NEWS

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IMPROVING THE ACCOUNTING PROFESSION: A SHARED RESPONSIBILITY

Address by

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Last week a newspaper columnist suggested that among hazardous professions, the "economist stands at the top of our list, right beside guide to Mt. Everest and New York City bomb-disposal expert." As an economist, I found this categorization interesting, and considering the persistent serious problems in our national economy, believe that it is not unfounded. It is generally recognized, however, that by their very nature, opinions expressed by economists are subject to a significant degree of imprecision because they are based on assumptions and judgments that often prove to be invalid. To some extent, accountant's opinions also are based on imperfect knowledge and judgment, but, as many of you may be painfully aware, accountants generally do not enjoy the luxury of expected imprecision.

Although accountants are subjected at times to the consequences of expectations of precision which are neither intended nor possible, users of accountants' work product, including government regulators and members of Congress, and members of the accounting profession itself, are also expressing legitimate concerns. It does not take an economist to understand that the ultimate value of a service is dependent not on what the provider of that service believes it to be, but rather on the extent to which users of the service perceive it as meeting

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their expectations. There can be little question that accountants' services have not met the expectations of a significant segment of users.

The AICPA's Commission on Auditors' Responsibilities ("Cohen Commission") concluded that "a gap exists between the performance of auditors and the expectations of users of financial statements," that "In general, users appear to have reasonable expectations of the abilities of auditors and the assurances they can give," and that "The burden of narrowing the gap between performance and expectations falls primarily on auditors and other parties involved in the preparation and presentation of financial information." The Cohen Commission made a number of recommendations intended to bridge this gap and to make the accounting profession more receptive to the forces of change in the future.

Similarly, the Metcalf Subcommittee Staff Report on the Accounting Establishment concluded that:

> Doubts as to the accuracy and reliability of information reported by corporations have resulted from continual revelations of corporate misconduct which was not found or not reported by independent auditors. Congress and the public have little assurance that corporate financial statements accurately portray the results of business activities because of flexible, alternative accounting standards. Public confidence in independent auditors, which is essential to the success of the federal securities laws, has been seriously erroded.

These are criticisms not only of the accounting profession but also of the Securities and Exchange Commission because of the Commission's responsibility to oversee the setting of financial reporting standards for public corporations and to assure the independence of accountants in the certification of financial statements. The Metcalf Subcommittee Staff Report went on to suggest that the Commission was not fulfilling its responsibilities and stated that "the SEC's long association with the private accounting establishment and insistent determination to rely on its accounting pronouncements casts substantial doubt on the SEC's ability to establish accounting standards which would restore public confidence in corporate financial reporting."

The Commission has long believed that it is in the public interest to create and maintain an environment in which members of the accounting profession will use their expertise and resources to fulfill the primary role in improving accounting standards and practices. I firmly support this approach because it encourages private initiative and minimizes government involvement and expense. Nevertheless, the Commission and the profession have been less than successful thus far in accomplishing what has been expected of us. To the extent that user expectations are unreasonable or misplaced, investors and others must be educated as to what can legitimately be expected from financial reporting and what the accounting profession's role in that reporting is. However, to the extent that user expectations are realistic, steps must be taken to see that every practitioner does his or her best to fulfill them.

Significant progress toward these two goals is being made. I believe a major step was taken last week when the Financial Accounting Standards Board issued its Final Statement on the Objectives of Financial Reporting. This is to be followed by an Exposure Draft on the Elements of Financial Statements. If the profession and other interested parties can agree on what financial statements should convey and how they should convey it, we will have come a long way toward correcting the public's misconceptions about financial reporting.

The efforts of the AICPA to implement various of the Cohen Commission's recommendations should also be helpful in clarifying the limits of financial statements. Particularly important in this regard is the work of the Special Advisory Committee on Reports by Management which is studying the Cohen Commission's recommendations to expand public financial reporting to include or be accompanied by a report of management acknowledging management's responsibilities for and the completeness of the financial data included in the report. Also important is the work of the Auditor's Reports Task Force which is exploring the desirability of expanding the auditor's report to communicate more effectively the auditor's role and responsibilities.

The SEC is encouraging and observing the efforts of these private groups and offering our counsel where appropriate. Our staff is also considering the possibility of recommending that the Commission propose for comment a requirement that there be a report by management on internal accounting controls. Such a report, in addition to accomplishing other purposes, should help clarify the responsibilities of the various parties involved in corporate financial reporting.

