. The following is a summary of the SEC’s powers:

- In most cases, the rules and standards of the PCAOB are not effective until the SEC approves them.
- The SEC has authority to amend or modify rules proposed by the PCAOB.
- The PCAOB must notify the SEC about any sanctions that are imposed on registered firms and associated persons, and the SEC has the authority to review the sanctions and modify or cancel them.
- The SEC can “censure or impose limitations upon the activities, functions, and operations of the Board, if the Commission finds, on the record, after notice and opportunity for a hearing, that the Board” has violated any provisions of the Act or has failed to enforce compliance.

\textsuperscript{9} The Board can impose a civil money penalty for each such violation, in an amount equal to not more than $100,000 for a natural person or $2,000,000 for any other person; and when there is intentional or other knowing conduct, not more than $750,000 for a natural person or $15,000,000 for any other person (Section 105(c)(4)).
• The SEC can “remove from office or censure any member of the Board, if the Commission finds, on the record, after notice and opportunity for a hearing, that such member” has willfully violated any provisions of the Act, abused authority, or failed to enforce compliance. The combination of the PCAOB duties and the SEC’s oversight of the Board summarized above may be considered by the Supreme Court in the process of determining whether Board members are principal or inferior officers. Prior to summarizing the legal issues, I discuss the players and timeline of the case.

PLAYERS AND TIMELINE OF THE FEF/BW CASE

Players

Free Enterprise Fund (hereafter, FEF) and Beckstead & Watts are the two named plaintiffs in the case. FEF is a non-profit, public interest organization that identifies itself as working to promote economic growth, achieve lower taxes, and identify the benefits of limited government. The entity does this through television and radio advertising campaigns, providing policy guidance to members of Congress, and publications on economic and fiscal issues (FEF/BW). FEF does not divulge its membership (beyond confirming membership of Beckstead & Watts) because it argues that some of its positions are unpopular; however, it does contend that it has members subject to the PCAOB’s oversight and that the actions of the PCAOB have caused them harm.

Beckstead & Watts is a niche audit firm providing services to “micro-cap” and “development stage” firms. Beckstead (2006) characterizes the firm’s typical client as having (1) limited assets and operations; (2) market capitalization of less than $10 million; (3) trading on the Over-the-Counter Bulletin Board; and (4) high risk, with the majority of the clients receiving “going concern” audit reports. The firm has one office (of 1,000 square feet) located in Nevada, with one partner and two other professional staff members (PCAOB 2005). According to Beckstead (2006), the firm had gross revenues of $750,000 and serves 61 issuers, which put it in the top 10 firms in the nation based on the size of its client base.

The PCAOB conducted fieldwork on Beckstead & Watts from May 17, 2004 to May 28, 2004. The inspection team reviewed the audits of 16 of Beckstead & Watts’ issuers and found eight of them to have significant deficiencies, including, among others, the failure to perform and document sufficient procedures to analyze the appropriate accounting treatment for acquisitions and revenue recognition and the failure to test liabilities for completeness and accuracy (PCAOB 2005).

Timeline

Exhibit 2 summarizes the timeline of the case. See Pildes (2009) for a full discussion of the timeline. Dates related to the lawsuit include the following: On February 2, 2006 the plaintiffs filed a lawsuit in the U.S District Court for the District of Columbia against the PCAOB. On March 21, 2007 the District Court granted summary judgment in favor of the PCAOB on all claims. On April 15, 2008 the case was argued before a three-judge panel of the D.C. Circuit. On August 22, 2008 the D.C. Circuit upheld (by a vote of 2 to 1) the District Court’s ruling of summary judgment. This ruling was then petitioned for a rehearing before all nine members of the D.C. Circuit Court and was denied on a closely divided 5-to-4 vote. The plaintiffs then appealed to the Supreme Court, and the Court granted writ of certiorari to the plaintiffs on May 19, 2009. The case will be argued and the Supreme Court will render a decision during the 2009–2010 term.

