



**SECURITIES AND
EXCHANGE COMMISSION**

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SPEECH TO THE
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AND TO THE
ACCOUNTANTS, BANKERS AND FINANCE DIVISION
OF THE
ANTI-DEFAMATION LEAGUE
CHICAGO, ILLINOIS
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"DIRECT AND INDIRECT REGULATION
OF ACCOUNTANTS BY THE SEC"

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THE ACCOUNTING PROFESSION TODAY, LIKE SO MANY OTHER ESTABLISHMENT INSTITUTIONS, IS CAUGHT IN A CRISIS OF CONFLICTING EXPECTATIONS. ON THE ONE HAND, THE CONSUMERISM WHICH FLOWERED IN THE 1960'S, AND WHICH CONTINUES TO INFLUENCE PUBLIC OPINION, HAS LED TO INCREASING PRESSURES FOR GREATER PROFESSIONAL ACCOUNTABILITY. CONGRESS AND THE COURTS HAVE ATTEMPTED TO FORMULATE MORE RIGOROUS LEGAL STANDARDS FOR ACCOUNTANTS IN ASSESSING THEIR LIABILITY TO USERS OF FINANCIAL REPORT INFORMATION. ON THE OTHER HAND, THE 1970'S HAVE SEEN THE GROWTH OF AN ANTI-REGULATORY ATTITUDE WHICH IS NOT RECEPTIVE TO NEW IDEAS OR LAWS FOR GOVERNMENT MANDATED REGULATION OF THE ACCOUNTING PROFESSION. ALTHOUGH THE PUBLIC DOES NOT HAVE MUCH TRUST AND CONFIDENCE IN THE PROFESSIONS GENERALLY, IT DOES NOT HAVE TRUST AND CONFIDENCE IN THE GOVERNMENT EITHER.

PERSONALLY, I BELIEVE THAT THE PROSPECTS ARE DUBIOUS FOR FEDERAL LEGISLATION DIRECTLY REGULATING THE ACCOUNTING PROFESSION. THIS IS NOT BECAUSE THE PUBLIC, THE CONGRESS, OR THE SEC IS WHOLLY SATISFIED WITH THE PERFORMANCE OF THE ACCOUNTING PROFESSION OVER THE PAST DECADE. RATHER, IT IS BECAUSE THERE IS DEEP SKEPTICISM ABOUT THE GOVERNMENT'S ABILITY TO IMPROVE MATTERS. ALSO, THE RELATIONSHIP OF REGULATION TO INFLATION IS BEING RECOGNIZED BY MANY. BOTH THE COSTS AND THE BENEFITS OF REGULATION ARE DIFFICULT TO QUANTIFY, AND THE PUBLIC FEELS THAT THE ADVERTISED SOCIAL AND ECONOMIC BENEFITS OF REGULATION HAVE NOT BEEN REALIZED. THEREFORE,

THE PUBLIC SEEMS TO BE CONCLUDING THAT REGULATORY AGENCIES LIKE THE SEC ARE FAILING TO PROTECT THE PUBLIC INTEREST SUFFICIENTLY TO JUSTIFY THEIR DIRECT AND INDIRECT COSTS. NEW CONSUMER PROTECTION LEGISLATION IS NOT POPULAR BECAUSE IT IS PERCEIVED AS USELESS AND EXPENSIVE.

ALTHOUGH THIS AUDIENCE MAY BE PLEASED BY MY PROGNOSTICATION, YOU SHOULD NOT BE. THE PUBLIC'S DISILLUSIONMENT WITH GOVERNMENT, BUSINESS AND THE PROFESSIONS BODES ILL FOR OUR SOCIETY. ALL SOCIETIES MUST HAVE INSTITUTIONS OF AUTHORITY IN ORDER TO FUNCTION IN A REASONABLY PEACEFUL AND CONTINUOUS MANNER. BUT IN A DEMOCRACY, THE INSTITUTIONS OF AUTHORITY MUST BE RESPECTED OR THEY WILL BE IGNORED AND THE SOCIETY WILL NO LONGER BE GOVERNED BY THE RULE OF LAW. I BELIEVE THAT OVER TIME THE ONLY WAY FOR INSTITUTIONS TO ACHIEVE AND MAINTAIN RESPECT IS TO OPERATE IN THE PUBLIC INTEREST.

ACCORDINGLY, THE MESSAGE I BRING YOU TODAY IS NOT TO REJOICE BECAUSE CONGRESS HAS NOT YET PASSED A PUBLIC ACCOUNTING REGULATORY ACT SUCH AS THE BILL INTRODUCED IN THE LAST SESSION BY CONGRESSMAN MOSS. RATHER, IT IS THAT YOU MUST WORK ON IMPROVING PROFESSIONAL RESPONSIBILITY AS INDIVIDUALS AND THROUGH PROGRAMS FOR SELF-REGULATION BY THE PROFESSION SO THAT THE PUBLIC'S CONFIDENCE IN THE ACCURACY AND ADEQUACY OF FINANCIAL REPORTING WILL BE ENHANCED.

