Accounting profession : years of trial, 1969-1980

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Notice to Readers

Pages 136 and 137 contain a paragraph describing a meeting between AICPA officials and spokesmen for petitioners in a lawsuit filed against the AICPA. The author states that four persons were present, namely, AICPA Chairman Stanley Scott, AICPA President Wallace Olson and Petitioners Eli Mason and Alan Brout. Actually, there were six persons present at the meeting, namely, AICPA Treasurer Harry Mancher, Petitioner Ronald Hertz in addition to the four named in the book.

In the same paragraph, the author states, "The two men refused to withdraw their petition unless the AICPA agreed to pay their legal fees and to hold a mail ballot on division issues." It has now been established that in an effort to explore various alternatives for settlement of the lawsuit a number of options had been discussed; however, the petitioners state that by participating in the meeting they were not putting forth either payment of legal fees or a mail ballot on division issues as conditions for withdrawal of the lawsuit which they believe may be inferred.

November 1, 1982
The Accounting Profession
YEARS OF TRIAL: 1969-1980

By Wallace E. Olson, Former President
American Institute of Certified Public Accountants

AICPA
Preface

At the time arrangements were being made for my retirement from the Institute, William Gregory, who was then serving as AICPA chairman, asked that I write a history of the profession during the 1970s. Although the task was not well defined, the general idea was to carry forward from where John L. Carey had ended volume 2 of *The Rise of the Accounting Profession*. The AICPA Board of Directors endorsed the chairman’s suggestion, and with considerable reservations I agreed to try to live up to the high standard that had been set by Mr. Carey.

Early in my employment at the Institute, I was forcefully reminded by the head of one of the large CPA firms that the AICPA is not the profession. He was right, of course; but the Institute, as the coordinating organization for collective decisions at the national level, is widely regarded as the profession’s authoritative voice. Accordingly, for the sake of convenience, this book has been written as though the AICPA and the accounting profession were one and the same.

Although CPAs follow a variety of careers in public practice, education, government, and industry, this history focuses almost exclusively on the Institute’s efforts to serve the interests of CPAs in public practice. I have not attempted to cover all that might be included because to do so would result in an unreadable tome. Neither have I dealt with the technical aspects of practice or major areas of service, such as federal taxation and management advisory services, except to the extent necessary to discuss important events affecting the profession. Rather, I have described in some depth those developments that I consider to have been most significant. The responsibility for the selection
of subjects and the judgments that are expressed are entirely mine.

During the period covered by this book, thousands of CPAs participated in the Institute's programs as officers or as members of committees or the governing bodies. For purposes of brevity, I have named only a few of them, and I apologize for not identifying all those who devoted so much of their time and talents in behalf of the profession.

Another omission has been a discussion of the important part played in the profession's affairs by the state societies of CPAs, some of which publish their own histories. Failure to deal with their role as a separate subject reflects only the desire to avoid duplication and to restrict the proportions of this book.

Finally, I owe a debt of gratitude to several members of the Institute's staff who assisted by commenting on portions of the manuscript or arranging for its publication. I particularly want to thank Donald Schneeman, who urged me to accept the assignment and provided invaluable assistance in carrying it out. He was a close associate during my term of service with the Institute and was a participant in most of the events that I have described.

I am saddened by the fact that Bill Gregory did not live to see the results of one of the many actions taken during his administration. His death early in 1981 deprived the profession of one of its most popular leaders. I am grateful to him for sponsoring this opportunity for me to record a portion of the history of the accounting profession. To quote Bill, "I am proud of being a certified public accountant."
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CHAPTER 1

An Overview of the Profession
1969–1980

The 1960s ended amid indications that the coming decade would be a turbulent time for the public accounting profession. Although the profession’s leaders were aware of the eroding public confidence in the work of auditors and in the reliability of financial statements, few CPAs foresaw the extent of the changes that the profession was about to undergo.

During the 1970s the profession achieved a new maturity, in which it realized more fully than before the responsibilities imposed by the securities acts of the thirties. Until then the profession had tended to devote most of its attention to the needs of management. Practitioners recognized that they had responsibilities to shareholders, credit grantors, and other third parties, but these obligations were ill-defined. Throughout the seventies hundreds of liability lawsuits against CPA firms, the actions of an activist SEC, investigations by Congress and governmental agencies into the profession’s performance, and AICPA activities served to define the responsibilities of independent auditors and to improve financial reporting.

Third-Party Liability Issues

Today, the emphasis on assistance to management has been overshadowed by the specter of liability to third parties. Indeed, some CPAs would assert that the pendulum has swung too far toward an adversarial relationship between independent auditors and management, thereby hampering the conduct of effective audits.

The impetus for independent auditors to be more responsible
toward shareholders and third-party users grew out of a period of widespread speculation in the securities markets in the late 1960s. A new breed of promoters and managers took advantage of inadequacies in accounting principles to inflate reported earnings, to build conglomerates, and to promote real estate and franchising ventures. A flood of new securities issues was snapped up by investors in a fever of speculation.

Ultimately, the speculative bubble burst, and numerous investors suffered severe losses. Many of them turned to their lawyers to salvage what they could through litigation, and auditors became prime targets of class-action liability suits. The plaintiffs alleged that financial statements were misleading and that the auditors had failed to meet their legal responsibilities to shareholders and credit grantors. The truth of such allegations was often less important to plaintiffs than the fact that the auditors' liability insurance offered the only available source of financial recovery.

The profession was ill prepared to meet this onslaught. CPAs had not previously encountered managements that used accounting principles to create instant earnings through what became known as the "front ending" of revenue and the "rear ending" of expenses, nor had they dealt with the large volume of complex corporate mergers and acquisitions or the intricacies of real estate and franchising ventures.

Although during the 1960s the AICPA had been planning for the future, the principal emphasis had been directed toward achieving a better internal structure to fit the enhanced size and status of the profession. The growing problems in the securities markets and their effect on practitioners caught the profession off guard.

**Standard Setting**

The profession's response in the early 1970s focused on the need to set standards in order to narrow the available alternatives in accounting principles. The profession had recognized this need as early as 1959, when the Accounting Principles Board was established to succeed the committee on accounting procedures.
By 1969 the work of the Accounting Principles Board had come under widespread criticism. Some critics alleged that the board was not acting swiftly enough and that its pronouncements left much to be desired; management, on the other hand, felt aggrieved by the burden of complying with the expanding reporting and disclosure requirements and objected to its lack of participation in the standard-setting process.

The setting of accounting standards had gained great attention in the financial pages of newspapers and business periodicals in conjunction with news of major business failures and lawsuits against CPA firms. Financial reporters were sharply critical of auditors' performance, and they questioned the right of a private professional organization to set accounting standards and to impose them on the entire business community.

The AICPA responded in 1971 by appointing two blue ribbon committees composed of both members and nonmembers of the profession. One, known as the Wheat committee, was charged with studying how and by whom accounting principles should be established. The other, referred to as the Trueblood committee, was directed to study and report on the objectives of financial reporting.

The Wheat committee issued its report in March 1972, recommending that an independent foundation and standard-setting board be established outside the AICPA and that it be sponsored by the various organizations whose members had a strong interest in financial accounting and reporting. This recommendation was approved and implemented during 1972, giving birth to the Financial Accounting Foundation, the Financial Accounting Standards Advisory Council, and the Financial Accounting Standards Board (FASB), which succeeded the Accounting Principles Board.

The Trueblood committee issued its report in October 1973. Its conclusions formed the basis of an FASB project to establish a conceptual basis for financial accounting. The project was still in process in 1981.

Concurrently, the AICPA completely overhauled its code of professional ethics. The revised code was adopted by a vote of the membership early in 1973. It contained a new rule 203, which mandated that AICPA members comply with the accounting
standards established by the FASB. This was a significant step because it explicitly brought the standards directly under the profession’s disciplinary machinery for the first time.

The SEC adopted a policy of reliance on the FASB for the development of accounting standards. Nonetheless, the SEC and the chief accountant seemed to undermine the FASB’s role by issuing a host of Accounting Series Releases requiring registrants to include new types of disclosures in their financial statements.

A major CPA firm sued the SEC, challenging the legality of its policy of reliance on the FASB. The challenge, which was based on an alleged failure to comply with the Federal Administrative Procedures Act, ultimately proved unsuccessful.

The oil embargo in 1974 and the ensuing energy crisis attracted the attention of Congress to the financial accounting practices of companies in the petroleum industry. The fact that their financial statements were not comparable because of the application of alternative accounting methods resulted in a directive in the 1975 Energy Act that the SEC see that uniform accounting standards were established for the industry. Although the SEC waited for the FASB to act, it ultimately took a position different from that of the FASB, thereby overruling the private sector’s standard-setting body.

Several other developments during the decade further eroded confidence in the accounting profession and the standard-setting process and increased the calls for governmental intervention. Among these developments were the Equity Funding fraud, the bankruptcy of Penn Central, and a series of other highly publicized bankruptcies of major corporations. Other factors were the illegal corporate political contributions, improper payments, and foreign bribes that were revealed as an outgrowth of the Watergate investigations. The large number of major corporations involved and the fact that the improprieties were not brought to light by the independent auditors raised serious questions about the reliability of financial statements. Finally, as might be expected, the FASB’s own pronouncements were sometimes highly controversial. Most notable perhaps was Statement of Financial Accounting Standards no. 8, dealing with accounting for transactions in foreign currency and the translation of foreign currency financial statements.

In October 1976 a congressional subcommittee, in an oversight
report on the federal regulatory agencies, recommended that the SEC establish a basis for uniform accounting standards. In 1977 and again in 1978 congressional hearings inquired into the propriety of the SEC's reliance on a private-sector body for the development of accounting standards.

Investigation of Auditor Performance

The same events that caused the concentration on accounting standards also gave rise to intensive investigations of auditor performance. Early in 1976 a Senate subcommittee began an extensive study of the profession, which led to a highly critical staff report called *The Accounting Establishment*. Beginning in April 1977, public hearings were held; and in November 1977 a subcommittee report was issued, which contained a long list of recommended reforms.

Meanwhile, a House of Representatives subcommittee was also directing its attention to the profession. Following public hearings early in 1978, the subcommittee chairman introduced a bill proposing the establishment of a federal statutory organization to regulate accountants practicing before the SEC. Under the bill, the organization would be subject to the oversight and control of the SEC. This action was followed by additional public hearings in July.

A major participant in the public hearings was the Commission on Auditors' Responsibilities, which had been appointed by the AICPA in October 1974. The commission, composed of members and nonmembers of the profession, had completed its study in November 1977 and issued its final report early in 1978. The report addressed a wide range of questions and contained many recommendations to improve auditor performance. Many of these recommendations were incorporated in the Senate subcommittee report.

In addition to the Commission on Auditors' Responsibilities, many members of the profession made written submissions and gave oral testimony to the two congressional subcommittees. Not all of them were complimentary to the profession, and most suggested a variety of reforms.

All this scrutiny made it clear that the profession would have
to expand its system of self-regulation. Otherwise, there would be a considerable risk that legislation would be enacted, with the support of the SEC, establishing additional federal regulation of the profession.

Not all members of the profession agreed with the AICPA’s opposition to any new form of federal governmental regulation. Some members supported legislation to require registration of CPAs or CPA firms with the SEC, and others proposed a more elaborate scheme of regulation. Nevertheless, a large majority of the AICPA Board of Directors and Council believed they were reflecting the view of most practitioners by opposing federal regulatory legislation.

A New Structure for Self-Regulation

By July 1977 the AICPA’s chairman and president had formulated a series of proposed actions designed to be responsive to the many recommendations that had been made. They proposed establishing two divisions for CPA firms to permit regulation of firms as entities, adding three non-CPA public representatives to the Institute’s Board of Directors, and opening policy-making meetings of the Council and senior committees to the public.

One division for CPA firms was to be for SEC practice, and the other for private companies practice. These were subsequently designated as sections of a single division for CPA firms when they were established by action of the Institute’s governing Council.

A key feature of both sections was the requirement for member firms to have their systems of quality control reviewed by a group of peers every three years. This was the outgrowth of peer review programs that had been evolving since the early 1970s, both on a voluntary basis and as a sanction imposed by the SEC under its disciplinary proceedings.

A key enforcement feature of the SEC practice section was the establishment of a public oversight board composed of five prominent public members to oversee and report publicly on the section’s activities. This was intended to provide the pressure of public scrutiny on member firms needed to ensure their contin-
ued participation and compliance with the section's requirements.

All of the proposed actions were approved, with minor modifications, at a historic meeting of the AICPA Council in September 1977, and steps were taken immediately for their implementation. All was not harmonious, however. A small number of members were so opposed to the establishment of the division for CPA firms that they instituted legal action challenging the authority of the Council's action. By mid 1978 the court decided against the petitioners' claims, and both sections continued in operation.

The SEC had been a principal participant in the congressional hearings, arguing that new regulatory legislation should not be considered until the profession had a chance to implement its expanded program of self-regulation. During the balance of the decade, the SEC used the threat of congressional intervention to keep pressure on the profession. In annual reports to Congress, the SEC repeatedly expressed the view that the profession had made progress toward self-regulation but that more must be accomplished. This was the status at the end of 1980, although by that time the interest of Congress had largely dissipated as a result of changes in its membership and the structure of its committees.

Through a combination of bold action and fortuitous circumstances, the profession had coped successfully with an unprecedented period of congressional investigation. Some practitioners felt that the new self-imposed regulation went too far and was unnecessary. They believed that the profession could have lobbied effectively to defeat any proposed legislation.

The validity of this contention is difficult to evaluate. In the judgment of the AICPA's officers and governing bodies, the possibility of failure was far too high to pursue a course of defending the status quo. In addition, many members believed that reforms were needed, as is evidenced by their testimony before Congress and by the reports of several AICPA committees relating to the profession's regulation.

However one judges the appropriateness of the actions taken in 1977 and 1978, there is little doubt that the great majority of CPAs were strongly opposed to federal legislation that would
have imposed additional regulation, and the fundamental fact is that the profession successfully avoided such legislation during this period.

Professional Competition

Financial reporting standards and auditor performance were not the only concerns that stimulated interest in the profession at the federal governmental level during the decade. The government also became involved in the areas of competition between CPA firms.

The Department of Justice embarked upon a campaign at the outset of the 1970s to strike down the competition prohibitions contained in the codes of ethics of various professional groups. Investigations were commenced, and lawsuits alleging violations of the federal antitrust laws were either threatened or actually filed. In general, the department achieved its objective through both consent decrees and litigation. The genesis of this entire effort was the concern for consumer protection that was championed by Ralph Nader and other activists.