10 The lawyers for the plaintiffs include Kenneth W. Starr, a former judge and the person who directed the investigation of President Bill Clinton’s relationship with Monica Lewinsky, and Michael A. Carvin, who represented candidate George W. Bush in litigation related to the 2000 election in Florida.
APPOINTMENTS CLAUSE AND SEPARATION OF POWERS\textsuperscript{11}

The \textit{FEF/BW} plaintiffs contend that Title I of SOX violates the appointments clause, the separation of powers doctrine, and the nondelegation doctrine.\textsuperscript{12}

**Appointments Clause**

The role of the appointments clause is to establish the President’s primacy in appointments with the goal of enhancing Presidential accountability.\textsuperscript{13} Article 2, Section 2, paragraph 2 of the United States Constitution provides that:

\begin{quote}
[The President] shall appoint … all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law; but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.
\end{quote}

\textsuperscript{11} For more detail on these legal issues, see the court documents at \url{http://www.law.du.edu/index.php/corporate-governance/fef-v-pcaob} and see Carvin et al. (2007), Helisek (2009), Nagy (2005), and Pildes (2009) for analysis by legal commentators.

\textsuperscript{12} The plaintiffs filed a \textit{facial challenge}, which is one contending a law should be invalidated across the board, as opposed to being invalidated only with respect to certain situations (“as applied”). Under this facial challenge the plaintiffs did not exhaust their arguments before the SEC or PCAOB, but rather argued that the very structure of the PCAOB was unconstitutional, and thus the case must be heard by courts to prevent violation of constitutional rights. See Metzger (2009) for a general discussion of facial challenges.

\textsuperscript{13} \textit{Freytag v. CIR}, 501 U.S. 868, 884–885 (1991) provides a summary of this clause by writing, “The Framers understood … that by limiting the appointment power, they could ensure that those who wielded it were accountable to political force and the will of the people … The Appointments Clause prevents Congress from distributing power too widely by limiting the actors in whom Congress may vest the power to appoint.” This is as quoted at: \url{http://www.law.cornell.edu/anmc/html/art2frag25_user.html#fnb470}.
This language, known as the appointments clause, expressly sets out the process for appointing officers of the United States to their positions. An officer of the U.S. is any appointee who exercises significant authority pursuant to the laws of the U.S. This clause requires that principal officers be appointed by the President with full advice and consent of the Senate. Inferior officers can be appointed by the President alone, by courts of law, or heads of departments. As noted above, PCAOB members are appointed by the SEC commissioners with consultation from both the Secretary of the Treasury and the Chairman of the Board of Governors of the Federal Reserve.

Exhibit 3 shows the three questions the Supreme Court will need to address in the process of deliberating whether the PCAOB appointments process conforms to the appointments clause. The first question is, “Are PCAOB members principal or inferior officers?” The criteria used to answer this question are vague, with commentators writing that “The constitutional definition of an ‘inferior’ officer is wondrously imprecise.” However, based on previous Supreme Court decisions related to this issue, the following are factors, although not definitive, in determining whether an officer is a principal or inferior officer:

- importance of the responsibilities assigned an officer;
- the fact that the duties are limited;
- jurisdiction is limited;
- tenure is limited; and
- work is directed and supervised at some level by others who were appointed by the President with advice and consent of the Senate.

The last item (work is directed) is considered particularly important in the determination of an

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14 The term principal officer does not appear in the language of the appointments clause, but is the term used to refer to officers of the United States who are not inferior officers.

15 The process for appointing inferior officers was included by the framers of the Constitution in anticipation of the future creation of a large number of offices that could be controlled by other members of the Executive Branch.

16 In Edmond v. United States, the most recent case to address the issue, the Court stated that “we think it evident that ‘inferior officers’ are officers whose work is directed and supervised at some level by others who were appointed by Presidential nomination with the advice and consent of the Senate.” 520 U.S. 651, 662 (1997).
inferior officer (http://www.law.cornell.edu/anncon/html/art2frag25_user.html). Thus one central question the Supreme Court will address is whether the SEC directs and supervises PCAOB members.