WITH THIS MESSAGE IN MIND, I WOULD LIKE TO REVIEW WITH YOU SOME RECENT DEVELOPMENTS AFFECTING THE REGULATION OF ACCOUNTANTS BY THE SEC. DURING THE LAST FEW YEARS, CONGRESS,

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THE PUBLIC, THE SEC AND THE ACCOUNTING PROFESSION HAVE SPENT MUCH TIME AND ENERGY EXAMINING THE ROLE AND REGULATION OF ACCOUNTANTS. THIS SCRUTINY WAS IN THE CONTEXT OF SERIOUS CRITICAL QUESTIONS CONCERNING THE ACTIVITIES AND ACCOUNTABILITY OF PUBLICLY-OWNED CORPORATIONS OPERATING IN THE UNITED STATES AND THROUGHOUT THE WORLD.

IN PART, THIS QUESTIONING WAS A RESPONSE TO UNEXPECTED FAILURES BY MAJOR CORPORATIONS AND DISCLOSURES OF WIDESPREAD QUESTIONABLE AND ILLEGAL ACTIVITIES BY THE MANAGERMENTS OF MANY PUBLICLY-OWNED CORPORATIONS. IT WAS UNCLEAR WHY THE INDEPENDENT ACCOUNTANTS HAD FAILED TO DETECT THESE FINANCIAL DIFFICULTIES OR QUESTIONABLE FINANCIAL ARRANGEMENTS OF THE CORPORATIONS AND WHETHER ACCOUNTANTS WERE ADEQUATELY PERFORMING THEIR INDEPENDENT REVIEW FUNCTIONS.

INDEPENDENT ACCOUNTANTS ARE NOT EXPECTED TO BE GUARANTORS OF THE ACCURACY OF FINANCIAL STATEMENTS. NEVERTHELESS, ACCOUNTANTS PLAY A SIGNIFICANT ROLE IN CORPORATE ACCESS TO CAPITAL FROM THE INVESTING PUBLIC BECAUSE OF THE STATUTORY REQUIREMENT IN THE SECURITIES ACTS THAT REGISTRATION STATEMENTS AND PERIODIC REPORTS INCLUDE CERTIFIED FINANCIAL STATEMENTS.

RECENT CONGRESSIONAL INTEREST IN THE ACCOUNTING PROFESSION BEGAN IN 1976 WITH THE REPORT OF THE SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS OF THE HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE, CHAIRED BY CONGRESSMAN MOSS. IT WAS CONTINUED, DURING THE SPRING OF 1977, BY THE SUBCOMMITTEE ON REPORTS, ACCOUNTING AND MANAGEMENT OF THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS, CHAIRED BY THE LATE SENATOR METCALF, WHICH UNDERTOOK A BROAD EXAMINATION OF THE PROFESSION.

THE STAFF OF THE SENATE SUBCOMMITTEE PUBLISHED A STUDY IN DECEMBER 1976 WHICH WAS VERY CRITICAL OF THE PROCESS BY WHICH ACCOUNTING STANDARDS ARE SET AND ENFORCED WITHIN THE PROFESSION AND THE DOMINATION OF THE "BIG EIGHT" ACCOUNTING FIRMS. THE STAFF RECOMMENDED BROAD FEDERAL INVOLVEMENT IN THE REGULATION OF ACCOUNTANTS. DURING HEARINGS HELD BY THE SUBCOMMITTEE, HOWEVER, THE ACCOUNTING PROFESSION PLEDGED TO INSTITUTE REFORMS IN THE PROFESSION AND THE COMMISSION PLEDGED TO USE ITS OVERSIGHT ROLE TO ENCOURAGE THE PRIVATE SECTOR'S EFFORTS. ON THE BASIS OF THESE ASSURANCES, THE SUBCOMMITTEE'S REPORT ENDORSED REFORM THROUGH SELF-INITIATED ACTION BY THE PROFESSION IN COOPERATION WITH THE COMMISSION. THE SUBCOMMITTEE'S DECISION TO GIVE THE PROFESSION AND THE COMMISSION SOME TIME, HOWEVER, DID NOT DE-EMPHASIZE IN ANY WAY THE

CONVICTION THAT IMMEDIATE CHANGE IN THE PROFESSION WAS NECESSARY TO INCREASE THE PUBLIC'S CONFIDENCE IN THE INDEPENDENCE OF ACCOUNTANTS. MOREOVER, THE HEARINGS CONVEYED CONGRESSIONAL AND PUBLIC CRITICISM OF THE COMMISSION'S DISCHARGE OF ITS OVERSIGHT ROLE OVER THE ACCOUNTING PROFESSION.