The AICPA's ethical rules prohibiting competitive bidding, advertising, and solicitation became an early target of the department's campaign. After extensive negotiations and careful consideration of outside legal advice, the AICPA entered into a consent decree in 1972 to not enforce its prohibition of competitive bidding. The members subsequently supported this action by voting in favor of a revised code of ethics that lacked the prohibition.

Because of the consent decree on competitive bidding, the Department of Justice decided not to take further action at that time regarding other AICPA rules that were viewed as being anticompetitive; however, the department reopened its file in 1976, and by 1979 the Institute's members had voted the repeal of rules prohibiting advertising, solicitation, encroachment on the practice of other CPAs, and employment of personnel of other CPA firms without prior notice. These actions were taken after outside legal counsel had advised that the AICPA had very little chance of successfully litigating to retain the prohibitions.

The elimination of the prohibition against uninvited solicita-
tion of a specific client proved to be highly unpopular among practitioners because it spurred competitive tactics that were widely viewed as unfair. Some Institute members believed that the legality of the prohibition should have been litigated, and in October 1980 a special committee was appointed to consider whether the prohibition should be restored. Accordingly, the issue remained active in the 1980s.¹

Scope of Services

Another issue that attracted the interest of government involved the range of services that is appropriate for CPA firms. During the decade the SEC questioned the propriety of certain types of management consulting engagements, such as executive recruiting for a fee. The scope-of-services issue was pressed by the SEC in 1970 and again in 1978–79, when it published two Accounting Series Releases (ASRs 250 and 264). The releases required proxy statement disclosures of certain nonaudit services provided by auditors and described criteria for determining an auditor’s independence. Also, a Senate subcommittee held a public hearing on the issue in August 1979, but no further action was taken by that body.

Two independent bodies studied the scope-of-services issue and reported their conclusions during the decade: the Commission on Auditors’ Responsibilities and the public oversight board of the SEC practice section. Several Institute special committees also addressed the difficult questions relating to scope of services. The conclusions reached by these various groups were not wholly satisfactory to the SEC, but for the time being an uneasy hiatus was reached, pending what would be revealed by the SEC’s newly adopted disclosure requirements.²

The question of appropriate scope of services is likely to continue to be raised because of the difficulty of determining whether the judgments of auditors are influenced by their per-

¹. Based upon the advice of independent legal counsel, the committee, in a September 1981 report, recommended against seeking reinstatement of a prohibition of uninvited solicitation of a specific client.
². In 1981, the SEC, in keeping with the Reagan administration emphasis on deregulation, withdrew ASRs 250 and 264 on the grounds that they were no longer deemed necessary.
formance of management consulting services for their audit clients.

Professional Specialization

Closely related to the scope-of-services issue was the question of the need for formal recognition of specialization within the profession. Several Institute special committees addressed this question during the 1970s, but their conclusions failed to gain the acceptance of the Institute's membership and governing bodies. At the end of 1980 it appeared that CPAs and the Institute's governing bodies were not ready to embrace formal accreditation of specialists or to admit non-CPA specialists to some form of associate membership in the AICPA.

Advancement of Accounting Education and Minority Participation

In addition to the changes brought about by governmental pressure and public criticisms, many significant developments were initiated from within the profession. These developments were less spectacular but were important nonetheless.

For example, during the decade the Institute adopted a policy of support for programs and schools providing professional accounting education. In 1969 the Institute Council had agreed to urge state boards of accountancy to require a five-year college education, and to drop requirements for practice experience, as a prerequisite for obtaining a CPA certificate. During the following years the Institute developed proposed standards for programs of professional accounting education. Also, working in conjunction with the American Accounting Association, the Institute persuaded the American Assembly of Collegiate Schools of Business to establish accreditation of such programs. When accreditation is fully implemented, it is expected to enhance the pre-entry education of future members of the profession.

The Institute was just as concerned about continuing education after entry into the profession. In May 1971 the AICPA Council passed a resolution urging the state boards of account-
ancy to adopt mandatory continuing professional education requirements for licensed practicing CPAs. By 1981 a total of forty states had taken such action, and a high proportion of the activities of the AICPA and the state societies was devoted to the availability of educational courses for practitioners.

The Institute also began a program to bring members of minority groups into the profession. In 1969 a fund was established to provide financial aid to minority college students majoring in accounting and to assist in the development of minority faculty members. During the next ten years, over $2,500,000 was raised and spent to achieve an integrated profession.

International Standards

Significant actions also were taken in the international field. Following an international congress in Sydney, Australia, in 1972, the AICPA joined with eight other national institutes to establish the International Accounting Standards Committee (IASC), based in London, to set international accounting standards. By the end of 1980, thirteen international accounting standards had been issued for application to international financial reports. They represent an important effort to improve reporting by multinational corporations. Nevertheless, it will take many years to achieve full compliance with accounting standards on an international basis.

The report of a working party to the congress in Sydney led to the establishment of the International Committee for the Coordination of the Accounting Profession (ICCAP) in 1972. It consisted of representatives of eleven countries. During the next five years it developed a proposed constitution for its successor, the International Federation of Accountants (IFAC). The new federation was formally established at the next international congress, held in Munich, Germany, in October 1977. At the end of 1980, the federation, based in New York, had seventy-six member bodies from fifty-eight countries and was engaged in a variety of activities to promote international harmonization, including the establishment of international auditing standards. In the years ahead, the federation should serve as a structure for achieving a truly international profession.
Institute Service by Members Not in Practice

An important event that attracted only limited attention at the time it occurred was the modification of the Institute’s bylaws in 1978 to permit members not in public practice to serve as AICPA officers or members of the trial board. Because nearly 46 percent of the Institute’s members are nonpractitioners, it can be expected that the chairman and other officers may be drawn from their ranks in the future. When this occurs, the AICPA will have achieved its long-term goal of full participation by all segments of the profession.

Association With Unaudited Financial Statements

A final development worthy of special note was the appointment of a new senior Institute committee to establish standards for the association of CPAs with unaudited financial statements of privately owned businesses. Its first pronouncement, Statement on Standards for Accounting and Review Services no. 1, was issued in December 1978. This pronouncement defined for the first time two specific types of unaudited financial statement engagements—reviews and compilations—and prescribed procedures and reports for both. The provision for differing levels of assurance points the way toward the tailoring of standards and engagements to fit the increasing variety of unaudited data with which CPAs are becoming associated.

These, briefly, have been the most salient occurrences of the 1970s, an uncomfortable period during which the profession made sweeping adjustments to meet new circumstances that resulted mainly from social, political, and business developments in the prior decade. It is to the profession’s credit that it was able to accomplish this transition through its own actions rather than through government fiat. Although external duress was involved, CPAs acted responsibly to redress the deficiencies that were identified by the scrutiny of members of the profession and outside parties.
The remainder of this book describes these developments in more detail. It is arranged by subject matter and is written from the perspective of the author, who was a participant during the entire period. The reader is cautioned to keep this in mind, since it is virtually impossible for anyone heavily involved in the affairs of the profession to be wholly objective, especially during such a time of great change.
CHAPTER 2

The Impact of Litigation Against Auditors

The plethora of civil liability and criminal lawsuits against CPA firms that began in the late 1960s and reached a peak early in the 1970s had a tremendous impact on the profession. Because the litigation involved major business failures, it attracted the attention of the financial press to auditors and accounting standards. The business failures also alerted the SEC, which brought enforcement and disciplinary proceedings against CPAs and their firms with increasing frequency, and Congress, which began to consider regulating the profession. This activity permanently altered the practice of public accounting.

The effects of litigation were the root causes of most of the changes that occurred in the profession during the 1970s. Auditors' responsibilities were broadened and more sharply defined by court decisions and SEC rulemaking. The establishment of financial accounting and reporting standards took on far greater importance, a development that led to the creation of the Financial Accounting Standards Board and to a host of detailed accounting and disclosure rules. This was perceived by many practitioners as an excess of standards, and it aggravated an already widening gulf between the large CPA firms auditing most publicly traded corporations and the rest of the practicing profession. The changed practice environment led to the establishment of a division for CPA firms with a separate section for SEC practice and to the imposition of peer reviews, which contributed, in turn, to increased internal disharmony within the profession.

It would be an overstatement to say that the lawsuits against CPA firms were the sole cause of the changes in the profession that occurred during the 1970s. To a great extent, the insurance
coverage of CPA firms, the actions of the SEC, the outcry in the press, and the effects of such events as the energy crisis and revelations of improper corporate payments were both causes and end results of litigation against auditors. But, it is indisputable that the lawsuits, in their turn, brought about important changes.

If one wishes to fully understand the profession's history during the 1970s, a study of the lawsuits against CPA firms is imperative. Space limitations and my lack of legal expertise make a definitive study of litigation against CPAs impracticable. What follows is a layman's account of how the AICPA participated in various lawsuits as a friend of the court by filing amicus curiae briefs on important issues affecting the responsibilities of auditors.

Continental Vending

The first such brief in the 1970s related to the Continental Vending case, in which two partners of Lybrand, Ross Brothers and Montgomery (later Coopers and Lybrand) were convicted of criminal fraud. The point at issue involved the question of what disclosures were required in financial statement footnotes about transactions between affiliated corporations and their officers. The profession had not established clearly defined rules for dealing with such related-party transactions, and the auditors in the case defended themselves on the grounds that they had complied with the profession's standards and had no intent to commit fraud. On the basis of the facts, however, the auditors were found guilty.

A subsequent appeal to the U.S. Court of Appeals was denied, and the defendants filed a writ of certiorari with the U.S. Supreme Court. The Institute filed an amicus curiae brief early in 1970 in support of the writ. It argued that the lower court had erred in determining that independent auditors had a duty to go beyond compliance with the profession's standards.

The writ was denied by the Supreme Court on March 30, 1970, putting the profession on notice that it could not rely solely on compliance with standards as a defense in litigation.

Needless to say, the profession was shocked by the outcome of this case. Few, if any, CPAs believed that the defendants had failed to meet their civil responsibilities as auditors, much less
been guilty of criminal conduct. "There but for the grace of God go I" was the almost universal reaction. Clearly, the words fairly presents in the auditor’s opinion had taken on new meaning, and the larger firms began to tighten their procedures to guard against becoming embroiled in similar litigation.

The Continental Vending case contributed to concern about what the profession viewed as excessive auditor exposure to liability under section 11 of the Securities Act of 1933. Section 11 placed the burden of proof in liability claims against auditors and other experts on the defendants, who had to show that they had acted with "due diligence." Because public offerings of securities involve huge sums of money, the potential exposure to liability is overwhelming.

The specter of CPA firms bankrupted by losses in liability suits caused the Institute’s Board of Directors, with the help of legal counsel, Covington and Burling, to consider seeking legislative relief. A study was made, and memorandums were presented to the chief accountant and general counsel of the SEC in September 1970. These measures were spearheaded by Ralph Kent, who had taken over as head of Arthur Young and Company. The proposal for legislative relief failed to win the commission’s support, and section 11 remains intact; nevertheless, the exercise alerted the commission to the problem and produced a more sympathetic attitude toward a limitation on liability when such a limitation was later included in a recodification of the securities acts proposed by the American Law Institute.

1136 Tenant’s Corporation v. Max Rothenberg & Company

The next amicus curiae brief filed by the Institute involved the 1136 Tenant’s Corporation v. Max Rothenberg & Company. The Rothenberg firm had prepared accounting records and unaudited financial statements for the client, 1136 Tenant’s Corporation. The CPA firm was charged with civil liability for failing to discover a defalcation by the corporation’s managing agent. Much to the astonishment of the profession, the CPA firm was found to be legally liable, and the judgment was affirmed on April 8, 1981, by the Appellate Division of the New York Trial Court.
When the New York Society of CPAs decided to file a brief in the appeal of this case, the AICPA, against the advice of legal counsel, decided to participate. It was argued that CPAs had little, if any, responsibility for errors in unaudited financial statements with which they were associated.

The trial court placed great emphasis on its construction of the tacit terms of the engagement of the CPA firm. There was no engagement letter, and the firm had billed for "audit services." The court concluded that one of the implied objectives of such an engagement was to guard against losses through defalcation.

The initial decision was upheld, and the profession had learned another important lesson: The legal responsibilities for CPAs associated with unaudited financial statements were apparently greater than was previously thought.

The case led to requirements by many CPA firms that their clients sign letters spelling out the terms of their engagements. The case also prompted the AICPA to appoint a committee to develop a guide for use by CPAs in the preparation of unaudited financial statements. For the first time, the AICPA suggested review procedures for nonaudit engagements in a guide that would later be superseded by pronouncements of the accounting and review services committee.

In their concern about the filing of briefs in cases in which the facts are somewhat unfavorable, the AICPA Board of Directors reexamined and finally reaffirmed its criteria for participation in litigation as a friend of the court. Under guidelines set in 1968, the board had decided that it would file briefs only in cases whose issues would have broad impact on the accounting profession. It would not seek to defend the position of CPA defendants and would not enter a case before the appeal stage. As a result of 1136 Tenants, the board further resolved to consider whether the general facts in a case would make amicus curiae participation undesirable.

**Herzfeld v. Laventhal, Krekstein, Horwath & Horwath**

The next case in which the Institute considered filing a brief was that of *Herzfeld v. Laventhal, Krekstein, Horwath & Horwath* in 1974.
In this case audited financial statements were used in connection with a private placement of securities of a corporation that subsequently went bankrupt. At issue was the adequacy of factual disclosure regarding a purported sale of real estate. The judge in the District Court, Southern District of New York, found the auditors liable for damages under the antifraud provisions of section 10(b) of the Securities Exchange Act of 1934 and SEC rule 10b-5.

One aspect of the case was particularly troubling. The auditors had qualified their opinion on the basis of the questionable collectibility of the amounts receivable from the sale of real estate, which were material to the financial statements. The judge held that an intent to mislead could be inferred from the mere fact that the auditors’ opinion was qualified.

Although the judge’s opinion seemed to go well beyond the normal auditor’s disclosure obligations, on one item not disclosed—namely, the net worth of the purchaser of the real estate—the court’s position seemed to be sound. Because the AICPA board did not feel it could take issue with this part of the decision, it decided not to file an amicus curiae brief in the appeal of this case. The board believed that to file a brief and remain silent on this critical point would hurt the defendant’s case. Although the inference of intent to mislead drawn from an unqualified auditor’s opinion was of considerable concern, the board felt that this point could be successfully overturned in other cases with different facts.

The Institute also declined to participate in a later petition for a rehearing of the case because the decision of the appellate court was partially based on different grounds than that of the trial court and was less objectionable from the standpoint of the profession.