The FEF/BW plaintiffs allege that PCAOB duties are consistent with those performed by principal officers because of the far-reaching effects brought about by (1) their powers of registration, inspection, and sanctions and (2) the fact that their work is not meaningfully directed and supervised by SEC commissioners. The plaintiffs argue that, although SOX gives the SEC oversight and enforcement authority, these have limited effect and are restricted to after-the-fact oversight. As an example of this limited effect, the plaintiffs point to Section 107, which states “The commission shall approve a proposed rule, if it finds that the rule is consistent with the requirements of this Act and the securities laws, or is necessary or appropriate in the public interest or for the protection of investors.” The plaintiffs argue that the SEC’s oversight is limited because this clause gives the Board great latitude, and the SEC’s actions are not supervision, but with a role of required approval.17

Parties who agree with the plaintiffs also argue that Board members are principal officers because of their level of pay (Carvin et al. 2007). Exhibit 4 shows a compensation chart provided by SEC Commissioner Atkins during a review of the PCAOB’s 2008 budget. As indicated in this exhibit, the salaries for non-chair PCAOB members ($515,000 per year) and for the chair

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17 See Whitehouse (2008) for comments by Kayla Gillan, a former PCAOB member, about the interactions between the PCAOB and the SEC. The article writes that “Gillan says the SEC staff wanted a much different outcome than what the PCAOB adopted ...” and the SEC “pushed, pushed, pushed, and really tried very hard to get something different than what (the PCAOB) ending up producing.” This is suggestive of the notion that SEC oversight may be limited during the deliberation of Board standards.
($633,450) are significantly higher than other government and non-profit executives. A discussion of the compensation chart by Commissioner Atkins can be found at [http://www.sec.gov/news/speech/2007/spch121807psa.htm](http://www.sec.gov/news/speech/2007/spch121807psa.htm). The plaintiffs argue that this is also evidence of the importance of PCAOB members, thus proving their status as principal officers. The respondents argue, in contrast, that SEC commissioners have broad and pervasive oversight and enforcement authority, thus making the PCAOB members, at most, inferior officers.

The second question is whether the SEC is a department. There is relative consensus on this issue, so the Supreme Court is not expected to disagree with the lower courts on it (FEF/BW opinion at [http://law.du.edu/documents/corporate-governance/fev-v-pcaob/fev-v-pcaob.pdf](http://law.du.edu/documents/corporate-governance/fev-v-pcaob/fev-v-pcaob.pdf)). If the PCAOB members are determined by the Court to be inferior officers, and the SEC is a department, the Justices will decide the third question, which is whether the SEC commissioners collectively amount to a department head. This question has precedent indicating that the head of a department can either be an individual or a Commission or Board with more than one member (Free Enterprise Fund v. Pub. Co. Account. Oversight Bd., No. 07–5127 at 17. D.C. Circuit. Aug. 22, 2008).

**Separation of Powers**

Unlike the Appointments clause, which is expressly provided in the U.S. Constitution, the separation of powers doctrine is implied in the structure of the Constitution. Its role is to serve as a system of checks-and-balances at the Federal government level. It accomplishes this by limiting the actions of each of the three branches of the federal government (the Executive, Legislative, and Judicial) so that none can intrude on the powers of the other branches. That is, the separation of powers doctrine is intended to prevent concentration of powers among the three branches and provides each branch with tools to limit encroachment by the others.

Separation of powers issues have been raised in connection with the President’s removal power. Limitations for the President to remove executive officers can, in theory, violate the separation of powers doctrine because they limit Presidential control over executive functions, impeding the ability to “take Care that the Laws be faithfully executed” (U.S. CONST., art. II, §3, *Morrison v. Olson*, 487 U.S. 654, 691 [1988]). The general application of this topic falls under the unitary executive theory. This legal theory maintains that the President has the right to control the entire Executive Branch, based on the wording of the Constitution that “the executive power” of

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18 Atkins (2007) indicates that salaries for FASB members may be justifiably higher than for PCAOB members because PCAOB members do not need to have the deep technical skills required of FASB members and the SEC has many potential candidates for the PCAOB.