CONGRESSMAN MOSS'S HOUSE SUBCOMMITTEE ALSO HELD HEARINGS EARLY THIS YEAR TO EXAMINE THE PROFESSION'S DEVELOPING SELF-REGULATORY PROGRAM AND THE MANNER IN WHICH THE COMMISSION WAS DISCHARGING ITS RESPONSIBILITIES UNDER THE SECURITIES ACTS. IN HIS STATEMENT OPENING THOSE HEARINGS, CONGRESSMAN MOSS REPEATED HIS INTENTION TO "INTRODUCE LEGISLATION TO CREATE A SELF-REGULATORY ORGANIZATION UNDER DIRECT SEC OVERSIGHT" IF THE PROFESSION DID NOT "ADDUCE PERSUASIVE EVIDENCE THAT IT IS TAKING EFFECTIVE STEPS ON ITS OWN TO IMPROVE THE QUALITY OF AUDIT WORK AND THE RESPONSIVENESS OF ACCOUNTANTS TO PUBLIC NEEDS."

ON JUNE 16, 1978, CONGRESSMAN MOSS AND FOUR OTHER CONGRESSMEN INTRODUCED THE "PUBLIC ACCOUNTING REGULATORY ACT" (H.R. 13175) RELATING TO THE ACCOUNTING PROFESSION. APPARENTLY, CONGRESSMAN MOSS CONTINUED TO BELIEVE THAT THE PROFESSION'S EFFORTS WOULD BE UNSUCCESSFUL ALTHOUGH HE AND HIS CO-SPONSORS HAD NOT YET RECEIVED THE COMMISSION'S JULY 1, 1978 REPORT PREPARED FOR CONGRESS WHICH ANALYZES THE PROFESSION'S PROGRESS TOWARDS SELF-REGULATION.

THE MOSS BILL WOULD CREATE A SELF-REGULATORY ORGANIZATION FOR ACCOUNTANTS PATTERNED AFTER THE NATIONAL ASSOCIATION OF SECURITIES DEALERS. AND IT WOULD REQUIRE REGISTRATION WITH THIS SELF-REGULATORY ORGANIZATION BY ACCOUNTING FIRMS THAT AUDIT FINANCIAL STATEMENTS FILED WITH THE COMMISSION AND WOULD AUTHORIZE DISCIPLINARY ACTION AGAINST THE REGISTERED FIRMS AND THEIR PRINCIPALS.

I RECOGNIZE THAT LEGISLATION MAY BE NECESSARY IF THE PROFESSION IS UNABLE TO DEVELOP AN EFFECTIVE SELF-REGULATORY STRUCTURE. EVEN IN THIS EVENT, HOWEVER, THE COMMISSION WOULD NEED TO UNDERSTAND THE REASONS FOR THE PROFESSION'S FAILURE BEFORE RECOMMENDING AN APPROPRIATE LEGISLATIVE ALTERNATIVE. MOREOVER, EVEN IF THE PROFESSION IS SUCCESSFUL IN DEVELOPING A VIABLE SELF-REGULATORY PROGRAM, LEGISLATION MAY BE NECESSARY TO ASSURE ITS LEGAL ROLE IN THE REGULATORY SYSTEM.

ONE OF THE FINDINGS SET FORTH IN CONGRESSMAN MOSS'S LEGISLATION (H.R. 13175 SECTION 2(3)) IS THAT THE PROFESSION "APPEARS UNABLE TO ESTABLISH, A SATISFACTORY SELF-REGULATORY ARRANGEMENT." I BELIEVE, HOWEVER, THAT IT IS PREMATURE AT THIS POINT TO REACH THAT CONCLUSION. THE PROFESSION SHOULD BE GIVEN MORE TIME BECAUSE IT NOW IS WORKING WITHIN THOSE ASPECTS OF THE SELF-REGULATORY STRUCTURE WHICH HAVE BEEN DEVELOPED. ITS EXPERIENCE WITH THE STRUCTURE SHOULD ENABLE REVISIONS AND IMPROVEMENTS TO THE SYSTEM AND SHOULD PROVIDE THE COMMISSION AND CONGRESS WITH ENOUGH INFORMATION TO JUDGE THE NEED FOR GREATER FEDERAL INVOLVEMENT THROUGH LEGISLATION.

I AM PERSONALLY COMMITTED TO SELF-REGULATION OF BUSINESS IN GENERAL AND PROFESSIONALS IN PARTICULAR. AN EXAMINATION OF THE LEGISLATIVE HISTORY OF THE FEDERAL SECURITIES LAWS REFLECTS A CONGRESSIONAL HESITATION TO ADOPT A REGULATORY SCHEME DEPENDENT UPON SUBSTANTIAL DIRECT GOVERNMENT REGULATION OF BUSINESS. AND I DO NOT BELIEVE THAT DIRECT FEDERAL REGULATION OF ACCOUNTANTS WOULD RESULT IN THE INCREASED PROFESSIONALISM AND INDEPENDENCE ADVOCATED BY THE METCALF COMMITTEE IN ITS 1977 REPORT.