National Student Marketing Corporation

The Institute filed several amicus curiae briefs in 1975. One was filed when a partner and an employee of Peat, Marwick, Mitchell and Co. involved in the audit of National Student Marketing Corporation appealed a trial court decision that found them guilty of criminal fraud. The case centered on audited and unaudited financial statements included in a National Student
Marketing Corporation proxy statement dated September 27, 1969. The unaudited financial statements later proved to be materially incorrect. The Institute's brief addressed only a single point, as follows:

The trial court did not instruct the jury on the lesser responsibilities of independent accountants with respect to unaudited financial statements and, by failing to do so, may well have led the jury to consider independent accountants to have the same responsibility for unaudited financial statements as the responsibility spelled out to the jury with regard to audited financial statements.

The appellate court specifically affirmed the appropriateness of the trial judge's charge to the jury but recognized that the independent accountant does not in ordinary circumstances have a duty to investigate the fairness of unaudited financial statements with which he may be associated. Nevertheless, the court suggested that, where the surrounding circumstances are sufficiently "suspicious," there does arise a duty to investigate the unaudited statements. The court affirmed in part and reversed and remanded in part the conviction of the two accountants.

Initially, the AICPA Board of Directors concluded that the profession could live with the appellate court's opinion regarding unaudited financial statements; however, under heavy pressure from the defendant's legal representatives, the board subsequently agreed to file a brief in connection with a petition to the U.S. Supreme Court for a writ of certiorari. The brief argued that clarification was needed since the appellate court's opinion contained conflicting conclusions about unaudited financial statements. It affirmed the trial judge's charge to the jury but also drew a distinction between audited and unaudited financial statements. The Institute also argued that an accountant should not be criminally liable merely because he has knowledge of suspicious circumstances regarding unaudited financial statements.

The defendant's petition was denied by the U.S. Supreme Court, and once again a criminal conviction of independent auditors was left standing.
Hochfelder v. Ernst & Ernst

A far more important case was that of Olga Hochfelder et al. v. Ernst & Ernst. In this case the auditors were charged with negligence and noncompliance with generally accepted auditing standards for not detecting and reporting an alleged inadequacy of a small brokerage firm's internal accounting controls. The plaintiffs, who had funds in an escrow account maintained by the president of the brokerage firm, sought to recover losses in a civil damage suit under section 10(b) of the Securities Exchange Act of 1934 and the SEC's rule 10b-5.

The U.S. Court of Appeals for the Seventh Circuit reversed a district court summary judgment in favor of the auditors, Ernst and Ernst. The appellate court held that liability for damages in a civil suit under the act can be predicated on negligence and that an auditor can be held liable on the basis of negligent failure to comply with generally accepted auditing standards. This decision contradicted a number of lower-court decisions and imposed a lower standard of proof for auditors as aiders and abettors under rule 10b-5 than the standard for those whose direct fraud they were accused of assisting. This was profoundly disturbing since auditors are almost always among the unwitting victims of fraud committed by their clients.

When the U.S. Supreme Court agreed to review the case, the AICPA filed an amicus curiae brief, which argued that liability for damages may not be imposed upon an auditor for aiding and abetting his client's violation of rule 10b-5 in the absence of knowledge of the client's fraudulent conduct and solely on the basis of negligent auditing. This time the Institute's brief was a success because the Supreme Court reversed the judgment of the appellate court. The Supreme Court held that scienter must be pleaded to sustain civil liability under section 10(b) and rule 10b-5. (Scienter was defined by the court as a mental state involving intent to deceive, manipulate, or defraud.)

This was a major victory for the profession, and there was a great feeling of comfort when the decision was announced early in 1976. The profession's satisfaction was offset, however, by the strong dissatisfaction of the SEC and members of Congress. Congressman John Moss and Senator Thomas Eagleton, among others, subsequently advocated the enactment of legislation to
eliminate proof of scienter as a requirement to sustain civil damage claims against auditors under the securities acts. Nevertheless, the *Hochfelder* decision remains intact, and there is no indication that it will be overturned by legislation.

**United States and Shea v. Coopers & Lybrand**

Another issue arose in 1975 when the Internal Revenue Service attempted to gain access to auditors' income tax accrual workpapers. The Internal Revenue Service brought suit in the U.S. district court in Colorado, seeking to enforce its subpoena of all the workpapers and files of Coopers and Lybrand relating to its audit of the financial statements of Johns-Manville Corporation for 1971 and 1972. The auditors, who had not prepared the company's tax returns, had complied in part with the subpoena but declined to provide workpapers or testify concerning the audit program and a tax pool analysis file with related papers.

The district court decision in *United States and Shea v. Coopers & Lybrand et al.* supported the position of Coopers & Lybrand and denied the petition of the Internal Revenue Service. As expected, the Internal Revenue Service appealed the decision in early 1976.

The federal taxation executive committee and several CPA firms urged the Institute board to file an amicus curiae brief in connection with the appeal. The tax committee was unalterably opposed to opening the tax accrual files of auditors to the scrutiny of the Internal Revenue Service because this would cause clients to withhold important tax information from their auditors. Such a result would not only make it more difficult to audit the propriety of tax accruals but would also lead to a transfer of tax planning engagements from CPAs to tax attorneys, whose confidentiality was legally protected. The board shared these concerns, and a brief was filed with the U.S. Court of Appeals for the Tenth Circuit in September 1976.

In February 1977 the appellate court affirmed the decision of the district court. For a time it appeared that the government would appeal the decision to the Supreme Court, but this did not occur. Apparently, the Internal Revenue Service decided to turn its attention to cases in which the facts were more favorable to its position.
United States and Murphy v. Arthur Andersen & Company

The Coopers and Lybrand case had established an important precedent, but it did not stop the Internal Revenue Service from continuing to seek access to auditors' complete workpapers and files relating to income tax accruals and tax planning. The issue was again addressed in *United States and Murphy v. Arthur Andersen & Company* in 1979, when the Internal Revenue Service sought to enforce its subpoena of the tax accrual records of the auditors of Good Hope Industries in the U.S. district court in Massachusetts. In responding, Arthur Andersen and Company cited the decision in the *Coopers & Lybrand* case and argued that the material it was withholding met the "not relevant" test under the standards previously enunciated by the U.S. Supreme Court. It asserted that the files in question were not used to prepare tax returns (although in this case the auditors had prepared the client's tax returns) and were therefore not relevant to the purpose of the Internal Revenue Service.

The district court ruled in favor of the Internal Revenue Service in July 1979. In doing so, it placed great emphasis on interpretation of the statutory language, "may be relevant," and refused to adopt the reasoning in the *Coopers & Lybrand* case. When Arthur Andersen and Company decided to appeal the decision to the U.S. Court of Appeals for the First Circuit, the AICPA filed an amicus curiae brief supporting the firm's position. Meanwhile, to avoid being found guilty of contempt of court, the firm complied with the I.R.S. demands. As a result, the appellate court dismissed the appeal on the grounds that the issue had become moot through compliance with the subpoena. In effect, the court said that a precondition of appellate review in a case of this sort was submission by the appellant to charges of contempt of court. This "catch 22" position left the district court decision unreviewed. After consideration, however, the CPA firm decided not to seek certiorari from the U.S. Supreme Court.

During 1980 and into 1981, internal revenue auditors increasingly sought access to CPAs' tax accrual workpapers. However, when Roscoe Egger, a top partner of Price Waterhouse, was appointed commissioner of the Internal Revenue Service in 1981, revised guidelines were issued to I.R.S. agents requiring them
to take a series of steps before, as a last resort, they request access to the independent auditor's tax accrual workpapers. This action may relieve some of the pressure, but the matter has not been resolved. Further litigation or legislation will no doubt occur before a final disposition is achieved.

**Tax Analysts and Advocates v. Internal Revenue Service**

Meanwhile, back in 1975, another case involving an issue relating to tax practice was *Tax Analysts and Advocates et al. v. Internal Revenue Service*. The plaintiffs were seeking public access, under the Freedom of Information Act, to approximately 160,000 unpublished private letter rulings issued by the Internal Revenue Service. This time, the Institute found itself at least partially supporting the position of the I.R.S.

In agreement with the Internal Revenue Service, the Institute filed an amicus curiae brief with the U.S. district court in the District of Columbia without waiting for an initial decision and an appeal. The brief urged that the identifying details in the unpublished rulings requested by the plaintiffs be deleted in certain circumstances, such as when a clearly unwarranted invasion of personal privacy would otherwise result. The Institute pointed out that the service's prior regulations had assured taxpayers and their advisers that the parties involved in private letter rulings would not be publicly identified. Taxpayers and their advisers had relied on such assurances, and a retroactive reversal of that policy would damage the public's confidence in the self-assessment system. The brief argued further that the Freedom of Information Act did not require that the identifying information be made public. In taking this position, the Institute was not advocating governmental secrecy or opposing publication of the private letter rulings but was attempting to forestall retroactive identification of the parties involved.

The district court ruled in November 1975 that the private letter rulings must be disclosed but conceded that "decisions on appropriate deletions to be made in the vast number of documents sought herein must be made by the Internal Revenue
Service and, eventually, reviewed by this Court where necessary. Although the court granted a stay in the proceedings to await the outcome of a related case, the private letter rulings were eventually made public with some deletions (determined administratively by the Internal Revenue Service).

Felix Kaufman v. Chief Judge Edelstein

A final case that surfaced in 1975 and resulted in the filing of a brief by the AICPA was Felix Kaufman v. Chief Judge David N. Edelstein. Mr. Kaufman, a partner and national director of management consulting at Coopers and Lybrand, sought to quash a subpoena to appear as an expert witness for the United States in an antitrust suit, United States v. I.B.M. Mr. Kaufman had no prior professional relationship with I.B.M. In a memorandum opinion, Judge Edelstein of the U.S. District Court for the Southern District of New York ruled that Mr. Kaufman was compelled to testify as an expert witness in the case. He based his ruling on the grounds that the testimony would be “highly productive and of assistance to the Court in the trial.”

This ruling concerned all professionals since the decision articulated a lower standard than that long upheld in the courts: namely, whether the testimony of a particular witness is necessary for disposition of a case. Without the higher standard, professionals could be forced almost indiscriminately to testify against their will as expert witnesses.

In January 1976 Mr. Kaufman filed a petition for a writ of mandamus in the U.S. Court of Appeals for the Second Circuit, seeking an order to Judge Edelstein to quash the subpoena. The Institute filed a supporting brief, arguing that a disinterested professional should be compelled to give expert testimony only if others of like qualifications are unavailable and the testimony is needed to reach a just result.

The petition was denied by the appellate court in April 1976, but the opinion was not completely clear about the standard it was applying in the denial. It concluded that the trial judge had not abused his right to exercise discretion and held that the district court had the power to issue a subpoena, at the request
of a party to civil litigation, requiring an expert to testify. It remains to be seen whether the sweeping nature of this opinion will be applied by district courts in the future.

Touche Ross v. SEC

During this period the Institute received many other requests to participate in litigation as a friend of the court. The AICPA Board of Directors declined these requests because the cases did not involve issues of broad importance to the profession or because the facts were unfavorable. One case in which the Institute declined to participate is worth mentioning: Touche Ross & Co. v. Securities and Exchange Commission.

On October 12, 1976, Touche Ross and Company brought an action in the U.S. District Court for the Southern District of New York to enjoin the SEC from bringing a public administrative proceeding against the firm pursuant to SEC rule 2(e). The firm challenged the legality of rule 2(e) and the holding of public proceedings under it.

The SEC had long contended that it had implied authority under the securities statutes to sanction professionals, but this had not been tested in the courts prior to this case. Thus, the firm’s complaint struck at the heart of the commission’s authority to regulate accountants practicing before it.

The commission moved for dismissal of the case on the grounds that the petitioner had failed to exhaust its administrative remedies by making a motion before the commission itself. The district court granted the commission’s motion, and the firm filed an appeal in the U.S. Court of Appeals for the Second Circuit. On May 10, 1979, the appellate court affirmed the decision of the lower court.

Shortly thereafter, Touche Ross agreed to a settlement under the rule 2(e) proceeding covered in Accounting Series Releases no. 153 and 153A. Among other things, the firm agreed not to seek judicial review of the appellate court decision and agreed to the performance of a peer review during 1979 under terms specified by the SEC.

Since the litigation was decided on procedural grounds, the legality of rule 2(e) remained untested. The Institute was ex-
tremely wary of becoming involved in this issue, partly because it seemed politically unwise to be challenging the SEC’s authority at a time when its support was vital to the Institute’s attempts to forestall legislation that would impose additional regulation on the profession. Equally important was the fear that if the Touche Ross suit were successful it would almost certainly trigger new legislation to grant the SEC explicit authority to regulate the profession. Such legislation might prove to be more stringent than the existing implied authority. In short, the case appeared to be a no-win situation, and some observers faulted Touche Ross for subordinating the interests of the profession to its own immediate interests.

The AICPA was sympathetic, however, to the firm’s objections to public proceedings. Public proceedings would improperly damage the reputation of a respondent CPA firm that is ultimately exonerated of the charges brought against it. Although the dismissal of the case left this matter unsettled, the commission subsequently backed away from a policy of public proceedings.


The Institute did participate in a different case involving Touche Ross and Company, Edward S. Redington, Trustee and Securities Investor Protection Corporation v. Touche Ross & Co. This case involved the liquidation of a brokerage firm, Weis Securities, whose officers had allegedly executed a scheme to conceal the firm’s dire financial condition and whose auditors were Touche Ross and Company. The trustee in the liquidation and the Securities Investor Protection Corporation (SIPC) sued the auditors for damages incurred by the customers of the brokerage firm on the grounds that the firm’s erroneous financial statements prevented the SIPC from taking timely action to avoid customer losses.

The District Court of the Southern District of New York dismissed the case. The plaintiffs appealed to the U.S. Court of Appeals for the Second Circuit, which reversed and remanded the case to the district court. Touche Ross then petitioned the
U.S. Supreme Court for certiorari, which the Court granted. It was at this juncture that the AICPA filed an amicus curiae brief in support of the position taken by Touche Ross.

The legal question at issue was whether a private right of action for damages could be judicially implied under section 17(a) of the Securities Exchange Act of 1934 in behalf of brokerage house customers against accountants in the absence of any allegation that the customers purchased or sold securities in reliance on the brokerage firm's financial statements. The appellate court had concluded that there was such an implied right, and this had far-reaching consequences for CPAs auditing all types of clients in addition to brokerage firms. In this instance the damages being claimed had been incurred not by investors in the audited firm but by its customers, and there was strong reason to doubt that section 17(a) was intended to cover such circumstances.

On June 18, 1979, the U.S. Supreme Court held that there was no implied private cause of action for damages under section 17(a), thereby reversing the judgment of the appellate court. This represented an important victory for the profession in preventing a serious expansion in its exposure to legal liability.