19 This chart may not portray a complete and balanced picture. For example, median law firm partner profits are shown, which includes every small law firm in the country. A more valid comparison may be for the measure to be profits per partner at large law firms—e.g., firms like Williams & Connolly and Baker & McKenzie because that is where Niemeier and Goelzer had previously worked. Also, the salaries of the FASB chair and Board members are relevant. Finally, the average salary of large non-profit CEOs may be understated. To wit, the CEO of FINRA (Robert Glauber) made $6.8 million (2005–06 IRS data); CEO of the Chamber of Commerce (Thomas Donohue) made $3.2 million; CEO of the Business Roundtable (John Castellano) made $2.9 million; CEO of the Graduate Management Admissions Council (David Wilson) made $2 million; and the CEO of the AICPA (Barry Melancon) made $1.4 million. Thanks to Joe Carcello for providing this information.

20 The definition of department for purposes of the appointments clause was addressed in the Supreme Court case of *Freytag v. Commissioner*. Departments were described as being “like the Cabinet level departments,” in that they are “limited in number and easy to identify.” Independent agencies, such as the SEC, almost certainly fall into this definition of department. *Freytag v. Commissioner*, 501 U.S. 868 at 918–919 (1991) (Scalia, J., concurring).

21 An exception to this separation of powers principle is removal powers for independent agencies, such as the Federal Trade Commission (FTC) and the SEC. Appointees of independent agencies are not removable at the will of the President, but rather the President may only remove such appointees for cause, which typically means cases of inefficiency, neglect of duty, or malfeasance in office. This provides independent agencies the ability to maintain their autonomy, and not have their officials removed for political reasons.
the United States vests with the President (Lessig and Sunstein 1994). Although the general principle is widely accepted, there is disagreement with some favoring a “strongly unitary” executive, while others a “weakly unitary” executive. Those arguing for a strong unitary executive believe that the President should control policy making for all executive agencies within congressional limits. Those advocating the weak unitary executive would permit more involvement by the Congress in such activities (Calabresi and Yoo 2008).

The FEF/BW plaintiffs argue that SOX violates the separation of powers doctrine in several ways. First, the President’s power is attenuated power because the SEC (an independent agency) has the power to appoint and remove, and the authority to oversee the work of the Board (who are considered executive officers). Specifically, SOX specifies that PCAOB members may be removed only by the SEC commissioners, and then only for-cause reasons, rather than at-will. Thus, the President can only bring about a change in PCAOB membership indirectly by inducing SEC commissioners to take action. However, this is a muted power because the President can only remove SEC commissioners based on for-cause justifications. Thus, SOX creates a double-for-cause removal architecture for the PCAOB members. This double-for-cause architecture is argued by the plaintiffs to limit the President’s power to remove officers who exercise executive powers.

**SUMMARY AND SUGGESTED FUTURE RESEARCH**

The Supreme Court is expected to hear arguments on the issues summarized above during its Fall 2009 session with a decision expected in Spring 2010. The Court’s decision is highly anticipated because of the importance of the outcome as it applies to the PCAOB, SOX, and the future of independent government agencies in general.

The case is contentious, as indicated by the two-to-one split vote of the three-judge D.C. Circuit panel. The majority of the D.C. Circuit panel argued that the PCAOB is constitutional because the SEC has meaningful oversight of the Board by being able to check the Board at every significant step. On the other hand, the dissenting judge characterized the PCAOB as being autonomous because of the double-for-cause architecture, and thus found that the process for appointing and removing the Board members violates the Constitution. The vote for a rehearing before all nine members of the D.C. Circuit Court was denied on a closely divided 5-to-4 vote, again indicating the contentiousness of the case.

Various commentators (some providing legal advice to the parties in the case) have expressed positions on the case. Commentators who share the plaintiffs’ opinions that the PCAOB is unconstitutional include Carvin et al. (2007) and Bader and Berlau (2005). In addition, Nagy (2009), writing in collaboration with a group of law professors, finds constitutional fault with the PCAOB. Helisek (2009) sees no constitutional problem with the appointments clause, but argues that the double-for-cause removal process violates the Constitution. Pildes (2009), in contrast, does not see a constitutional problem on either issue. Thus, the positions by commentators are decidedly mixed.