PRESIDENT ROOSEVELT EMPHASIZED IN HIS MESSAGE TO CONGRESS IN WHICH HE RECOMMENDED THE LEGISLATION WHICH BECAME THE SECURITIES ACT OF 1933 THAT THE PURPOSE OF THIS LEGISLATION WAS "TO PROTECT THE PUBLIC WITH THE LEAST POSSIBLE INTERFERENCE TO HONEST BUSINESS." WHILE THE SECURITIES EXCHANGE ACT OF 1934 HAS BEEN AMENDED TO AUTHORIZE MUCH MORE REGULATION THAN ENVISIONED BY ITS DRAFTERS, IT, TOO, ATTEMPTS TO AVOID UNDUE DIRECT GOVERNMENT REGULATION. RATHER, THE EXCHANGE ACT ESTABLISHES A SELF-REGULATORY STRUCTURE SUBJECT TO COMMISSION OVERSIGHT FOR THE SECURITIES INDUSTRY. THE LEGISLATIVE HISTORY OF THAT ACT REFLECTS A BALANCING OF THE FACTS THAT DIRECT GOVERNMENT REGULATION MIGHT BE INEFFICIENT BECAUSE OF THE VASTNESS OF THE INDUSTRY WHILE THE SELF-REGULATORS MIGHT NOT BE AS DILIGENT AS NECESSARY.

SELF-REGULATION IS BENEFICIAL FOR OTHER REASONS BESIDES AVOIDANCE OF UNDUE GOVERNMENT REGULATION AND GOVERNMENT INEFFICIENCY. CONGRESS HAS RECOGNIZED THAT SELF-REGULATION ENABLES ACTUAL PARTICIPATION IN THE REGULATORY PROCESS BY THOSE PERSONS SUBJECT TO REGULATION. THIS NOT ONLY RESULTS IN INCREASED EXPERTISE AND UNDERSTANDING IN THE REGULATORY PROCESS, BUT MAKES THE IMPOSITION OF REGULATORY CONTROLS MORE PALATABLE. I HAVE A STRONG PREFERENCE FOR SELF-REGULATION OVER GOVERNMENT REGULATION BECAUSE IT PLACES RESPONSIBILITY AND ACCOUNTABILITY WITH THE PEOPLE WHO HAVE THE GREATEST STAKE IN WEIGHING THE COSTS OF REGULATION AGAINST THE BENEFITS RECEIVED.

THE EXTENT OF THE COMMISSION'S PRESENT AUTHORITY OVER ACCOUNTANTS IS UNCLEAR IN MANY RESPECTS. SOME CRITICS HAVE ARGUED THAT THE SEC HAS ABDICATED ITS AUTHORITY OVER FINANCIAL ACCOUNTING AND FINANCIAL STATEMENTS BY PERMITTING THE PRIVATE SECTOR TO FORMULATE ACCOUNTING STANDARDS. OTHERS HAVE ARGUED THAT THE SEC HAS EXERCISED POWER WHICH GOES BEYOND ITS STATUTORY AUTHORITY IN DISCIPLINING ACCOUNTANTS PURSUANT TO RULE 2(E) OF THE COMMISSION'S RULES OF PRACTICE. THE MOSS AND METCALF COMMITTEES HAVE URGED THE COMMISSION TO EXERCISE GREATER REGULATORY AUTHORITY OVER ACCOUNTANTS AND THE COMMISSION HAS THUS FAR DECLINED TO DO SO.

THE COMMISSION'S RESTRAINT IN THIS REGARD IS UNUSUAL FOR A GOVERNMENT REGULATORY AGENCY, I HOPE THAT THE SEC WILL CONTINUE TO REFUSE TO RECOMMEND LEGISLATION OR ACT TO SUPERSEDE OR CONTROL SELF-REGULATION OR PRIVATE SECTOR STANDARD SETTING. HOWEVER, SUCH CONTINUED REGULATORY RESTRAINT DEPENDS IN PART ON HOW WELL ACCOUNTANTS RESPOND TO CURRENT CRITICISM OF THEIR PERFORMANCE.

THE CRITICS OF THE ACCOUNTING PROFESSION AND THE COMMISSION HAVE FOCUSED ON THREE ISSUES WHICH HAVE RECEIVED INADEQUATE ATTENTION IN THEIR VIEW: THE REGULATION OF THE PROFESSION, THE INDEPENDENCE OF ACCOUNTANTS; AND THE ACCOUNTING STANDARD-SETTING PROCESS.