I am confident that the combined efforts of the FASB, the AICPA and the Commission will result in a better appreciation by the Congress, the investing public, the corporate community and all users of financial statements of the nature and responsibility of the accountant's role in financial reporting and a concomitant increase in the profession's credibility.

The need to improve the quality of accounting and auditing work,which is the other side of the credibility gap, is also receiving considerable attention. While views differ among various groups and individuals as to how to improve the quality of accounting and auditing, there is general agreement on the primary elements of appropriate action. To assure continuing high quality professional work by accountants, there must be:

1. Functioning quality control procedures to which all practitioners are subject.
2. Mechanisms for identifying sub-standard work and correcting its underlying causes.

3. Appropriate remedial and disciplinary measures for those who demonstrate an unwillingness or inability to meet the high standards of the profession.

4. Public credibility for all of these measures.

These broad objectives are not limited to accounting matters in SEC filings, nor even to the practice of accountancy as it relates to the wider area of public companies, but extend to all accounting and auditing by members of the accounting profession. In my opinion, no single government or private sector body is in a position to meet all of these objectives in a satisfactory manner. Instead, they will be achieved only through the combined and coordinated efforts of all public and private sector groups and individuals whose legal or professional responsibilities give them a valid interest in resolving the problems.

As solutions are sought, it is important to keep in mind that public accountants are professionals. As professionals, the fulfillment of their responsibilities requires integrity, objectivity, high quality work, and the exercise of considered judgment based on training and experience. To be fully successful, I believe that any initiative, regulatory or otherwise, must build upon this professionalism. In turn, this professionalism should result in responsible reactions to the initiatives which are now underway.

In the Commission's July 1978 "Report to Congress on the Accounting Profession and the Commission's Oversight Role" the bulk of the discussion regarding enhancement of the quality of auditing and accounting work was devoted to the AICPA's newly created Firms Division, especially its SEC Practice Section. While expressing our hope that this important private sector initiative would be successful, the staff and the Commission did not hesitate to point out that, in our opinion, there are significant difficulties yet to be overcome if the program is to succeed. The Commission continues to believe that the program would have a greater chance of success if the Public Oversight Board has direct authority over the activities of the Section. In addition, the Board must address the problems of whether audits which are the subject of litigation and the foreign portions of domestic audit engagements should be included in peer reviews or whether there are acceptable alternatives. Also, the Commission must have sufficient access to the peer review process to permit us to evaluate its adequacy. Finally, in the long run, the success of the SEC Practice Section initiative will depend on the Board's commitment to assure that the public interest is served. A viable SEC Practice Section may well resolve many problems which are of concern to the SEC and the accounting profession.

Nevertheless, this program has certain limitations which preclude it from being the complete solution to the profession's credibility problems. Perhaps the most significant limitation is that both the Private Companies Practice Section and the SEC Practice Section are voluntary programs and 100 percent participation by U. S. public accounting firms cannot be expected. Moreover, foreign accounting firms and non-CPA accounting firms are not eligible to join, although such firms constitute an important segment of the accounting profession on which American investors and others rely.

In addition, the as yet untested disciplinary mechanisms of the Institute's program are restricted in their impact by both the voluntary nature of the program and its emphasis on firm practices rather than individual performance. The Commission's oversight and support may serve to mitigate certain of these limiting factors, but the Commission's authority also has practical and legal limits.

It has been suggested that a partial answer to the limitations of the Firms Division may lie in the ethical programs of the AICPA and state professional societies if these groups are willing and able to play a more active disciplinary role than they have traditionally. However, the ultimate sanction which can be imposed by these professional societies is expulsion from membership, a privilege which is not necessary to practice public accounting. In addition, professional societies traditionally postpone remedial action until related legal proceedings have run their course. While this policy may be justifiable, nonetheless, it has created a credibility problem.

A third group involved in the effort to improve the quality of auditing and accounting work is comprised of the more than 50 state boards of accountancy which govern the practice of accounting throughout the United States and its territories. The state boards possess many of the attributes which the purely private sector bodies lack. These organizations operate under statutory mandate, and within its own jurisdiction each board has full regulatory authority over all types of accounting professionals, including those who practice before the Commission.