Another case in which the AICPA participated successfully was Adams et al. v. Standard Knitting Mills, in which Peat, Marwick, Mitchell and Co. was a codefendant. Peat, Marwick had audited the financial statements of Chadbourne, a hosiery manufacturer, which were included in a proxy statement with respect to a merger with Standard Knitting Mills. The plaintiffs, in behalf of the shareholders of Standard Knitting Mills, sought compensation under section 10(b) of the Securities Exchange Act of 1934 and rule 10b-5 for damages incurred in connection with the merger. The grounds for the complaint were allegations that the auditors failed to comply with generally accepted auditing standards with an intent to deceive. Included among the charges was an allegation that the auditors had a duty to report deficiencies in Chadbourne's internal controls in the audit report.

On May 19, 1976, the U.S. District Court of the Eastern
District of Maryland found in favor of the plaintiffs and ordered the award of damages. Included in the district court's opinion was the conclusion that the auditors had acted "wilfully with intent to 'deceive' and 'manipulate'" because they were aware of material weaknesses in Chadbourne's internal controls and failed to report them in their report on the financial statements. This clearly called for a response by the Institute since the profession had long contended that it was not responsible for auditing or reporting on internal accounting controls as a part of its reporting on audits of financial statements. Furthermore, the profession had consistently maintained that proper audits could be performed even though such controls might be lacking.

Peat, Marwick appealed the case to the U.S. Court of Appeals for the Sixth Circuit, and the AICPA filed an amicus curiae brief addressing the internal control issue. Fortunately, on May 2, 1980, the appellate court reversed the district court decision on the issue of the auditing firm's liability. In doing so, the court acknowledged that auditors might bring weaknesses of internal accounting control to the attention of management but that they are not necessarily obligated to inform the stockholders. This was a particularly welcome result because the SEC had been pressuring the Institute to require its members to comment on internal accounting control weaknesses in their reports on audits of financial statements.

In July 1980, shortly after the appellate court's decision, the Institute's Auditing Standards Board issued Statement on Auditing Standards no. 30, Reporting on Internal Accounting Control. The statement stopped well short of any obligation to report on internal accounting controls to shareholders in connection with audits of financial statements. However, in Statement on Auditing Standards no. 20, issued in August 1977, the board's predecessor committee had established a requirement to communicate to senior management and boards of directors or their audit committees material weaknesses in internal accounting controls detected during the course of audits of financial statements.

Cases Not Involving Accountants

On two occasions in 1980 the Institute sought permission to file briefs in support of petitions for writs of certiorari although
accountants were not involved as participants in the cases. These cases involved interpretations of the liability sections of the securities statutes that had significant bearing on the profession's exposure to liability.

In *Ross et al. v. A. H. Robins Company, Inc., et al.* the interplay between sections 18 and 10(b) of the Securities Exchange Act of 1934 was in dispute. This was important because section 18 requires plaintiffs to prove that they relied on filings with the commission to sustain claims for damages, whereas under section 10(b) such reliance is presumed if a material misrepresentation was established or the market price of publicly traded stock was affected.

In this case a district court dismissed an action under rule 10b-5 on the grounds that the conduct could have involved a violation of section 18 and under such circumstances section 18 provided the exclusive remedy. The U.S. court of appeals reversed this decision, and the AICPA sought permission to file a brief when the defendants petitioned the U.S. Supreme Court to hear the case. A brief was not filed because the Court denied the defendant's petition for review.

A somewhat similar action occurred in *Peter E. Aaron v. Securities and Exchange Commission*, in which the question at issue was whether proof of scienter was necessary for the SEC to obtain an injunction against stock fraud. This question had been left open by the *Hochfelder* case, in which the U.S. Supreme Court determined that scienter was necessary to sustain damages under rule 10b-5. The issue was of concern to CPA firms because they had been the targets of numerous injunctive actions brought by the SEC during the 1970s. If proof of intent to defraud was necessary, it would be more difficult for the SEC to sustain such injunctive actions.

The U.S. Court of Appeals for the Second Circuit held in March 1979 that the SEC need not prove scienter in its enforcement actions. The Institute filed an amicus curiae brief with the U.S. Supreme Court when a writ of certiorari was granted in the case. The brief argued that under section 21(d) of the 1934 act the SEC was required to prove scienter to sustain an injunction restraining acts or practices in violation of section 10(b) and rule 10b-5. The Supreme Court affirmed the decision of the appellate court, contrary to the position taken by the AICPA.
Effect of the Litigation

During the 1970s the Institute was only on the periphery of the litigation affecting accountants' liability, since its participation was not as a defendant but as a friend of the court in a relatively small number of lawsuits. The large national CPA firms, however, were defendants in literally hundreds of class-action and other civil-damage suits, which took a heavy toll in the diversion of partner time, legal fees, and rapid escalation in premiums and deductibles for liability insurance. Often, millions of dollars of damages were being claimed, and there was a real fear that one or more CPA firms might be bankrupted by the litigation.

The threat of severe financial damage and even bankruptcy caused CPA firms to tighten their policies and procedures to minimize the exposure to liability suits. New criteria for acceptance of clients, internal inspections of operating offices, independent engagement reviews, and heavy emphasis on liability risks in partner and staff training programs were among the steps taken by the firms. Acquisition and retention of clients became less important, and avoidance of lawsuits became an urgent priority. The concern about litigation led CPA firms to exhibit a better balance between service to clients and protection of the users of financial statements, a basic shift that was probably the most important development of the decade.

The lawsuits emphasized that the profession was indeed "public." This message was greatly reinforced when Congress carried out its inquiries about the profession and the SEC promised to more vigorously fulfill its oversight responsibilities. By that time, the CPA firms had already taken the steps necessary to avoid exposure to new litigation and had become acutely aware of their responsibilities under the securities acts. If any vestiges of complacency remained, they were eradicated by the actions of Congress and the SEC.

The profession would no doubt have preferred to avoid the painful legal liability experiences encountered during the 1970s. In retrospect, however, they helped the profession to reach a maturity that was necessary to meet the demands of a changing society. It was fortunate that the profession was able to adjust quickly, before the damage to its credibility became great enough to destroy public reliance on independent auditors.
CHAPTER 3

The Federal Government Examines the Profession

Much of the profession’s attention during the 1970s was centered on developments in Washington involving principally Congress, the Securities and Exchange Commission, the General Accounting Office, the Internal Revenue Service, the Department of Justice, and the Federal Trade Commission.

A More Effective Washington Office

At the outset of the decade, the Institute’s Washington office was ill-prepared to cope with the increased governmental pressures. The office was a small space shared with the National Automotive Dealers Association and located far from the center of governmental activities. The director of the Washington office devoted most of his energy to monitoring proposed legislation and regulatory agency rules that might affect the profession. He issued a steady stream of memorandums urging the AICPA’s officers to act on virtually every new development, however trivial. His efforts proved ineffective, largely because of the lack of discrimination and the high volume of alerts, and partly because those officers were located in New York and were burdened with other duties.

As a result, the Institute could not cope effectively with legislative proposals that threatened the profession’s interests. For example, the Institute failed in its attempt to forestall legislation creating the Cost Accounting Standards Board to establish uniform standards of accounting for the costs of negotiated defense contracts.

It became increasingly clear that the Washington office needed
a strong director with considerable authority who would act in conjunction with committees that worked closely with the various agencies and branches of government. Marshall Armstrong, who was then serving as AICPA president, ordered the staff to prepare a summary of all of the Institute’s Washington activities for study by the board of directors. This document was prepared and discussed during the course of 1971. Walter Oliphant, who succeeded Mr. Armstrong as president in October 1971, appointed a special committee to develop recommendations to improve the effectiveness of the Washington office.

Wholesale changes were implemented during the first half of 1972. Gilbert Simonetti, Jr., director of the federal taxation division, moved from the New York office to head the new effort as vice president in charge of federal government relations. Other experienced staff members were also transferred to Washington, and the Washington office received responsibility for staffing the federal taxation division and all committees and task forces maintaining liaison with the various governmental agencies. The office was moved to 1620 I Street, less than two blocks from the White House and readily accessible to all major governmental activities affecting the profession. The staff was quickly expanded to a total of about twenty-five, structured to cover the many segments of the executive and legislative branches of government. A new federal government relations executive committee was appointed, along with subcommittees to deal with the General Accounting Office, federally assisted programs, and several other special areas of government. The office began issuing a weekly newsletter to report concisely on new developments in the federal government that had a bearing on the profession.

By 1973 a completely revamped operation was functioning. Mr. Simonetti was making good progress toward establishing the necessary relationships to obtain vital information on a timely basis and to exercise influence in behalf of the profession. The capability of the office improved steadily during the following years, and I, as the Institute’s new full-time, paid president, began devoting an increasing portion of my attention to the growing demands in Washington.

Early in 1976, the AICPA Washington office entered a temporary hiatus when Mr. Simonetti left to join the Washington
office of Price Waterhouse and Company. The firm’s offer to Mr. Simonetti reflected the fact that many of the largest CPA firms had awakened to the need for strong representation in Washington and were seeking candidates for their staffs.

A special committee was appointed to seek a replacement. After an extensive search, the committee selected Theodore A. Barreaux, who was then director of congressional relations for the chairman of the SEC. Although only thirty-three years old, Mr. Barreaux brought to his new position a wealth of contacts, expertise, and political judgment that were to prove invaluable in the succeeding years. Mr. Barreaux became vice president for federal government relations on May 10, 1976.

**Increased Involvement With the Executive Branch**

The profession had long maintained close relations with the SEC, the IRS, and the General Accounting Office, but its contacts with the White House and the departments of the executive branch had been minimal, and its dealings with Congress had been confined to the expression of views on proposed tax legislation. This began to change in the early part of the decade when events forced the Institute to become more active.

Changes at the SEC led to greater interest in the profession. Andrew Barr, chief accountant of the SEC, retired after many years of service and was replaced by John C. Burton. In addition, for the first time a CPA commissioner was appointed: James Needham, the partner in charge of the New York office of A. M. Pullen and Company. The new lineup took a strong interest in the profession’s performance and launched several initiatives to improve the quality of financial reporting.

Maurice Stans, a former president of the AICPA, had become the commerce secretary under President Nixon. Mr. Stans arranged for the AICPA to receive a government grant to promote the ownership of businesses by minority groups. Also, when the Nixon administration imposed wage and price controls on the economy, Mr. Stans enlisted the aid of the Institute to form a group of CPAs to assist with the development of control guidelines.

This trend continued when William Seidman, head of Seid-
man and Seidman, joined President Ford's administration as a White House economic advisor. The Institute maintained close relations with Mr. Seidman and consulted with him on various matters.

Other steps were taken to maintain good relations with the White House. A group of leading CPAs participated in a White House conference on national issues. CPAs were recruited in every state to act as advisors to both parties in the presidential election campaign in 1976. A committee of CPA experts was appointed to advise President Carter on certain personal income tax matters. Some of these activities were coordinated through Richard Harden, CPA, a member of the AICPA and a prominent member of the White House staff. Working relations were also established with the new Reagan administration.

Congress and Accounting Standards for Oil and Gas Companies

Although relations with the executive branch improved, relations with Congress became ever more troublesome. In the early and mid 1970s, for the first time, Congress and the profession became embroiled over matters other than tax legislation. The major factor during this period was the drive to reform the securities markets, which resulted from the rash of broker-dealer failures beginning in the late 1960s. The first serious conflict, though, had its origin in the energy crisis of 1973 and 1974. The House Subcommittee on Oversight and Investigations, which oversees the SEC, began investigations of the oil and gas industry. Subcommittee Chairman John Moss discovered, to his dismay, that the major oil companies were not using uniform accounting standards in preparing their financial statements, making financial statistics for the industry unreliable.

On June 24, 1975, during the late stages of the development of the Energy Conservation and Oil Policy Act of 1975 (H. R. 7014), Congressman Moss introduced an amendment to correct the lack of accounting uniformity. The amendment mandated that the General Accounting Office establish uniform accounting standards for oil and gas companies and perform audits of companies engaged in the petroleum industry.
This action caused great alarm at the AICPA, the FASB, and the SEC. The Institute wrote a letter of protest to Mr. Moss on July 14, 1975, and enlisted the assistance of the state CPA societies in contacting the various members of the House Interstate and Foreign Commerce Committee, which was considering the legislation. The FASB, SEC, and GAO also filed objections to the amendment.

The Energy Policy and Conservation Act of 1975, which finally emerged from a conference committee on October 31, 1975, contained few of the objectionable features of the Moss amendment. It did, however, direct the SEC to see that uniform accounting standards were established within twenty-four months for the oil and gas industry. The act authorized the SEC to rely on the FASB for this purpose but required the commission to seek public comment on any proposal before taking final action.

The Institute emerged from this skirmish with a qualified victory, but it was only the beginning of a continuing series of encounters with Congressman Moss and other members of Congress.

Congressional Oversight of the SEC

During this period the House Subcommittee on Oversight and Investigations conducted a study of federal regulatory agencies, including the SEC, which touched upon corporate accountability and accounting and auditing matters. In conducting its hearings in the spring of 1976, the subcommittee invited a single CPA witness, Professor Abraham J. Briloff, to testify on accounting and auditing matters. Professor Briloff was a well-known critic of the profession with a knack for colorful phrasemaking. His testimony before the subcommittee was consistent with previous attacks on the effectiveness of the FASB and the work of the large CPA firms.

Upon learning of Professor Briloff's testimony, Theodore Barreaux and I met with a leading congressional staff member, Carolyn Emigh. We demanded to know why no other representative of the profession had been invited to testify and suggested that the subcommittee was confusing accounting
standards with auditing standards and the responsibilities of auditors to detect fraud.

Nevertheless, the subcommittee refused to allow testimony by additional witnesses. Ms. Emigh blamed the AICPA for not responding to the published announcement of the subcommittee hearings. Although she was technically correct, the announcement was misleading in that it related to matters of SEC oversight. Furthermore, it was inexcusable for the subcommittee not to seek other viewpoints.

The subcommittee issued its final report, *Federal Regulation and Regulatory Reforms*, in October 1976. Chapter 2 of the report, dealing generally with the SEC and corporate accountability, contained two extremely objectionable statements relating to the setting of accounting standards: "The FASB has accomplished virtually nothing toward resolving fundamental accounting problems," and "Considering the FASB's record, the SEC's continued reliance on the private accounting profession is questionable."

In a seven-page letter to Congressman Moss, FASB Chairman Marshall S. Armstrong objected to these statements and criticized the testimony of Professor Briloff. He also complained of not being given an opportunity to appear before the subcommittee to provide a rebuttal. Predictably, Mr. Armstrong's strongly worded letter drew no concessions from Congressman Moss. Professor Briloff responded in a speech on November 4, 1976, which was equally uncompromising.

The AICPA decided that entering this fray would not be very productive and elected to await a response to the subcommittee from the SEC.