IN OUR JULY 1, 1978 REPORT TO CONGRESS ON THE ACCOUNTING PROFESSION, THE COMMISSION ADDRESSED THESE ISSUES AND HOW THEY ARE BEING FACED BY THE PROFESSION WITH COMMISSION OVERSIGHT. DURING THE YEAR PRECEDING ISSUANCE OF THE REPORT, THE COMMISSION AND ITS STAFF WORKED HARD WITH THE PROFESSION TO DEFINE THE OBJECTIVES OF A SELF-REGULATORY PROGRAM AND DEVELOP A PROGRAM WHICH WOULD IMPLEMENT THE OBJECTIVES. WHILE THE PROFESSION'S EFFORTS THUS FAR CANNOT BE JUDGED AS WHOLLY SATISFACTORY, THE COMMISSION CONCLUDED IN ITS REPORT TO CONGRESS THAT THE DEGREE OF PROGRESS JUSTIFIES THE CONTINUED OPPORTUNITY FOR THE PROFESSION TO PURSUE ITS EFFORTS AT SELF-REGULATION.

ONE STEP THAT THE PROFESSION TOOK WHICH THE COMMISSION REGARDS AS A MAJOR ACCOMPLISHMENT AND AS MEANINGFUL TO THE DEVELOPMENT OF SELF-REGULATION IS THE AICPA'S CREATION OF A NEW DIVISION OF CPA FIRMS AND WITHIN THAT DIVISION AN SEC PRACTICE SECTION WHOSE VOLUNTARY MEMBERSHIP WOULD CONSIST PRINCIPALLY OF FIRMS SERVING PUBLICLY-HELD AND OTHER COMMISSION SUPERVISED CORPORATIONS. THE SECTION WOULD INCLUDE A PUBLIC OVERSIGHT BOARD, COMPOSED OF DISTINGUISHED INDIVIDUALS FROM OUTSIDE THE PROFESSION. ITS MEMBERSHIP REQUIREMENTS INCORPORATE MANDATORY PEER REVIEW, CONTINUING PROFESSIONAL EDUCATION, SECOND PARTNER REVIEW, AUDIT PARTNER ROTATION, AND AN IMPLICIT AGREEMENT TO COOPERATE WITH ANY DISCIPLINARY MEASURES IMPOSED BY THE EXECUTIVE COMMITTEE OF THE SECTION.

THE MANNER IN WHICH THE AICPA SET UP THIS NEW DIVISION WAS CHALLENGED IN A SUIT FILED IN JANUARY 1978 BY 18 PARTNERS AND SENIOR MEMBERS OF SMALL AND MEDIUM-SIZED ACCOUNTING FIRMS. AT THE END OF JULY, A NEW YORK SUPREME COURT JUSTICE RULED THAT THE AICPA'S COUNCIL HAD ACTED WITHIN THE AICPA BYLAWS WHEN IT APPROVED THE NEW CLASSIFICATIONS OF GROUPS OF MEMBERS IN THE ORGANIZATION. THE DECISION REPRESENTS A SIGNIFICANT TRIUMPH FOR THE PROFESSION'S SELF-REGULATORY EFFORTS.

THERE ARE, OF COURSE, OTHER HURDLES WHICH THE PROFESSION WILL HAVE TO OVERCOME IN DEVELOPING A VIABLE SELF-REGULATORY SCHEME. THE EFFECTIVENESS OF THE SECTION DEPENDS UPON THE PROFESSION'S RESPONSE TO VARIOUS OTHER CONCERNS, INCLUDING,

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WHETHER OR NOT ALL ACCOUNTING FIRMS AUDITING PUBLICLY-OWNED COMPANIES WILL BECOME MEMBERS OF THE SECTION; WHETHER THE PUBLIC OVERSIGHT BOARD WILL HAVE ADEQUATE AUTHORITY OVER THE SECTION AND ITS DISCIPLINARY PROCESSES; AND WHETHER THE PROPOSED PEER REVIEW PROGRAM WILL BE SUCCESSFUL.

THE PURPOSE OF PEER REVIEW IS TO ASSESS WHETHER AN ACCOUNTING FIRM'S WORK CONFORMS TO THE HIGH STANDARDS EXPECTED OF THOSE WHO ASSUME THE RESPONSIBILITIES OF INDEPENDENT ACCOUNTANTS UNDER THE FEDERAL SECURITIES LAWS. TO ACHIEVE THIS OBJECTIVE THE PEER REVIEW PROGRAM PROVIDES FOR EXAMINATION AND EVALUATION EVERY THREE YEARS OF THE WORK OF EACH ACCOUNTING FIRM WHICH AUDITS PUBLICLY-HELD CLIENTS.

THE PEER REVIEW PROGRAM AS DEVELOPED THUS FAR CAN BE CRITICIZED ON VARIOUS GROUNDS. THE PROGRAM DOES NOT PROVIDE FOR COMMISSION ACCESS TO THE PROCESS FOR EVALUATION. THE RIGHT OF AN AUDITED FIRM OR ITS CLIENT TO LIMIT THE SCOPE OF THE AUDIT BY REQUESTING EXCLUSION OF CASES IN LITIGATION OR OF CERTAIN ENGAGEMENTS IS AN ARBITRARY AND QUESTIONABLE LIMITATION ON AUDITS. THE PROCEDURE WHEREBY THE REVIEWING FIRM IS SELECTED BY THE REVIEWED FIRM RAISES QUESTIONS OF OBJECTIVITY AND CREDIBILITY. HOWEVER, THE ISSUANCE OF AN INDEPENDENT REPORT ON THE ADEQUACY OF THE QUALITY CONTROL SYSTEM OF THE REVIEWED FIRM BY A "QUALITY CONTROL REVIEW PANEL", APPEARS TO PROTECT THE SUBSTANTIVE INTEGRITY OF THE REVIEW PROCESS.