Several repercussions are expected if the Supreme Court upholds the D.C. Circuit’s decision that the PCAOB is constitutional. As a starting point, this decision will allow the Board and SOX to continue as they have to date. However, this outcome has other related implications. First, such a ruling would give Congress grounds to establish similar organizations creating regulators who have the double-for-cause removal architecture. This would introduce a set of bodies that are more insulated from executive oversight than previous agencies. Some argue that this would affect the relative power of the Legislative Branch of the U.S. government relative to the Executive Branch. Second, Nagy (2005) argues that such architecture creates the possibility of an asymmetric situ-

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22 It is customary for the President to have for-cause removal powers over heads of independent agencies, such as the SEC.
ation where the Executive and Legislative Branches take political credit for regulatory successes but blame the independent regulator when policies are unpopular. This potentially reduces regulatory stability and thus makes it difficult for citizens and businesses to plan.

On the other hand, if the Supreme Court finds the PCAOB to be unconstitutional, the possible implications apply to both the current set of independent agencies and the oversight of auditing. Some have argued that this could have very dramatic consequences, possibly leading to the conclusion that SOX in its entirety is unconstitutional because the law does not have a severability clause. Given the current congressional profile, many believe that it is unlikely for Congress to pass a law with the same comprehensive impact as SOX currently has. Taking an opposite position, Judge Kavanaugh (who in his dissenting opinion argued that the PCAOB is unconstitutional), believes a finding of the Board being unconstitutional is easily remedied. He argues that if the PCAOB is found unconstitutional, it could be corrected by (1) having Congress modify SOX so that PCAOB members are appointed by the President with the advice and consent of Senate or (2) making the PCAOB part of the SEC—directed, supervised, and removable at-will by the SEC commissioners just like typical inferior officers.

One central theme highlighted by this case is the importance that the U.S. Constitution places on the combination of independence and accountability. This concern has its roots in the fact that at the time of the writing of the Constitution, England was considered to have oppressive (independent) agencies that had great power to affect the citizens, with little or no accountability. Thus, the U.S. Constitution includes the following:

The History of the present King of Great-Britain is a History of repeated Injuries and Usurpations, all having in direct Object the Establishment of an absolute Tyranny over these States. To prove this, let Facts be submitted to a candid World … HE has erected a Multitude of new Offices, and sent hither Swarms of Officers to harrass our People, and eat out their Substance.

This statement clearly indicates the deep concern that drafters of the Constitution had about agencies that held governmental powers, but without accountability. This concern provided the rationale for the drafters to include the appointments clause and the separation of powers doctrine.

Most commentators agree that Congress created meaningful independence for the PCAOB. However, the issue of providing a structure to enhance accountability is potentially in question (Glover et al. 2009). Future research could investigate how to balance independence and accountability in auditing standard setting. Such balance is important because the underlying reason for the existence of auditing is to enhance the functioning of markets, not for independence in the abstract (Kinney 2005; Simunic 2005). One potential approach would be to create a framework that articulates the differences and similarities of the independence/accountability combination at all levels of the audit-supply chain. That is, articulate how independence/accountability might be characterized for individual auditors (Nelson 2006), audit firms (Simunic 1984), standard setters (Bratton 2007; Zeff 1998), and researchers (DeFond and Francis 2005; Carcello 2005). Such a framework could help researchers and policy makers consider the relevant trade-offs and incentives at each of the levels and how these levels produce audits that accomplish economic and social goals.

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23 That is, without a severability clause, a finding that one part of the law is unconstitutional makes the entire law unconstitutional.
24 There is research on independence and accountability being pursued in the area of administrative law (Ackerman 2009), supervising the financial sector (Masciandaro et al. 2008), and judicial powers (Collett 2009; Pimentel 2009).
REFERENCES