Mr. Moss summarized the chapter 2 recommendations in a speech that he delivered on July 25, 1977:

Our report included recommendations that publicly owned corporations adopt and enforce codes of conduct; that independent auditors attest to the quality of internal controls and the quality of enforcement of those controls; that corporate boards review and approve the corporation's code of business conduct and system of internal controls; that corporations have audit committees, and that such committees have available to them independent advisors.

We also concluded that the SEC should play a more active role... with respect to the setting of accounting principles and the establishment of auditing standards. My Subcommittee concluded that the SEC should prescribe a framework within which the private
sector would set principles and standards. The SEC would establish parameters within which the private sector determines accounting principles and sets auditing standards. The SEC would suggest priorities based upon national and international needs. And the SEC would exercise in a much more vigorous fashion its oversight of proposed principles and standards and the operation of those already in place, exercising its right of pre-emption when necessary.

Mr. Moss went on to explain why his subcommittee had become concerned about the profession:

Congressional interest in accounting has built up over the better part of a decade. It began with the great scandals that have shaken our country over the past few years—Equity Funding; Penn Central; Four Seasons Nursing Homes; and National Student Marketing readily leap to mind. In all of those situations publicly-owned companies went bankrupt and caused substantial harm to investors with no prior warning from their independent auditors that anything was amiss. Those of us in Congress began to wonder where the auditors were during the period those companies were headed for their falls.

Interest was further aroused as we began to study particular industries and experienced difficulty working with the accounting methods used. In the securities industry, for example, we found certain capital rules that allowed firms to arrive at 8 or 9 different net capital ratios depending upon the methods they employed. This helped lead to the demise of over 100 brokerage firms in the late 1960s with resultant harm to their customers. We felt compelled to legislate in this area in the Securities Acts Amendments of 1975.

As the energy problem became clearer to us, we discovered that we were unable to obtain reliable data concerning companies involved in the energy industry. As a result, I proposed a provision in the Energy Policy and Conservation Act calling for certain uniform accounting procedures.

But the largest impetus to study the accounting profession came with the disclosure of the illegal and improper payments made by some of our nation’s largest and most prestigious corporations. Bribery, illegal political contributions, kickbacks, slush funds and secret bank accounts were matters that independent auditors either did not discover or did discover but chose not to publicly disclose.

Correspondence between the SEC and Mr. Moss subsequently revealed that the impact of the report would be more moderate than was initially feared. Nevertheless, it was sufficient to stimulate great concern at the SEC and the AICPA about the potential for unwanted legislation, and the report ultimately led to further subcommittee hearings on the profession early in 1978.
Corporate Governance and the Improper Payments Scandal

Meanwhile, also in the spring of 1976, the Senate Commerce Committee conducted hearings on corporate rights and responsibilities. The hearings focused on proposals contained in the Ralph Nader organization report, Federal Chartering of Corporations, a portion of which dealt with the appointment and rotation of auditors. On June 16, 1976, the AICPA testified in opposition to mandatory rotation of auditing firms and provided an analysis of the nature of auditor independence.

The hearings did not lead to proposed legislation, but they were indicative of the concern about corporate responsibilities and behavior that had resulted from recent scandals regarding improper corporate payments. The scandals surfaced in 1974 when the Watergate investigations revealed that illegal political contributions had been made by some of the largest blue chip corporations. Then came the discovery of unrecorded slush funds, secret bank accounts, and other devices to hide foreign and domestic bribes and kickbacks by over 200 major companies. The cry went up, "Where were the auditors?" and the financial press had a field day criticizing the corporate world and the profession.

The profession was ill-prepared to respond because it had been generally unaware that the practices existed. Most of the improper transactions went unrecorded and involved the collusion of top company officials. Such transactions are difficult, if not impossible, to detect in a normal audit of financial statements. Those transactions that were recorded generally were misclassified in the books and were not sufficiently material in amount to be caught in the net of the auditor's tests. Even when they were detected, no action was taken because the amounts involved had no material effect on the company's financial statements. Unfortunately, the public was unwilling to accept these explanations.

The SEC, a presidential task force, and Congress all scrambled to find a legislative panacea to prevent such corporate misbehavior in the future. Senators William Proxmire, Harrison Williams, and Frank Church and Congressman Bob Eckhardt were among the first to propose specific legislation, while the SEC worked feverishly to cope with the problem through investigations, enforcement proceedings, and a program of amnesty for corpo-
rations making voluntary disclosures. In a May 12, 1976, report to the Senate Banking, Housing, and Urban Affairs Committee, the SEC proposed its own legislation to amend section 13(b) of the 1934 Securities and Exchange Act. This proposal provided that it would be a criminal offense for registrants to perform certain acts relating to internal control systems, the maintenance of books and records, the falsification of books and records, or the misleading of independent auditors.

The accounting language of all the initial legislative proposals was so vague and sweeping that AICPA officers opposed the bills. Nevertheless, the Senate passed a composite bill containing the SEC's accounting provisions on September 15, 1976, by a vote of eighty-six to zero. The bill died in the last days of the ninety-fourth Congress when the House Subcommittee on Consumer Protection and Finance failed to secure a quorum to act on a companion bill. This represented a temporary victory for the AICPA, which was seeking a delay in order to modify the language of the bills. By this time it was clear that some form of legislation eventually would be adopted.

In January 1977 Senator Proxmire introduced a new bill (S.305), which again included the offensive accounting language proposed by the SEC. The AICPA's representatives tried once again to have the accounting provisions deleted. The attempt failed; however, over the strong objections of the SEC, they gained the support of Senator Proxmire and ultimately Congressman Eckhardt for suggested modifications in the accounting section of the bill. These modifications were the only ones to be adopted by the conference committee and incorporated in the final bill, which was enacted early in December 1977. Thus, the Foreign Corrupt Practices Act of 1977 omitted any reference to either the falsification of books and records or misrepresentations to independent auditors. The act incorporated the AICPA's suggestions for the language dealing with systems of internal control and the maintenance of books and records.

The new legislation caused widespread fears that the accounting provisions would result in criminal charges without regard to intent or traditional concepts of materiality. Because the appropriateness of internal accounting control systems is largely a judgmental matter and clerical errors in accounting records are inevitable, it was feared that hordes of corporations and individ-
uals would be convicted of violating the new law. To make matters worse, the SEC adopted rules, effective March 23, 1979, which made it clear that falsification of books and records and misrepresentations to auditors by officers and directors would not be tolerated.

Fortunately, the SEC exercised restraint in applying the new law. It was invoked in only a few cases, which involved other, more egregious acts. In January 1981 Chairman Williams indicated that the SEC would apply the law sparingly and only in combination with other violations of the securities acts.

This was where the matter stood early in 1981. The practical effect of the legislation was to generate engagements of CPA firms to review and report on corporate systems of internal accounting controls, but the real significance of the scandals was the damage done to the reputation of corporate officials and auditors. Investigations of the profession and demands for reforms in corporate governance continued throughout the late 1970s.

Another response to the scandals was the action of the Internal Revenue Service in April 1976: The service instructed its auditors to require corporate officers and independent auditors to answer eleven questions designed to elicit information leading to disallowance of deductions for income tax purposes. The profession strongly resisted this provision on the grounds that clients would become less cooperative and would thereby impair accountants' ability to conduct independent audits. After a series of meetings and letters, the IRS agreed to modify its policy and to accept a carefully worded representation by the audit partner in charge that he knew of no improper payments based on his best recollection, without referral to the audit working papers. The IRS and the larger CPA firms gradually worked out solutions to the problem on a case-by-case basis, and eventually the matter was resolved by concessions from both sides.

Metcalf Subcommittee Study of the Accounting Establishment

The loss of credibility resulting from the improper payments scandals helped motivate the Senate Subcommittee on Government Operations, chaired by Senator Lee Metcalf, to conduct a
study of the profession in 1976 and 1977. On May 7, 1976, Senator Metcalf sent a letter to the AICPA requesting answers to a number of questions about the Institute and its activities. This was followed by a questionnaire directed to CPA firms and others who had extensive knowledge about the profession.

During the following months the subcommittee's staff gathered a great deal of data about the profession. On December 7, 1976, an advance copy of a 1,760-page staff report entitled *The Accounting Establishment* was released to the AICPA. The report subsequently was released to the public and was almost as damaging to the profession as the Japanese attack on Pearl Harbor was to the U.S. Navy in 1941. In general, the facts and data contained in the report were accurate, but the conclusions drawn from the information were often either greatly exaggerated or completely off the mark.

In his covering letter, Senator Metcalf stated the following:

In particular, I am disturbed by two of the study's major findings. The first is the extraordinary manner in which the SEC has insisted upon delegating its public authority and responsibilities on accounting matters to private groups with obvious self-interest in the resolution of such matters. The second is the alarming lack of independence and lack of dedication to public protection shown by the large accounting firms which perform the key function of independently certifying the financial information reported by major corporations to the public.

Based upon its analysis of all the information reviewed during the course of this study, the subcommittee staff has prepared several recommendations which are designed to restore confidence in the integrity and usefulness of corporate financial reports, and help fulfill the intent of the Federal securities laws. I believe these recommendations serve as sound guidelines for action by Congress to achieve necessary reforms of accounting practices.

The report contained sixteen recommendations for reforms that would transfer complete control of the profession's affairs to the federal government. According to the subcommittee's staff, either the General Accounting Office or a separate board, similar to the Cost Accounting Standards Board, should establish financial accounting standards for publicly owned companies; Congress should establish comprehensive accounting objectives and abolish percentage-of-completion, inflation, and normalized accounting methods.

The report suggested that auditing standards should be set
by the GAO, the SEC, or federal statute and that the federal government should define the responsibilities of independent auditors to require assurance on the fairness of financial statements and on the completeness and accuracy of corporate records. If independent auditors cannot provide such assurance, the government should seek alternative methods of performing that function. The report suggested that the SEC should promulgate and enforce standards of conduct for auditors practicing before it and that it should specifically prohibit direct or indirect representation of clients' interests and performance of management advisory services for clients. The federal government should employ audit firms only to conduct audits and not for management advisory services.

The report recommended that Congress consider ways to increase competition between CPA firms, whether by requiring the rotation of auditors or by having more than one firm on the ballot for election by shareholders of SEC registrants. The Federal Trade Commission and the Department of Justice were urged to investigate the possibility of antitrust violations in the supply of accounting and auditing services and to act to relieve excessive concentration in the supply of such services to publicly owned corporations.

The report also urged that the fifteen largest CPA firms be required to file annual financial statements with the SEC and that periodic quality reviews of CPA firms auditing publicly owned companies should be made by the GAO, the SEC, or a special audit inspection agency. It was proposed that the SEC should impose equal sanctions on large and small CPA firms and that Congress should enact legislation to repeal the U.S. Supreme Court decision in the Hochfelder case, which limited the circumstances under which auditors would be legally liable. Finally, the report recommended that federal employees should not serve on AICPA committees.

Anyone familiar with the profession will recognize that these recommendations struck at the heart of virtually everything that CPAs viewed as crucial.

The AICPA was in the forefront of the profession's reactions. On January 17, 1977, Chairman Chetkovitch released a statement to the press disputing the conclusions of the staff report and suggesting that the recommended changes would impair rather
than improve the quality of financial reporting. Other steps were taken in anticipation of the subcommittee hearings, which were expected to be held in April: The Institute retained several special legal counsels whose congressional experience could prove helpful; visits were paid to key members of the Senate Government Operations Committee, including Senators Jackson, Nunn, and Percy, to discuss the AICPA’s concerns about the staff report; A. A. Sommer, Jr., a prominent securities lawyer and a former SEC commissioner, was engaged to help draft an in-depth response to *The Accounting Establishment*.

Senator Nunn requested the AICPA’s and the Financial Accounting Foundation’s comments on the subcommittee staff’s report and recommendations. Accordingly, on March 28, 1977, the Institute sent Senator Nunn a summary letter and an accompanying memorandum of comment, both of which were reproduced in a pamphlet distributed to all members of the AICPA. The pamphlet, entitled *The Institute Responds*, contained a ringing defense of the profession’s record, as well as arguments against adoption of the subcommittee staff’s recommendations.

**Metcalf Subcommittee Hearings**

The AICPA benefited from certain other steps that it had taken in 1976. Experience with Congressman Moss had convinced the Institute officers and board of directors that they should improve their ability to deal with Congress. A program had been organized through the state societies to identify CPAs who had close personal acquaintance with key members of Congress and who could be called upon to communicate the profession’s views. This became known as the *key person program*. Beginning in January 1977, AICPA staff members would meet annually with coordinators from the state societies to inform them of developments at the federal level and to enlist their assistance in dealing with Congress. The AICPA board also approved the establishment of a political action committee (PAC), a political fund-raising entity authorized by newly enacted laws governing federal elections. An initial appeal to AICPA members yielded over $60,000 to be used for contributions to the re-election campaigns of incumbent members of Congress who served on committees
having some relationship to matters involving the profession. Although the funds were used sparingly, they proved very useful in recognizing members of Congress who were sympathetic to the profession’s views. Finally, because it had become apparent that quick action was often necessary with respect to congressional initiatives, a special committee was formed to act in behalf of the board of directors when an issue could not await convening of the board.

All of these precautionary steps were brought into play when the Metcalf subcommittee held hearings in April, May, and June 1977. The first witness was Congressman Moss, followed by Professor Chatov from the School of Management, State University of New York at Buffalo, both of whom sharply criticized the profession. The other witnesses on the first day were the AICPA’s representatives, including Messrs. Chetkovich, Barreaux, and myself. The following individuals testified during the course of the hearings:

MARSHALL S. ARMSTRONG, FASB
ALVA O. WAY III, FAF Board of Trustees
GORDON ANDERSEN, CPA, Veltkamp, Dore & Co.
NORMAN J. ELLIOTT, CPA, Norman J. Elliott & Co.
ROBERT A. SATIN, CPA, Local Practitioners Action Forum
THOMAS S. WATSON, JR., CPA, Watson, Rice & Co.
JOHN C. BIEGLER, CPA, Price Waterhouse & Co.
JAMES FITZPATRICK, Esq., Arnold & Porter
ROBERT HALF, Robert Half Personnel Agencies, Inc.
THEODORE BARRY, Theodore Barry & Associates
WILLIAM R. METTE, JR., CPA, Alexander Grant & Co.
J. B. DRESSELHAUS, CPA, Associated Accounting Firms International
IRVING KELLOGG, CPA, Kellogg & Anderson
NORMAN H. STAVISKY, CPA, Stavisky, Shapiro & Whyte
WALTER E. HANSON, CPA, Peat, Marwick, Mitchell & Co.
RUDOLPH J. PASSERO, National Society of Public Accountants
CHARLES T. HORNGREN, CPA, American Accounting Assn.
CHARLES C. HORNBOSTEL, Financial Executives Inst.
WILLIAM M. YOUNG, JR., National Assn. of Accountants
HARVEY KAPNICK, CPA, Arthur Andersen & Co.
The testimony of Chairman Williams and the other SEC commissioners was significant because it staked out a position that simultaneously placed severe pressure on the profession to initiate changes and urged Congress to defer consideration of regulatory legislation. To persuade Congress to hold off, the commission had to promise that it would become more aggressive in its oversight, which was a tacit admission that it had been lax in meeting its oversight responsibility. Chairman Williams discussed the subjects of independence, accounting and auditing standards, and discipline and suggested how improvements could be accomplished. His testimony is summarized in the following quotation:
The crux of the Commission testimony this morning has several dimensions:

1. Time is running and the need for substantive progress is great.
2. It is desirable that the establishment of accounting and auditing standards continue to be primarily a private sector responsibility with active SEC oversight. No one knows the problems better than the profession, or is able to deal with them if it is motivated to do so.
3. The Commission has not always been diligent in pressing to secure timely address and resolution of accounting issues. It intends to pursue a vigorous program in the future as it has for the past period of years.