IN ADDITION TO THE DEVELOPMENT OF A SELF-REGULATORY SCHEME, THE PROFESSION MUST TAKE STEPS IN RESPONSE TO COMMENTS THAT THE INDEPENDENCE OF ACCOUNTANTS MUST BE STRENGTHENED. THE INDEPENDENCE OF AN AUDITOR IS A PREREQUISITE TO HIS ROLE UNDER THE SECURITIES ACTS. WHILE PROFESSIONALISM AND INDEPENDENCE CANNOT BE ACHIEVED THROUGH LEGISLATION OR RULE-MAKING, THERE IS PRESSURE ON THE PROFESSION TO WORK TOWARDS ENHANCING THE OBJECTIVITY, CREDIBILITY AND RESPECT OF ACCOUNTANTS AND THE OVERALL INTEGRITY AND CREDIBILITY OF FINANCIAL REPORTING.

THE COMMISSION POINTED OUT IN ITS REPORT TWO ISSUES RELATING TO THE INDEPENDENCE OF ACCOUNTANTS WHICH MUST BE ADDRESSED: THE ESTABLISHMENT OF INDEPENDENT AUDIT COMMITTEES AND THE DETERMINATION OF THE SCOPE OF SERVICES WHICH ACCOUNTANTS SHOULD BE PERMITTED TO PERFORM FOR THEIR AUDIT CLIENTS. THE FORMATION OF AUDIT COMMITTEES COMPOSED OF INDEPENDENT DIRECTORS SHOULD STRENGTHEN AUDITOR INDEPENDENCE BECAUSE THE ACCOUNTANTS WOULD BE ABLE TO REPORT DIRECTLY TO THE AUDIT COMMITTEE AND ACCORDINGLY WOULD BE INSULATED FROM INORDINATE MANAGEMENT PRESSURES. THE NEW YORK STOCK EXCHANGE REQUIRES LISTED COMPANIES TO HAVE AN AUDIT COMMITTEE WHICH MEETS CERTAIN SPECIFIED CRITERIA AND THERE HAVE BEEN A NUMBER OF OTHER PRIVATE SECTOR INITIATIVES IN THIS AREA. THE COMMISSION, HOWEVER, MAY RECOMMEND FOR COMMENT PROPOSALS TO REQUIRE COMPANIES TO ESTABLISH AUDIT

COMMITTEES IF THE PRIVATE SECTOR EFFORTS DO NOT RESULT IN REQUIREMENTS INTENDED TO ACHIEVE THIS GOAL.

THE OTHER ISSUE WHICH HAS RECEIVED SUBSTANTIAL ATTENTION IS THE QUESTION OF THE APPROPRIATE RANGE OF SERVICES WHICH ACCOUNTING FIRMS SHOULD BE PERMITTED TO OFFER TO THEIR AUDIT CLIENTS. ALTHOUGH THE SENATE SUBCOMMITTEE STATED THAT INDEPENDENT AUDITORS SHOULD PERFORM ONLY THOSE SERVICES DIRECTLY RELATED TO ACCOUNTING, THE COMMISSION HAS NOT ENDORSED THE SUBCOMMITTEE'S RECOMMENDATION. IN ITS REPORT, THE COMMISSION RECOGNIZED THE COMPLEXITY OF THIS QUESTION AND URGED THAT THE PROFESSION BE GIVEN MORE TIME TO CONSIDER THE APPROPRIATE RANGE OF AUDITOR'S SERVICES.

THE COMMISSION BELIEVES, HOWEVER, THAT THE AUDIT COMMITTEE SHOULD CONSIDER THE POSSIBLE RELEVANCE OF AUDITORS' SERVICES TO THE APPARENT OR ACTUAL INDEPENDENCE OF AUDITORS. THEREFORE, IN JUNE 1978, THE COMMISSION ISSUED ACCOUNTING SERIES RELEASE No. 250 WHICH ANNOUNCED THE ADOPTION OF A RULE REQUIRING DISCLOSURE OF THE NATURE OF SERVICES RENDERED BY AUDITORS TO THEIR AUDIT CLIENTS, THE PERCENTAGE RELATIONSHIP OF THE FEES FOR THE NON-AUDIT SERVICES RENDERED EXPRESSED AS A PERCENTAGE OF THE AUDIT FEE AND WHETHER THE AUDIT COMMITTEE, OR IN THE ABSENCE OF AN AUDIT COMMITTEE, THE BOARD OF DIRECTORS, HAD APPROVED ALL SERVICES PROVIDED BY THE AUDITORS.