Until recently, most state boards were inactive and thus suffered from a lack of credibility. To the credit of many of you and your fellow professionals, this situation is changing as more state boards of accountancy begin to exercise their statutory responsibilities in an assertive but responsible fashion. Florida practitioners can be justifiably proud that the Florida Board has been one of the leaders in taking positive steps to assure a quality of practice which will be of significant benefit in the overall effort to restore public confidence in the accounting profession.

I understand that the Florida Board initiated reviews of financial statements which were prepared or audited by CPAs and filed with state agencies and found that on their face, about one third of the reports contained deficiencies representing deviations from existing professional standards.

Florida practitioners have responded in a positive way to these findings. The vast majority appear to be much more anxious to demonstrate the future quality of their work than to be contentious about its quality in the past. Other state boards which have instituted positive enforcement programs have also found that the level of compliance with technical and professional standards unacceptable. It is encouraging, however, to note that the response of practitioners in remedying identified deficiencies and in taking steps to assure that they do not recur has generally been both positive and professional. In Florida and elsewhere, it has been the consistent experience that the Boards have only rarely been forced to exercise their full array of regulatory muscle. Cynics would, of course, claim that this is purely a matter of survival. I would like to think, however, that it is an indication that professionalism is still the governing attribute among practitioners of the accountant's art. Professional responses to professional problems have produced workable solutions.

In our July 1978 report to Congress, the staff referred favorably to the progress being made by many state boards but also noted that there are significant practical problems which are hampering their efforts. These problems result primarily from a lack of resources. For a state board to perform credibly in its particular role of helping to ensure quality performance by those it regulates, it must be able to carry out its administrative functions of examination and licensing, to monitor the quality of public practitioners' work, to conduct inquiries and investigations where appropriate, and to follow-up on those actions where necessary.

Board members around the country who have committed their board to making the switch from a passive to an active role have been innovative and skillful in overcoming these problems. Some have supplemented their staffs with practitioners working on behalf of the Board for nominal compensation. This has frequently helped convince cost-conscious legislators to increase state board budgets sufficiently to permit expansion of their inadequate staffs.

Another potentially limiting factor is that the vast majority of state board members and their staffs are themselves members of the accounting profession. I say potentially because I do not view this as necessarily undesirable. Certainly accountant members of boards in those states such as your own which have taken steps to assure that their regulatory role is a meaningful one have demonstrated their professionalism in an unmistakable manner. However, to the extent that accounting professionals who are board members permit the continuation of passive--and largely ineffective--policies by their boards, critics will charge that control of accountancy boards by accountants represents a built-in conflict of interest and that such boards can never be effective.

One answer to this charge would be to remove accountants from boards. A better answer, however, is for boards to vigorously pursue their statutory mandates and demonstrate that accountant members are professional enough to regulate meaningfully their peers and colleagues.

Other practical problems in instituting effective regulatory programs at the state level include enabling legislation which is sometimes archiac or unclear and organizational and technical snags which are always present in start-up situations. These difficulties are being overcome by the work of individual board members, interested members of the profession, and the National Association of State Boards of Accountancy. NASBA has served as a coordinator for and adviser to many state boards, has been responsible for assuring that the experiences of successful programs can be shared, and thus deserves substantial credit for the accomplishments to date.

The increased private and public activity at both national and state levels has given rise to the criticism that the accounting profession is becoming or perhaps already is "over-regulated." This could be a serious problem if unnecessary duplication results. At present, however, the principal danger is that even the increased activity may be insufficient to adequately address all of the problems at all levels. Therefore, I believe that it would be premature to attempt to limit the role which any organization may play.

In order to avoid creating new problems in the very process of formulating solutions to old ones, it is especially important to avoid "territorial fights." I understand that there is some controversy between the AICPA and the state societies on the one hand and NASBA and the state boards on the other over who should be doing what. My only comment on this dispute is that each group should be working toward the same goal. Each professional and regulatory body has an obligation to recognize the roles of the others and to avoid placing undue burdens on practitioners to the extent permitted by particular statutory and other responsibilities.