Mr. Williams concluded by indicating that the commission would submit an annual report (beginning July 1, 1978) to the subcommittee analyzing the progress being made by the commission and the profession. The following statement is taken from the commission's written submission:

Some witnesses have suggested that a legislative restructuring of the accounting profession, designed to place it more closely under federal control, is necessary. While this may ultimately prove to be the case, there are certain specific steps which the profession and the Commission should take, within the framework of the profession's present structure, which could obviate the need for increased federal regulation. Accordingly, the Commission recommends that the profession be given some fixed period of time, probably one year, to initiate positive and effective action. At that time, Congress should review whether the profession has demonstrated the capability to unite voluntarily behind constructive responses to the challenges it faces or whether legislative action is necessary.

The CPAs who appeared before the subcommittee were far from uniform in their positions. Most opposed portions of the staff recommendations, and nearly all suggested changes in the profession. In general, representatives of the smaller firms agreed with the report's conclusions that the large CPA firms controlled the AICPA and the profession, and they complained about what they considered to be unfair competitive practices. Representatives of large firms tended to dispute the staff's conclusions about the profession and appeared to vie with each other in suggesting programs for improvement. Unfortunately, no consistent pattern of recommended changes arose; by the time the hearings had concluded, the CPA witnesses had suggested virtually every imaginable reform.
The most surprising testimony was that of John Biegler, head of Price Waterhouse, who called for legislation to require CPA firms practicing before the SEC to formally register with the commission. Such firms would also be required to have a quality review every three years and to file annual financial statements with the SEC. Under the proposal, the requirements for smaller firms could be made less stringent, and information relating to the business affairs of clients would be confidential.

This proposal outraged other large firms, and the Institute’s officers and directors were almost equally dismayed. Furthermore, most firms objected to further control by the SEC, and several of them were adamantly opposed to making public their financial statements.

Some observers suspected that the Price Waterhouse proposals were partially motivated by the fact that the firm had been singled out for criticism by the subcommittee’s staff because it had audited several large companies that had made improper payments. Those who were closely acquainted with the firm’s top partners, however, were convinced that the firm sincerely believed that the proposed legislation was the best long-run solution and had a good chance of being adopted without unwanted amendments—a view apparently based on the premise that any voluntary regulatory program would prove ineffective.

The testimony of Harvey Kapnick, head of Arthur Andersen and Company, was also somewhat surprising. He suggested that the profession be given a year to develop a better self-regulatory system within the framework of the AICPA. Previously, Mr. Kapnick had been quite critical of the Institute, and he was generally regarded as a maverick bent on taking unilateral action. His public pledge to support a new effort within the Institute was a welcome note at a time when it was badly needed.

The Profession's Response

As the hearings continued in May and June, it was clear that the profession could not stand pat, since the risk that both the SEC and members of Congress would conclude that legislative reforms were necessary was too great. Furthermore, nearly all the large firms had implied that changes were necessary.

By the end of May, Chairman Chetkovich and I had sifted
through the many recommendations and had developed a comprehensive program of proposed changes. Included in that program were proposals to establish two divisions for CPA firms within the AICPA, to add three public members to the Institute's Board of Directors, to open meetings of the AICPA senior committees and Council to the public, and to mandate the publication of names of members found guilty of violating the code of professional ethics. Other proposals would repeal prohibitions on advertising and on employment offers to staff members of other CPA firms.

By October 1977 a program of far-reaching changes had been approved by the Institute Council, and the profession was embarked on a course that had the qualified approval of the SEC. Congressman Moss, however, remained unconvinced; in speeches and correspondence, he expressed strong reservations about many aspects of the new SEC practice section of the division for CPA firms and continued to push for a greater role for the SEC. On November 16, 1977, Mr. Moss summed up his reservations in a speech before an Intermountain Accounting Seminar in Utah:

I am on record as having stated that I would hold Subcommittee hearings this fall if I were not satisfied with the results of the AICPA Annual Meeting. It is clear that I am not totally satisfied. However, I have been advised by the AICPA that between now and January the Executive Committee, the Peer Review Committee, and the Public Oversight Board and their respective staffs will be in place for both the SEC and Private Practice Sections of the Division. In addition, their rules and regulations should also be in place. I will expect a visible trail of progress to be evident at that time and, consequently, I have rescheduled my hearings for late January.

But the final countdown is on. If after our January hearings I am not convinced that the AICPA's self-regulatory measures will be effective and the SEC is not actively and aggressively exercising its legislative authority to monitor the accounting profession and protect the public, I shall not hesitate to introduce the legislation I have drafted that would require them to do so.

**Metcalf Subcommittee Report**

This statement was made shortly after the report of the Metcalf subcommittee was issued on November 4, 1977, summarizing
the conclusions and recommendations reached on the basis of the hearings held during the preceding May and June. The report, concluding that smaller CPA firms have interests and needs that often differ greatly from those of larger firms, claimed to apply only to that segment of the profession serving publicly owned corporations. It recommended that there be "sensible provisions to ease compliance with standards and procedures for accounting firms with only a few publicly owned corporate clients."

The report concluded that an organization of accounting firms should be established, comprising all firms that serve, or want to serve, as independent auditors for publicly held corporations. Membership would be mandatory. The member firms' annual financial statements would be made public, and teams including nonaccountants would conduct quality reviews of member firms every three years. Reports on the quality reviews would be supplied to the SEC, which would be responsible for oversight of the organization. The organization itself would have the power to impose sanctions for substandard performance. Disciplinary proceedings against member firms should not await the outcome of litigation.

The report recommended several actions relating to auditing. A new standard-setting process should be established, featuring due process, a broad representation of interests, and sufficient staff and funds. The standard auditor's report should be improved, and the partner in charge of an audit should sign the report. Auditors should be held legally liable for simple negligence, with no limit to the amount of their liability. Among other things, auditors would be expected to monitor the abuse of perquisites by corporate executives and report all illegal activities to audit committees and appropriate government authorities; all publicly held corporations would be required to have independent audit committees. Finally, audit personnel should be rotated from year to year.

The report proposed measures to increase auditor independence. It proposed confining management advisory services to computer and systems analyses that are necessary for improving internal control procedures and suggested that the SEC should impose restrictions in this area. In addition, the report maintained that audit firms should not place their employees with clients.
The subcommittee concluded that the profession's restraints on advertising should be removed, and it recommended the establishment of professional schools of accounting.

The report concluded with these words: "The amount of time for achieving reforms is not unlimited. Therefore, the subcommittee expects the accounting profession and the SEC to act in a timely manner to implement the policy goals in this report."

Many of the subcommittee's recommendations were strongly opposed by the Institute's governing bodies. There was grave concern within the profession that the Moss subcommittee would use the report as a form of checklist during its hearings in January 1978. In response, the AICPA decided to prepare a progress report emphasizing all the initiatives that it had taken. Accordingly, Report of Progress—The Institute Acts on Recommendations for Improvements in the Profession was published on January 30, 1978. This was submitted to the Moss subcommittee and included as a part of the record of its hearings held in January, February, and March 1978.

Moss Sub委员会 Hearings

Hearings began on January 30, 1978. The witnesses on the first day were as follows:

Senator Percy, Metcalf subcommittee
Stanley Scott, AICPA
Wallace E. Olson, AICPA
Walter Hanson, SEC practice section
Donald Neebes, Peer review committee of SEC practice section
John McCloy, Public oversight board
Ray Garrett, Jr., Public oversight board
Harvey Kapnick, Arthur Andersen & Co.

It was a cold January day, and the draft from windows behind the hearing panel apparently aggravated the condition of Mr. Moss, who was recovering from a bout with influenza. Those familiar with Mr. Moss's normal aggressiveness attributed his uncharacteristic docility on that day to the state of his health. Indeed, he became ill and failed to appear on the next two days, when the hearings were chaired by other members of the subcommittee.
The principal interrogator on the first day was the head of Mr. Moss's staff, James Nelligan, who had developed a strong interest in the profession. The bulk of his questioning was aimed at discrediting the workability and effectiveness of the new AICPA Division for CPA Firms and the public oversight board of the SEC practice section. The testimony of the representatives of the AICPA, the SEC practice section, the public oversight board, and Arthur Andersen and Company was directed toward defending the Institute's program of self-regulation and urging that no legislation be introduced until the profession's initiatives had been given time to succeed.

In subsequent testimony, members of the Securities Exchange Commission also recommended postponement of any legislation. The commission, however, criticized the SEC practice section on several counts, maintaining that quality reviews of one firm by another lacked credibility and that the public oversight board should be given line authority over quality reviews and sanctions to offset the influence of the large firms. They also suggested that work performed outside the United States should be subject to quality reviews. The SEC should be given full access to quality review working papers; disciplinary cases should not be delayed pending the outcome of litigation; and the AICPA should require that, in order for an SEC registrant to be audited, the registrant must have an audit committee. SEC Chairman Williams also indicated that he expected various procedural matters to be resolved promptly so that quality reviews would begin during 1978. He closed by stating that if the Institute's program did not meet the commission's expectations, it would recommend some form of regulatory legislation.

Other witnesses who appeared at the hearings were—

Eli Mason, Mason & Company
Joseph Alam, Alam, Morris & Company
Alan Brout, Brout & Company
Charles Kaiser, Harris Kerr Forster & Co.
Norman Auerbach, Coopers & Lybrand
Professor John C. Burton, Columbia University

Messrs. Mason and Burton offered their own plans for regulation of the profession, which would entail legislative implementation. Messrs. Alam, Brout, and Kaiser criticized the AICPA and the division for CPA firms and complained about what they
considered to be unfair competition on the part of the large CPA firms. Mr. Auerbach defended the performance of management advisory services by auditors and expressed concern about the impact of various proposals on the ability of smaller firms to compete. He also urged that a small full-time panel be established under the Financial Accounting Foundation to set auditing standards.

Chairman Moss closed the hearings on March 3, 1978, with a promise that a report on the hearings would be prepared. He was clearly unimpressed with what the profession had accomplished and expressed great concern about the competitive problems of the smaller CPA firms and what he believed to be the excessive power and control of the large firms. He finished by promising to introduce legislation to regulate the profession.

**The Moss Bill (H.R. 13175)**

Mr. Moss proved to be a man of his word. On June 16, 1978, he introduced the public accounting regulatory bill (H.R. 13175), which proposed the establishment of a National Organization of Securities and Exchange Commission Accountancy (NOSECA). Under the provisions of the bill, the NOSECA would be established under the rule-making authority of the SEC and would be under SEC oversight. Membership in the NOSECA would be mandatory for all CPA firms practicing before the SEC unless they had no more than five SEC clients, none of which had total assets in excess of $5 million. The NOSECA would be governed by a five-member board appointed by the SEC—two members from CPA firms, two from outside the profession, and one not engaged in public practice. It would employ a staff and assess sufficient dues to operate on a self-financing basis. The organization would require members to submit information, including lists of their SEC clients and the annual financial statements of their firms; would require quality reviews of member firms every three years; and would conduct investigations and disciplinary proceedings and impose sanctions in cases involving noncompliance with auditing and accounting standards.

In addition, the bill would require the SEC to compile lists of needed auditing and accounting standards, to set priorities, to
monitor the progress of bodies designated by the commission to set such standards, and to take independent action when necessary. Each SEC registrant would be required to establish an audit committee composed of independent directors. The bill would allow CPA firms to audit SEC clients across state lines without being licensed in the different states.

Under the provisions, a CPA firm would be legally liable to private parties for damages resulting from reliance on the firm’s audit report if the firm was negligent in preparing the report. Foreign accounting firms performing audits included in filings with the SEC would be subject to the same membership and liability provisions as domestic firms.

The legislation would have placed both the standard-setting bodies and CPA firms practicing before the SEC more squarely under the direct authority of the commission and would have diluted the authority of the state boards of accountancy and substantially weakened the AICPA. Registration with the SEC was only a short step from national licensing and federal control of the CPA examination, and the NOSECA disciplinary proceedings would almost certainly replace those of the AICPA. The possibility of such legislation was a frightening prospect to nearly everyone connected with the profession, with the exception of those practitioners who would welcome more governmental regulation of the large firms in the dubious belief that the smaller firms would not be affected.

The bill, cosponsored by Mr. Moss and four congressmen on his subcommittee, was referred to the House Committee on Interstate and Foreign Commerce. Fortunately for the profession, the committee spent the balance of 1978 dealing with President Carter’s program to solve the country’s energy crisis. As a result, the Moss bill remained stuck in committee and died with the expiration of the ninety-fifth Congress at the end of 1978.

Additional Moss Subcommittee Hearings

After receiving the SEC’s first annual report, which described the issues that needed to be resolved before the SEC could give its unqualified approval to the AICPA’s self-regulatory program, Mr. Moss scheduled another day of hearings. On July 28, 1978, he
opened the hearings by questioning the effectiveness of the Institute’s self-regulatory measures and, in particular, its peer review program.

In the June 2 letter, the SEC Chairman stated:

"From the beginning, we have urged that an effective peer review program required rigorous standards of quality control and a process characterized by independence both in appearance and fact. Unfortunately, over the past several weeks, we have seen an increasing rigidity in the Institute's approach to these important objectives."

In addition to these strong views, the Chairman added that the profession's self-regulatory program "now stands perilously close to being reduced to a self-serving effort conducted behind closed doors."

How the Institute’s increasing rigidity in opposition to meaningful self-regulation can be interpreted by the SEC as sufficient progress is somewhat mystifying.

Clearly, the commission’s strategy of keeping strong pressure on the profession was coming dangerously close to making untenable its posture of continuing support for the Institute’s program. It was mainly through the adept testimony of the witnesses that such a result was avoided.