THE THIRD ISSUE RELATING TO THE ACCOUNTING PROFESSION WHICH HAS RECEIVED SUBSTANTIAL ATTENTION FROM BOTH THE GOVERNMENT AND THE PUBLIC, BESIDES A SELF-REGULATORY SCHEME AND INDEPENDENCE, IS THE ACCOUNTING STANDARD-SETTING PROCESS. CRITICS HAVE QUESTIONED THE CREDIBILITY OF FINANCIAL STATEMENTS AND THE METHOD BY WHICH STANDARDS ARE DEVELOPED TO ACHIEVE UNIFORMITY AND COMPARABILITY. WHETHER THE GOVERNMENT OR THE PRIVATE SECTOR SHOULD BE SETTING ACCOUNTING STANDARDS IS ANOTHER TOPICAL QUESTION.

SINCE 1938 WHEN ACCOUNTING SERIES RELEASE No. 4 WAS ISSUED, THE COMMISSION HAS BELIEVED THAT THE PRIVATE SECTOR SHOULD ESTABLISH AND IMPROVE ACCOUNTING STANDARDS SUBJECT TO COMMISSION OVERSIGHT. THE PROFESSION HAS GREATER RESOURCES, EXPERTISE AND ABILITY TO DETECT EMERGING ACCOUNTING PROBLEMS AT AN EARLIER STAGE THAN THE COMMISSION.

ALTHOUGH THE COMMISSION RECOGNIZES THE FASB AS THE ENTITY DESIGNATED BY THE PRIVATE SECTOR TO PROVIDE THE INITIATIVE IN SETTING ACCOUNTING STANDARDS, IT HAS NOT DELEGATED ITS RULEMAKING AUTHORITY TO THE FASB. THE FEDERAL SECURITIES LAWS AUTHORIZE THE COMMISSION TO PRESCRIBE THE ACCOUNTING PRACTICES TO BE APPLIED IN THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS INCLUDED IN THE DOCUMENTS FILED PURSUANT TO THEIR PROVISIONS. THEREFORE, THE COMMISSION RETAINS FINAL RESPONSIBILITY FOR RULES GOVERNING THE FINANCIAL DATA PREPARED TO COMPLY WITH THE SECURITIES LAWS.

NEVERTHELESS, IN ACCOUNTING SERIES RELEASE No. 150, ISSUED ON DECEMBER 20, 1973, THE COMMISSION REAFFIRMED ITS POLICY OF RELYING ON THE PRIVATE SECTOR TO PROVIDE THE INITIATIVE IN SETTING ACCOUNTING STANDARDS.

THE STANDARD-SETTING PROCESS HAS BEEN GENERALLY SATISFACTORY. IT IS CLEAR, HOWEVER, THAT THERE IS CONSIDERABLE EMPHASIS ON THE PROFESSION'S PROGRESS ON ITS CONCEPTUAL FRAMEWORK PROJECT. AN EFFECTIVE CONCEPTUAL FRAMEWORK WILL SET FORTH GOALS AND OBJECTIVES FOR FINANCIAL REPORTING BY PROFIT-MAKING ENTERPRISES WHICH WOULD SERVE AS PRINCIPLES UPON WHICH THE ACCOUNTING PROFESSION WOULD BASE ITS APPROACH TO EMERGING ACCOUNTING PROBLEMS. A RESULT OF THIS FRAMEWORK SHOULD BE INCREASED COMPARABILITY OF INFORMATION IN FINANCIAL STATEMENTS AND GREATER AND MORE TIMELY RESPONSIVENESS OF THE PRIVATE SECTOR TO DEVELOPMENTS IN THE EXPECTATIONS FOR FINANCIAL REPORTING. MOREOVER, THE DEVELOPMENT OF THIS FRAMEWORK WOULD IMPROVE THE CREDIBILITY OF FINANCIAL STATEMENTS AND, CONCOMITANTLY, RESPECT FOR THE PROFESSION'S ABILITY TO CONFRONT ACCOUNTING PROBLEMS.

YOU MAY QUESTION WHETHER THE COMMISSION'S DECISION REGARDING OIL AND GAS ACCOUNTING REPRESENTS A DEPARTURE FROM ITS POLICY OF LOOKING TO THE ACCOUNTING PROFESSION FOR STANDARD-SETTING. I DO NOT BELIEVE IT DOES.