Thus, while a regulatory body need not automatically accept the conclusions of a voluntary peer review where it cannot objectively verify the nature, scope and results of the review, it should recognize that private sector actions already taken or in progress may reduce or eliminate the necessity for additional inquiry or disciplinary action. On the other hand, a state board which has identified sub-standard work on the part of a firm or practitioner which it regulates might give consideration to membership in the SEC Practice Section and the expected benefits of such membership in determining appropriate remedial action. Moreover, each organization involved in this process should, to the extent practicable, share the information it has with the others.

Certainly the Commission shares information with state boards, the AICPA, and at their request, with the state societies.

Rather than dispute responsibilites, each group should concentrate on solving those problems which it is particularly suited to address. Thus, certain aspects of the work of professional societies like your own seem certain to expand. Continuing professional education, for instance, is becoming increasingly important to practitioners in their effort to stay current. Programs such as the one in which we are participating today can be of benefit to both the profession and the public, and state societies are undoubtedly in a position to administer them efficiently and effectively.

Professional societies should also be concerned with striking the appropriate balance between their representation of the business and professional interests of their members and their obligations as societies of professionals who serve the public to recognize the public interest. There is nothing inherently unsavory about self-interest. It is the driving motivation of a private enterprise economic system. Professional groups should be encouraged to speak out on behalf of the business and professional interests of their members. As long as this is done in an open and professional manner, it is beneficial. But it must be balanced against the broader public interest which each member of the profession is obligated to uphold.

The credibility of professional societies--and ultimately their effectiveness as the voice of the profession--will surely be lost if the public perceives that positions taken by these societies are weighted toward private advantage and against the public interest.

The most important participants in improving the credibility of the accounting profession are accounting professionals themselves. To the extent individual members respond with professionalism to the criticisms of your profession, develop creative and meaningful solutions in their individual practice and support the progressive efforts of your professional organizations, there will be less need for governmental bodies such as state boards, the SEC, and legislatures on the national or state level to become more involved in regulating the profession.

There is more than a little truth in the aphorism: "You're either part of the problem or part of the solution." Every member of the profession has a very real interest in the process of seeking solutions and should participate in this process fully. There are many ways that this can be accomplished. I would like to mention only a few of them.

First, the measures being undertaken by both private and public sector organizations are substantial ones, requiring people and resources at a level which is probably several times greater than will be needed in the future, as these programs become more established and routine. It is unlikely that any assistance you might offer will be refused.

Second, I think every professional accountant would do well to consider the role which he or she can individually play in the attitude adjustment phenomenon which is an inevitable part of the changes taking place. No one enjoys receiving criticism and few enjoy criticizing others. Yet, in the present environment, fulfillment of the difficult and complex obligations which accountants face appears to demand constructive criticism. Such criticism should be taken in light of what it has to offer. Conversely, the traditional reluctance of accountants to criticize their fellow professionals must be overcome, not merely in the institutional context, such as peer review, but in other circumstances where valid criticism may be useful. No professional should be content to remain silent when he is aware that one of his peers is doing work which fails to meet minimum professional standards.

There is also another aspect to accountants' professionalism to which everyone should be sensitive. Whether a sole practitioner, or part of a national or even an international accounting firm, every professional accountant is to some extent a specialist. I realize, of course, that there is no official or profession-wide recognition of specialization and I'm not sure that there should be. Nevertheless, nearly all accountants in public practice tend to gravitate toward a certain kind of work, be it systems, tax or audit. If nothing else, the explosion of government regulations, pronouncements by standard-setting bodies, and of information in general tends to assure that not even the most talented professional can hope to stay current in every area. The implications are plain: Every practitioner must be aware of both talents and limitations and be prepared to refuse a professional engagement when the necessary expertise is not available. I am not suggesting that individual practitioners and smaller accounting firms lack necessary talent, because I do not believe that quality can be equated with size. Rather, the talents of practice units of all sizes should be carefully applied.

I realize that these suggestions I have made may in some cases be difficult for accountants to carry out because so much is happening in the profession with regard to both standard setting and quality improvement. The initiatives which I have discussed, from those of the AICPA and the SEC at the national level, to those of the state societies and boards, are transforming the environment in which accountants practice and making numerous demands on members of this profession. This process of change is neither easy nor painless. I believe, however, that if the members of the profession bring the traditional strong points of accounting professionalism--integrity, objectivity, and quality of work--to bear on the profession's problems, solutions will be facilitated and the accounting profession will emerge with a sense of pride and enjoy a renewed public confidence which will make the efforts well worthwhile.