The witnesses during this final day of Moss hearings were as follows:

DONALD NEEBES, Peer review com. of the SEC practice section
WILLIAM L. CARY, Public oversight board
RAY GARRETT, JR., Public oversight board
JOHN D. HARPER, Public oversight board
ARTHUR M. WOOD, Public oversight board
HAROLD M. WILLIAMS, SEC
CLARENCE A. Sampson, SEC

The bulk of the questioning was carried out in behalf of the subcommittee by James L. Nelligan. Mr. Neebes described in detail the progress that had been achieved in implementation of quality reviews and resolution of the issues raised by the SEC. The public oversight board members gave details about the operations of the board and its progress to date. The SEC chairman devoted most of his responses to extricating the commission from the corner it had painted itself into by the severity of its criticisms.
At 1:45 p.m. the hearings were quietly adjourned with no indication of what might follow. It later proved to be the point at which the peak of congressional interest had passed. Congressman Moss did not seek reelection and Senator Metcalf died in December 1977. However, it was not the last of the congressional hearings about the profession.

**Eagleton Subcommittee Hearings**

After the death of Senator Metcalf, there was some confusion about the fate of his subcommittee. Eventually, it was discharged, and its responsibilities were assigned to various other panels. Those matters pertaining to accounting and auditing were assigned to the subcommittee on governmental efficiency and the District of Columbia of the Senate Committee on Governmental Affairs. This subcommittee was chaired by Senator Thomas Eagleton, who had played a prominent role in dealing with the accounting and auditing problems of the financially beleaguered District of Columbia. The reassignment included the transfer to the subcommittee's staff of John Chesson, who had authored the Metcalf staff study, *The Accounting Establishment*.

Senator Eagleton, assisted by Mr. Chesson, promptly launched a new investigation of the profession. On April 3, 1978, he mailed questionnaires to the AICPA and a number of CPA firms. The one directed to the AICPA contained fifty-four questions mainly regarding actions taken in response to the recommendations of the Metcalf subcommittee. After receiving responses to the inquiries, Chairman Eagleton scheduled hearings for August 1 and 2, 1979.

In meetings with Senator Eagleton before the hearings, AICPA representatives determined that his principal interests were threefold: legal liability of auditors on the basis of negligence, limitations on management advisory services by auditors, and the duty of auditors to report criminal or illegal acts. These interests were the main focus of the questions directed to the witnesses by Mr. Eagleton during the course of the hearings.

SEC Chairman Harold Williams was the first witness. He expressed the SEC's continuing qualified support for the profes-
sion's self-regulatory program. He also explained the commission's position regarding the three issues identified by Mr. Eagleton. In general, Mr. Williams' testimony was supportive of the profession and less critical than in earlier hearings. Senator Eagleton was visibly dissatisfied with the chairman's responses and, at one point, accused the SEC of having a "ho-hum attitude."

The second group of witnesses were the representatives of the AICPA, who once again explained the profession's progress toward implementation of its self-regulatory program.

The next witness was Ray Garrett, Jr., vice chairman of the public oversight board, who related the actions taken to date by the board and reviewed the results of its study of the impact of management advisory services on the independence of auditors. Mr. Garrett gave very lucid answers to questions about auditors' independence and legal liability, and his obvious expertise seemed to have a considerable effect on Senator Eagleton.

The succeeding witnesses addressed questions relating to their particular interests, including the prohibition of management advisory services by auditors, the setting of accounting standards, the Federal Trade Commission study of the profession, the competitive problems of practitioners in smaller firms, and accounting standards for state and local governments. Of prime interest to the AICPA was Paul Turley's report on the Federal Trade Commission investigation of the profession begun in March 1977. After studying the profession's actions to remove restrictions on advertising, solicitation, encroachment, competitive bidding, and other business activities, the FTC staff had concluded that direct governmental intervention was unnecessary. Although the AICPA previously had general information about the study, this was the first official word about its scope and conclusions.

The hearings were adjourned on August 2, 1979, with no indication of what further action the subcommittee might take. Sometime later, Mr. Chesson, who had played such a leading role in the congressional investigations of the profession, left the subcommittee staff for other employment. As a result, no report on the hearings was issued, and Senator Eagleton was diverted by other, more urgent matters.
Relief and Continued Vigilance

By the end of 1979, it was apparent that the period of high congressional interest had come to an end, at least for the time being. Only the SEC's promise to file annual progress reports with Congress remained as a potential source of renewed activity.

By early 1981 there was reason to hope that the reports would be discontinued. Chairman Williams resigned, effective March 1, 1981, and the commission's staff showed signs of becoming weary of preparing annual reports. The new administration under President Reagan was dedicated to a philosophy of deregulation, and it seemed unlikely that the changed Congress would initiate new investigations of the profession in the near future.

Nevertheless, the profession knew that it must continue to exercise strong self-regulation and to maintain good relations with Congress. The AICPA Board of Directors had this in mind when it authorized a program, proposed by me, to hold periodic breakfast meetings with state delegations of senators and congressmen, one state at a time. The first such breakfast was held at the Capitol building on March 22, 1979, with members of Congress from Maryland. Key CPAs from the Maryland society were present, and the participants offered to assist Congress in the areas of the profession's expertise. By the end of 1980, more than twenty states had been covered. All of the congressional delegations seemed pleased, and several requests for assistance resulted from the effort. The AICPA hoped that the profession could, over time, position itself as a friend of government and find a way to contribute its skills toward solving some of the difficult problems facing the nation.

At the moment, all was calm on the Washington front with respect to the profession. The storm that began in 1974 and lasted until the fall of 1979 had been weathered, but it had left a great deal of change in its wake: quality reviews by peers, a structure to regulate CPA firms, removal of virtually all restrictions on competition, operation in the "sunshine," and the inclusion of public members on the Institute's Board of Directors and Council. The profession had come to a much clearer understanding of what is expected of it and had gained maturity in dealing with the federal government.
The Setting of Accounting Standards

The Accounting Principles Board

When the Accounting Principles Board was established to succeed the accounting procedures committee in 1959, there was great hope that the new structure would satisfy the growing concern about the reliability of financial reporting and the availability of alternatives among generally accepted accounting standards. For a variety of reasons, these expectations were not fully met.

One limiting factor was the lack of consensus about the board's objectives. One group of CPAs believed that the board should establish only broad accounting principles, leaving their application in specific circumstances to CPAs' professional judgment. They believed that the development of detailed rules would reduce auditing to a mechanical function rather than a professional activity. Other accountants believed that specific rules were required if the number of alternative accounting treatments was to be reduced and financial statements were to be prepared on a comparable basis.

This sharp difference about the desirable degree of specificity in accounting standards led to a bitter debate at the May 1964 meeting of the Institute's governing Council. It was proposed that the board's opinions be made enforceable, but supporters of a "broad principles" approach viewed enforceability as an additional step toward the elimination of professional judgment in the financial reporting process. A shattering split within the profession was narrowly averted when the Council adopted the following compromise resolution:

RESOLVED, That it is the sense of this Council that audit reports of
members should disclose material departures from Opinions of the Accounting Principles Board, and that the president is hereby authorized to appoint a special committee to recommend to Council appropriate methods for implementing the substance of this resolution.

A special committee was subsequently appointed, and its report defined generally accepted accounting principles as those that had substantial authoritative support. The report stated that opinions of the Accounting Principles Board constituted substantial authoritative support and that substantial authoritative support could exist also for accounting principles that differed from opinions of the Accounting Principles Board. The report advocated that members disclose in their reports, or require the entity to disclose in financial statement footnotes, departures from Accounting Principles Board opinions and, where practicable, the effects on the financial statements. This procedure would be followed only if a member was satisfied that the accounting principle being applied had substantial authoritative support; otherwise, a qualified or adverse opinion would be required.

The committee's recommendations were approved by the Council in October 1964. This action increased the authority of the Accounting Principles Board but stopped short of making its opinions enforceable under the code of professional ethics. The concept of substantial authoritative support, which had its origin in SEC Accounting Series Release no. 4, issued in 1938, was sufficiently broad and flexible to be adopted by Council without a dissenting vote.

Another factor contributing to the APB's ultimate downfall was the early undermining of its authority by the SEC. In January 1963, the SEC issued Accounting Series Release no. 96, overruling APB Opinion no. 2, which required the deferral of investment tax credits over the useful lives of the assets to which they applied. The SEC release allowed either deferral or immediate recognition of the tax credits. The APB was forced to issue APB Opinion no. 4 to bring its prior opinion into conformity with the policy adopted by the SEC. Because this was a hotly contested accounting issue at the time, the SEC action was widely viewed as a serious blow to the authority of the APB.

A much more serious problem, though, was the continued
use of diverse accounting methods. The boom in corporate mergers and acquisitions during the late 1960s highlighted the fact that widely differing financial results could be achieved through use of either the pooling or the purchase accounting method. Also, the manner in which goodwill was calculated and accounted for in business acquisitions provided opportunities for the manipulation of earnings. These problems attracted a great deal of critical attention in the financial press.

During the 1960s many companies engaged in what became known as "shopping for accounting principles." If a company's auditors refused to issue an unqualified opinion because they disagreed with management's accounting treatments, the company sought other auditors that might be more agreeable. In determining compliance with generally accepted accounting principles having substantial authoritative support, auditors often reached different conclusions. This rather embarrassing difference in the exercise of professional judgment was made possible by the leeway built into the concept of substantial authoritative support. Auditors were content to determine whether management had complied with generally accepted accounting principles, and they refused to make subjective judgments about whether financial statements were fair or not misleading on an overall basis.

The shopping practices contributed to widespread discontent with the quality of financial reporting and the manner in which accounting standards were being established. Some leaders of the profession publicly criticized the APB. They were joined by a chorus of financial reporters, financial officers in industry, financial analysts, and academicians. Some critics called for establishment of an accounting court to settle accounting disputes. Others deplored the ad hoc approach to dealing with individual accounting issues and called for the development of a basic set of accounting principles or concepts to serve as a consistent framework for the setting of individual standards.

By 1969 it had become clear that the elimination of financial reporting abuses required accounting standards consisting of specific, enforceable, detailed rules. The APB had long since adopted a specific rulemaking approach. What remained was the problem of explicit enforceability. At its May 1969 meeting,
Council authorized a mail ballot of the AICPA membership on the following amendment to rule 202(e) of the Institute's code of professional ethics:

In expressing an opinion on representations in financial statements which he has examined, a member or associate may be held guilty of an act discreditable to the profession if:

- he fails to disclose in his report, when material in effect:
  1. the omission of any generally accepted auditing procedure applicable in the circumstances; or
  2. the use of any accounting principle which departs from generally accepted authoritative accounting principles because it lacks substantial authoritative support, in which case he must also either qualify his opinion or give an adverse opinion as appropriate; or
  3. unless otherwise disclosed in the financial statements, the use of any generally accepted accounting principle which differs from an Opinion of the Accounting Principles Board but which has other substantial authoritative support.

Disclosure must be made in his report or in the financial statements of the approximate effect of the departures under (2) and (3), or a statement made as to the impracticability of determining such effect.

Approval by two-thirds of those voting was required for adoption, and the amendment failed by a vote of 66.1 percent for and 33.9 percent against. Apparently, a considerable minority still clung to the belief that the exercise of professional accounting judgment would be unduly circumscribed by the proposed amendment. Because of the amendment's importance to the future credibility of the APB, the AICPA Board of Directors considered resubmitting it for another ballot. The board decided against resubmission because it was considering a complete revision of the code of professional ethics, including a new rule that would require compliance with APB opinions.

Another problem, which surfaced in 1970, was the establishment by Congress of a Cost Accounting Standards Board to set cost standards for settling government defense contracts. This was viewed at the time as a serious dilution of the profession's influence over accounting standards. This fear later proved to be largely unwarranted, and the APB was essentially unaffected.

In the face of these threats, pressures, and uncertainties, the Accounting Principles Board struggled to restore confidence in
its efforts. In 1969 the APB appointed a subcommittee of its own members to review the board's operations. In October 1970 Philip Defliese, head of Lybrand, Ross Brothers and Montgomery (later Coopers and Lybrand), became chairman of the APB. Mr. Defliese was a strong leader who recognized the need to expand the board's due-process procedure to give a greater voice to the issuers of financial reports. Unfortunately, his statements to the press and his efforts to spur the board to quicker action caused turmoil within the board itself. At the same time the technical vice president of the Institute, Leonard Savoie, was engaging in similar activities in an effort to make the board more effective and less vulnerable to criticism. Disagreements between the two men only exacerbated the situation.

The Trueblood and Wheat Committees

Finally, in January 1971 Marshall Armstrong, president of the Institute, convened a special meeting of thirty-five leaders of the profession representing twenty-one accounting firms to discuss the setting of accounting standards. After two days of intensive discussions, the participants agreed that two small, blue ribbon committees, composed of both members and nonmembers of the profession, should be commissioned to study the following questions:

1. How and by whom should financial accounting standards be established?
2. What are the objectives of financial statements?

This recommendation was promptly approved by the AICPA board, and by March 1971 the two groups had been appointed.

While these events were taking place, the American Accounting Association was also proposing to appoint a commission to study the manner in which accounting standards should be set. The association invited the AICPA to cosponsor the effort. The AICPA Board of Directors declined the invitation in view of its decision to take independent action.

The committee charged with examining the objectives of financial statements was chaired by Robert Trueblood, head of Touche Ross and Company and a former president of the
AICPA. Serving with him on the committee were the following people:

RICHARD M. CYERT, Carnegie-Mellon University
SIDNEY DAVIDSON, Graduate School of Business, U. of Chicago
JAMES DON EDWARDS, College of Business Administration, U. of Georgia
OSCAR S. GELLEIN, Haskins & Sells
C. REED PARKER, Duff, Anderson & Clark, Inc.
ANDREW J. REINHART, The Singer Company
HOWARD O. WAGNER, Jewel Companies, Inc.
FRANK T. WESTON, Arthur Young & Company

The committee worked for more than two years, issuing its final report, Objectives of Financial Statements, in October 1973. The report generated very little controversy, and the AICPA commended the committee's conclusions to the FASB. Included were a number of concepts regarding the users of financial statements and their needs, which served as a springboard for the FASB's conceptual framework project in succeeding years.

The committee appointed to study how and by whom accounting standards should be established was chaired by Frank Wheat, a partner of a leading Los Angeles law firm, Gibson, Dunn and Crutcher, and a former commissioner of the Securities and Exchange Commission. Also serving on the committee were the following people:

JOHN C. BIEGLER, Price Waterhouse & Co.
ARNOLD I. LEVINE, J. K. Lasser & Co.
WALLACE E. OLSON, Alexander Grant & Company
ROGER B. SMITH, General Motors Corp.
THOMAS C. PRYOR, White Weld & Co.
DAVID SOLOMONS, Wharton School, U. of Pennsylvania

At the outset, the committee members held widely differing views, ranging from the belief that the profession alone should set accounting standards to the position that standard setting is an essentially legislative process that belongs in the province of government. In between was the view that the process should remain within the private sector but should include participation by issuers and users of financial statements.