THE ENERGY POLICY AND CONSERVATION ACT REQUIRED THE COMMISSION TO MAKE AN INDEPENDENT DECISION ON THE APPROPRIATE ACCOUNTING METHOD FOR OIL AND GAS PRODUCING ENTITIES AND THEREFORE ACCOUNTING SERIES RELEASE No. 253, ISSUED AUGUST 31, 1978, IS UNIQUE AS A PRODUCT OF A LEGISLATIVE REQUEST. THE FASB HAD DETERMINED THAT COMPANIES IN OIL AND GAS PRODUCTION SHOULD USE THE SUCCESSFUL EFFORTS METHOD OF ACCOUNTING. AFTER CONDUCTING HEARINGS AND EXAMINING THE ISSUES, THE COMMISSION CONCLUDED, HOWEVER, THAT A NEW METHOD OF ACCOUNTING BASED ON A VALUATION OF PROVED OIL AND GAS RESERVES WOULD SIGNIFICANTLY IMPROVE THE MEASUREMENT OF ASSETS AND EARNINGS IN THE FINANCIAL STATEMENTS OF OIL AND GAS PRODUCING COMPANIES.

SOME PERSONS IN THE ACCOUNTING PROFESSION HAVE EXPRESSED SUBSTANTIAL OPPOSITION TO THE COMMISSION'S APPROACH AS WELL AS CONCERN THAT THE COMMISSION'S ACTION WILL UNDERMINE CONFIDENCE IN THE FASB. THE COMMISSION'S RESPONSE TO THE VERY DIFFICULT QUESTION OF APPROPRIATE ACCOUNTING FOR OIL AND GAS PRODUCERS SHOULD NOT BE VIEWED, HOWEVER, AS INDICATIVE OF A CHANGE IN THE POLICY ANNOUNCED IN ASR No. 4 AND No. 150. NOR SHOULD THE COMMISSION'S CONCLUSION BE CONSIDERED AN EXPRESSION OF DISSATISFACTION WITH THE FASB'S STANDARD-SETTING PROCEDURES.

THEREFORE, THE PROFESSION MUST CONTINUE TO WORK FOR THE DEVELOPMENT OF A CONCEPTUAL FRAMEWORK AND THE ESTABLISHMENT AND IMPROVEMENT OF ACCOUNTING STANDARDS REGARDLESS OF THE COMMISSION'S OIL AND GAS DECISION. IT MUST MOVE FORWARD WITH EVEN MORE DEDICATION TO RESOLVE COMPLEX ACCOUNTING AND REPORTING ISSUES SO AS TO MAINTAIN THE MOMENTUM ESTABLISHED DURING THE LAST FEW YEARS. I AM VERY PLEASED THAT THE TRUSTEES OF THE FINANCIAL ACCOUNTING FOUNDATION, WHICH IS RESPONSIBLE FOR SELECTING MEMBERS OF THE FASB, RECOGNIZE THE CONTINUING RESPONSIBILITIES OF THE BOARD AND AGREE THAT THE BOARD SHOULD CONTINUE IN ITS LEADERSHIP ROLE IN ESTABLISHING AND IMPROVING ACCOUNTING STANDARDS.

I WOULD LIKE TO CONCLUDE ON A PERSONAL NOTE. AS YOU PROBABLY KNOW, I AM NOT AN ACCOUNTANT AND I AM UNABLE TO FULLY UNDERSTAND ALL OF THE COMPLEX ISSUES WHICH ACCOUNTING PRINCIPLES ADDRESS. AS ANOTHER PROFESSIONAL, HOWEVER, I AM VERY APPRECIATIVE OF THE POSSIBLE ADVERSE IMPACT ON A PROFESSION WHICH INCREASED FEDERAL GOVERNMENT REGULATION WOULD MEAN. ALTHOUGH THE COUNTRY SEEMS TO BE IN REVOLT AGAINST GOVERNMENT REGULATION, THE CONSUMER MENTALITY OF THE GENERAL PUBLIC TENDS TO ENGENDER MORE REGULATION. FURTHER, THE PUBLIC AND ITS ELECTED REPRESENTATIVES IN CONGRESS ARE DISTRUSTFUL OF PROFESSIONALS. IN PART,

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THIS DISTRUST COMES FROM DISAPPOINTED EXPECTATIONS. ACCOUNTANTS HAVE FOSTERED THE MYTH THAT ACCOUNTING IS AN EXACT SCIENCE IN WHICH BOTTOM LINE RESULTS CAN BE STATED WITH MATHEMATICAL CERTAINTY.

I HOPE AND EXPECT THAT YOUR EFFORTS AT SELF-REGULATION WILL SATISFY CONGRESS AND THE PUBLIC THAT THE ACCOUNTING PROFESSION IS ABLE TO REGULATE ITSELF EFFECTIVELY AND FAIRLY. I LIKEWISE ANTICIPATE THAT ACCOUNTING STANDARDS WILL CONTINUE TO BE FORMULATED BY THE PRIVATE SECTOR. BUT, I BELIEVE THAT THE ONLY REAL ALTERNATIVE TO INCREASED FEDERAL REGULATION OF ACCOUNTANTS IS IMPROVED PERFORMANCE AND BETTER EDUCATION OF THE PUBLIC AS TO THE LIMITS OF THE PROFESSION'S ABILITY TO GUARANTY THE ACCURACY OF FINANCIAL INFORMATION.