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Self-Regulation of the Accounting Profession
Eleventh Annual Conference
American Institute of Certified Public Accountants

John S.R. Shad
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When I had the pleasure of addressing this Conference two years ago, I announced a number of initiatives affecting the accounting profession. The objectives cited were to simplify the Commission's accounting rules and regulations; and to place greater reliance on the accounting profession: to establish financial reporting principles; and to enforce high standards of conduct within the profession.

Nonaudit Services

Shortly after that Conference, the Commission rescinded its rule requiring disclosure of nonaudit services performed by independent accountants for their audit clients. There was little investor interest in such information and it is publicly available through the AICPA's SEC Practice Section.

Internal Accounting Controls

Next, the Commission announced that it was no longer considering requiring managements to report on their internal accounting controls. The Commission observed that many companies were voluntarily providing such information and that influential private sector groups - such as the Financial Executives Institute and the AICPA - were advancing the concept of such voluntary disclosures. We continue to believe that the need for such disclosures should be determined by the private sector.

Accounting Series Releases

Next, the Commission rescinded 79 outdated Accounting Series Releases and codified the remaining 71 in a ready-reference manual. This exceptional effort by the Office of the Chief Accountant has been applauded by the profession and industry.

Acquisition Accounting

In 1982, the Commission also adopted simple uniform instructions for the presentation of pro forma financial information; codified staff practices regarding the presentation of such information; and simplified the financial reporting requirements for business acquisitions.

S-X Review

Last year, the Commission simplified the financial statement requirements for investment companies and bank holding companies; and substantially completed its review of Regulation S-X -- which governs the form and content of financial statements in Commission filings. The streamlined S-X regulations conform to current industry practices and eliminate rules which duplicate GAAP. The merger proxy rules are presently under study, with a view to further improvements.

Thus, the Commission has simplified its accounting rules and regulations.

Areas of Self-Regulation

Now, I would like to mention three specific areas of self-regulation by the accounting profession. First, the comprehensive projects on the Financial Accounting Standards Board's agenda, and its ability to provide timely guidance on emerging accounting issues. Second, the profession's self-regulatory system. And third, the profession's timely response to major economic and regulatory changes in the financial service industries.

FASB Projects

With regard to setting accounting standards, the Commission's role has been one of oversight - rather than regulation. This is consistent with the view that the private sector can regulate itself more effectively than the government can.

Pension Funds

The FASB is grappling with highly complex accounting issues concerning pensions, income taxes and consolidations. Today, the ability of even sophisticated users, including corporate executives and security analysts, to assess the impact of pensions on companies' financial positions and results of operations, and to make valid comparisons between companies is limited, at best. The Board has suggested more uniform measurements and has taken a bold step in suggesting that pension obligations be recorded on the balance sheet.

The Commission's staff believes this approach is consistent with the FASB's concept statement particularly with respect to the definition of a liability. The staff has read over 480 comment letters and recognizes the substantial opposition from knowledgeable and responsible sources. Neither the staff nor the Commission has a predetermined conclusion as to the "right" answer. Our goal is simply to promote the efficiency of the capital markets through more useful financial reporting in this area.

Timely Guidance

In addition to the major projects on the FASB's agenda, the Board has an opportunity to strengthen its role in providing timely guidance on emerging accounting issues. I know this audience appreciates the importance of such guidance. On occasion, the Commission has reluctantly found it necessary to issue its own rules and interpretations, and to publicize decisions concerning individual registrants.

Software Development Costs

An example of the need for timely guidance was the Commission's recent moratorium on the shift to capitalizing, instead of expensing, computer software development costs. The accounting literature was ambiguous on this issue. The Commission imposed the moratorium because of concern that the diversity of practice was having an adverse effect on the comparability of financial statements. The moratorium specifically stated that it would be rescinded upon the effective date of an FASB pronouncement which provides specific guidance on this issue.

Quasi-Defeasances

In another area, the Commission supported the FASB's prohibition of accounting for "quasi-defeasances" as extinguishments of debt. In quasi-defeasances assets are dedicated to the future servicing and repayment of currently outstanding debt, but the debt is not legally discharged. The FASB recently concluded that quasi-defeased debt can be recognized in certain circumstances under irrevocable trusts. Both the debt and the assets placed in trust are removed from the balance sheet, with appropriate footnote disclosure. Although there are substantive arguments on both sides of this issue, the Commission has withdrawn its prohibition, because the FASB's approach is an acceptable solution.

I am sure you - like we and others - are encouraged by the FASB's project to study ways in which to provide more timely guidance on emerging accounting issues. The Commission will continue to be involved, because it has to resolve accounting and disclosure questions for registrants, but it encourages the FASB to assume greater presence in providing timely guidance.

Self-Regulation System

Another area is the opportunity for the accounting profession to strengthen its self-regulatory system. The primary vehicle is of course the AICPA's Division for CPA firms. Recently, membership in the SEC Practice Section has been growing. It now includes 439 firms, which audit over 85% of all publicly-held companies.

A special AICPA Committee has been studying the Division for CPA Firms, based on its five year's operating experience. The Commission is hopeful that the program will be strengthened.

Peer Reviews

Peer reviews are a key aspect of the program. Based on reviews of peer review workpapers and Public Oversight Board files, the staff has concluded that the Commission can rely heavily on the POB's oversight of the peer review program in fulfilling the SEC's responsibilities.

The Commission also recognizes that the program is evolving. For example, the Commission supports the recent decision to require peer reviewers to consult immediately with the Peer Review Committee, when they discover serious potential problems. The Commission also supported establishment of the 30-day deadline to ensure timely submission of peer review reports.

Special Investigation Process

The Commission is not able to express an opinion on the special investigation process, because very little information is available to the Commission. We agree with the suggestion in the latest POB annual report that the public should be better informed about peer reviews and the special investigation process. Particularly, concerning actions taken by the SEC Section for serious deficiencies.

The United Kingdom self-regulatory organization for accountants describes its investigative activities and summarizes in its annual report the sanctions imposed in each case. In the United States, publicity concerning alleged audit failures, damages confidence in the profession and invites greater government intervention. U.K. type disclosures provide guidance to the profession, inspire public confidence in the process and may forestall governmental intervention.

SEC Enforcement Actions

The Commission has recently taken enforcement action against a number of accountants, their firms and clients for alleged improper accounting practices, audit failures and financial fraud. A number of such investigations are also in process. While they only involve a tiny fraction of the profession and public companies, such cases add fuel to the fire of the critics, who question the profession's ability to regulate itself.

Financial Institutions

One final area is the challenge posed to the profession, by rapid changes in the financial services industries. Major mergers and acquisitions and new products and services are blurring the distinctions between banks, thrifts and securities firms. Economic developments have also compounded problems concerning loan loss reserves, foreign loan disclosures, novel real estate lending practices, financial futures transactions and purchase accounting adjustments.

Some of these issues must be addressed by Congress and the regulatory agencies. They also raise serious accounting issues. The bank regulators have concurred in recent Commission staff bulletins which discuss foreign loan disclosures and accounting for purchased intangibles.

Conclusion

In conclusion, the Commission's initiatives are placing greater reliance on the private sector to establish financial reporting principles and to enforce high standards of conduct within the accounting profession. Improvements in the implementation of these programs are enabling the profession to assume greater self regulatory responsibilities and permitting the Commission to limit its involvement to an oversight role.

Thank you.