The committee interviewed spokesmen for the various interest
groups and viewpoints, held public hearings, and observed the APB in action. After these extensive inquiries, it went into executive sessions to formulate its conclusions.

By this time the thinking of the committee members had converged on several important points. Belief was now overwhelming that the process should remain within the private sector and should not be taken over by government. The members realized that, to ensure the broad support necessary for a standard-setting body, provision must be made for due-process procedures and the participation of all groups having an interest in financial statements, particularly issuers and users. Finally, it was clear that non-CPAs viewed the APB as a captive of the public accounting profession, and they suspected board members of being unduly influenced by the makeup of their firms' clienteles.

These considerations formed the basis for the committee's recommendations. It proposed an independent Financial Accounting Foundation to finance and oversee a standards board. The foundation was designed to attract broad-based support and to demonstrate that standard setting is not under the exclusive control of the public accounting profession. To maximize its objectivity and to ensure that adequate time was devoted to the task, the foundation would oversee a Financial Accounting Standards Board (FASB) composed of seven full-time paid members. The committee also recommended a Financial Accounting Standards Advisory Council, composed of representatives of various interest groups, to warn of emerging accounting problems and to advise the standards board on its agenda and priorities. A full explanation of the committee's reasoning is eloquently presented in the report, written largely by Messrs. Wheat and Solomons.

Formation of the FASB

The Wheat committee issued its report in March 1972, during Walter Oliphant's term as president of the AICPA. Mr. Oliphant was a strong leader and organizer who immediately acted to implement the recommendations. At a historic meeting on April 10 and 11, 1972, the Institute's Board of Directors approved the Wheat committee report and appointed a committee to establish
the recommended foundation, standards board, and advisory council. The committee was chaired by Marshall S. Armstrong of George S. Olive and Company, and its members included John C. Biegler of Price Waterhouse and Company; Winston Brooke of Brooke, Freeman, Berry and McBrayer; LeRoy Layton of Main LaFrentz and Company, and John Lawler of the AICPA. The board set a target date of July 1, 1972, for establishing the foundation and January 1, 1973, for achieving an operational FASB.

Within less than a month, at the May 1 to 3 AICPA Council meeting in Boca Raton, Florida, approval was accorded the Wheat committee report and a green light given to the board’s actions. Although support for the recommendations was overwhelming, it was by no means unanimous; some council members, among them Richard Baker, head of Ernst and Ernst (later, Ernst and Whinney), denounced the profession’s surrender of its existing control of the standard-setting body.

The Wheat committee had anticipated and attempted to mitigate this reaction by providing that the foundation’s trustees would be elected by the AICPA Board of Directors. Although adopted initially as a palliative to AICPA members, this provision of the bylaws was later changed in response to objections by other participating interest groups.

By the end of 1972, much had been accomplished. Organizations representing financial analysts, financial executives, academicians, investment bankers, and CPAs had agreed to become sponsoring members of a Financial Accounting Foundation and to raise funds for its operations. The eight largest CPA firms had each pledged $200,000 a year for five years in support of the new FASB. Articles of incorporation and bylaws were adopted and filed for the Financial Accounting Foundation, and trustees were elected. Marshall Armstrong was appointed as the first chairman of the FASB, and the process of employing a staff and obtaining office space had begun.


In December 1973 the FASB issued its first Statement of

During the transition period it became apparent that the AICPA would need a new committee to prepare official Institute responses to FASB proposals and to advise the FASB at an early stage about accounting problems being encountered in practice. To meet this need, the Institute appointed a new accounting standards executive committee (AcSEC) in November 1972. Some of the larger firms objected to the duplication of effort: responding to the FASB on their own behalf and contributing manpower to prepare responses in behalf of the AICPA. Ultimately, however, firms recognized that official positions on accounting matters had to be taken on behalf of the organized profession. Also, it was evident that the AICPA needed to continue issuing auditing and accounting guides for special industries, and an accounting standards committee was necessary to deal with the accounting aspects of these guides.

Meanwhile, the Institute voted on a restated code of professional ethics. The revised code, adopted early in 1973, included a new rule 203:

A member shall not express an opinion that financial statements are presented in conformity with generally accepted accounting principles if such statements contain any departure from an accounting principle promulgated by the body designated by Council to establish such principles which has a material effect on the statements taken as a whole, unless the member can demonstrate that due to unusual circumstances the financial statements would otherwise have been misleading. In such cases his report must describe the departure, the approximate effects thereof, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

As authorized by rule 203, Council passed a resolution at its May 1973 meeting designating the FASB as the body “to establish such principles.” This action, for the first time, explicitly brought compliance with accounting standards under the disciplinary machinery of the profession. It settled the dispute that had aroused so much passion in the preceding years and put in place the final piece of the present standard-setting structure.

In retrospect, the changes that occurred in the setting of accounting standards over the brief span of three years were
truly remarkable. The profession and its leaders deserve praise for their willingness to surrender the profession's exclusive jurisdiction over the standard-setting body and to share it with other interest groups. Although some CPAs still argue that this was a serious mistake, few dispute the boldness of the steps taken. By its actions, the profession kept the standard-setting process within the private sector, and without the new structure there is serious doubt whether the congressional challenges that were to follow could have been successfully met.

FASB Relations With the SEC

The FASB, however, did not live happily ever after. Its troubles began almost immediately when the SEC, under Chairman William Casey and the new chief accountant, John C. Burton, expressed its intention to deal directly with accounting disclosure matters, although it would continue to rely on the FASB to deal with accounting measurement. In effect, the SEC announced that it would preempt a substantial portion of the FASB's role. During the years that Mr. Burton served as chief accountant, an unprecedented number of Accounting Series Releases were issued, many of which dealt with accounting disclosure matters.

The FASB made every effort to maintain close communications and good working relationships with the SEC, and, eventually, closer cooperation was achieved. To demonstrate its support for the FASB, the commission, on December 20, 1973, issued Accounting Series Release no. 150, which reaffirmed the SEC's policy of reliance on the private sector:

The Commission intends to continue its policy of looking to the private sector for leadership in establishing and improving accounting principles and standards through the FASB with the expectation that the body's conclusions will promote the interests of investors.

In Accounting Series Release No. 4 (1938) the Commission stated its policy that financial statements prepared in accordance with accounting practices for which there was no substantial authoritative support were presumed to be misleading and that footnote or other disclosure would not avoid this presumption. It also stated that, where there was a difference of opinion between the Commission and a registrant as to the proper accounting to be followed in a particular case, disclosure would be accepted in lieu of correction of the financial statements themselves only if substantial authorita-
tive support existed for the accounting practices followed by the registrant and the position of the Commission had not been expressed in rules, regulations or other official releases. For purposes of this policy, principles, standards and practices promulgated by the FASB in its Statements and Interpretations will be considered by the Commission as having substantial authoritative support, and those contrary to such FASB promulgations will be considered to have no such support.

Arthur Andersen Sues the SEC

In December 1974 and April 1975 the SEC exposed for comment two securities acts releases (ultimately issued together as Accounting Series Release no. 177 on September 10, 1975), which, among other things, would require an independent auditor to express an opinion about whether, when a registrant made a change in its accounting method, the new method was preferable. Virtually all practitioners and CPA firms strongly opposed the requirement because it would force them to make subjective judgments about the fairness of financial statements. They believed that there were no reliable criteria for judging fairness and that an auditor's responsibility should only be to ensure compliance with generally accepted accounting principles. One CPA firm, Arthur Andersen and Company, felt so strongly about the issue that it filed suit to enjoin the SEC from adopting the preferability requirement.

The head of the firm, Harvey Kapnick, was a strong-willed, outspoken critic of both the SEC and the FASB, which may explain, in part, why the firm's suit also challenged the legality of the SEC's policy of reliance on the FASB. The complaint alleged that this reliance constituted an unlawful delegation of authority by a statutory body and that Accounting Series Release no. 150 had been adopted without the due process required under the Federal Administrative Procedures Act.

This challenge endangered the continuing viability of the FASB, and both the Financial Accounting Foundation and the AICPA filed amicus curiae briefs in opposition to the plaintiff. The SEC, of course, filed a vigorous rebuttal.

While the litigation was in progress, the commission issued Accounting Series Release no. 177 in its final form. Since other CPA firms did not choose to join in the litigation on the side of
Arthur Andersen, they elected to comply with the release. As compliance became accepted practice, the litigation was rendered moot except as a challenge to SEC reliance on the FASB.

The court declined to impose a temporary restraining order on the SEC, and after long delays Arthur Andersen and Company finally withdrew its complaint. By that time members of Congress were questioning whether the SEC should be relying on a private-sector body to set accounting standards. Presumably, the firm concluded that the preferability issue was a lost cause and that pursuit of its petition might result in the establishment of a governmental standard-setting body.

The IRS Booking Requirement

Another problem confronting the FASB involved an IRS proposal that had first been made in 1971. The Internal Revenue Service proposed requiring taxpayers to use the same accounting treatments for their books and financial statements as they used for income tax purposes. This was commonly referred to as a booking requirement. If the requirement were adopted, the Internal Revenue Service would effectively be able to establish financial accounting standards, since few corporations were likely to forego favorable tax treatments.

Representatives of the AICPA, FASB, and SEC attempted to persuade the IRS not to impose its proposed booking requirement. Although the IRS never completely abandoned its position, it modified its requirements to the extent that it would not appear to be establishing accounting standards.

The Role of AcSEC

During the first years of their existence, considerable friction also arose between the FASB and the newly established AICPA Accounting Standards Executive Committee. Members of AcSEC felt a strong need to provide CPA firms with guidance on emerging accounting problems so that auditors would be following a uniform accounting treatment. The AICPA was still concerned about forestalling the practice of shopping for accounting prin-
principles. Many CPAs felt that the FASB had such a full agenda that it was unlikely to deal on a timely basis with the emerging problems, which were usually of an urgent and highly specialized nature. Furthermore, the FASB's due-process procedures almost precluded fast action. AcSEC, therefore, began issuing Statements of Position on accounting issues, which were intended to provide timely interim guidance to auditors until the FASB took official action. Similar pronouncements were also issued by AcSEC to cover the accounting portions of the AICPA's new and amended auditing and accounting guides for special industries.

While the FASB was not particularly disturbed by these activities, many of its constituents, particularly members of the Financial Executives Institute, raised strong protests. In their view, the AICPA was continuing to set accounting standards in defiance of the general agreement that there should be only one private-sector standard-setting body, the FASB.

The FASB attempted to find a satisfactory compromise by devising procedures for a special screening committee to review emerging problems and to determine whether they should be dealt with by the FASB or left to AcSEC for disposition through Statements of Position. Although this was less than a complete resolution of the issue, it was sufficient to quiet the controversy for a while.

The Marketable Equity Securities Issue

Typical of the urgent problems being encountered by auditors in the field was the question of when to write down investments in securities when it appeared that their market values had been permanently depressed below cost. In December 1974 the country was in the midst of a deep recession. Stock market prices had suffered a steep decline; huge real estate ventures were on the verge of bankruptcy, and banks faced heavy losses on their loans to real estate investment trusts (REITs). Auditors of major banks and insurance companies were confronted in January 1975 with the write-down question for both securities and loans receivable, and accounting standards provided no clear answers.

Because major banks and insurance companies had huge amounts at risk, the problem ultimately led to discussions among
AcSEC, the FASB, the SEC, congressional banking committees, and the chairman of the Federal Reserve Bank, Arthur Burns. The political pressures from members of Congress, the Federal Reserve Bank, and the bank associations were so intense that neither AcSEC nor the SEC saw fit to impose a conservative write-down requirement that would be charged to earnings. Instead, the SEC issued Accounting Series Release no. 166 on December 23, 1974, requiring disclosure of the details of loan loss provisions. It also requested the FASB to determine in the following year what further action should be taken.

Eventually, the FASB issued its Statement of Financial Accounting Standards no. 12, which prescribed the accounting treatment to be accorded marketable equity securities. Except where the decline in market value of individual securities was deemed to be permanent, the board stopped short of requiring that unrealized losses on noncurrent portfolios be charged to earnings.

The magnitude and urgency of this problem increased CPA firms’ concern about the need for an effective means of dealing with emerging accounting problems on a timely basis. This may well have been one of the factors leading to strong public criticism of the FASB in 1975 and 1976, especially by Harvey Kapnick of Arthur Andersen and Company. In a speech in New Orleans, Mr. Kapnick challenged the leadership of Chairman Armstrong and called on the AICPA to reconstitute the Wheat committee to review the operations of the Financial Accounting Foundation and the FASB. The Institute’s board officially declined to take such action and expressed its full confidence in the Financial Accounting Foundation to oversee the FASB.

**The FAF Structure Committee**

In view of this growing unrest in the private sector and threatening statements from Congress, the Financial Accounting Foundation trustees decided that a reappraisal was in order. Accordingly, a committee, chaired by Russell Palmer, head of Touche Ross and Company, was appointed to review the structure and operations of the foundation, the FASB, and the Financial Accounting Standards Advisory Council. The committee recommended a
number of changes. The Financial Accounting Standards Advisory Council should be reconstituted and chaired by a separate part-time, paid chairman. The research staff should be consolidated under a research director. The election of foundation trustees by the AICPA Board of Directors should be discontinued and replaced with a new procedure. The requirement that at least four members of the FASB be CPAs should be dropped. Finally, the voting requirements for board decisions should be changed from five out of seven votes to a simple four-vote majority. These recommendations were promptly implemented.

Congressional Interest in Accounting Standards

The committee issued its report in April 1977, and its timing could not have been more fortuitous. It coincided with the initiation of congressional inquiries into the performance of the public accounting profession and the structure for setting accounting standards. The House of Representatives Subcommittee on Oversight and Investigations, chaired by Congressman John E. Moss, led the way in October 1976 with a report on its oversight of the SEC. The report included the following recommendation:

To the maximum extent practicable, the SEC should prescribe by rule a framework of uniform accounting principles. In instances where uniformity is not practicable, the SEC should require the independent auditor to attest that the accounting principles selected by management represent financial data most fairly. He should also prescribe supplemental data to permit a translation from one set of assumptions to another, thereby permitting comparability among companies in a particular industry.

Mr. Moss later elaborated on the intent of the recommendation:

My subcommittee concluded that the SEC should prescribe a framework within which the private sector would set principles and standards. The SEC would establish parameters within which the private sector determines accounting principles and sets auditing standards. The SEC would suggest priorities based upon national and international needs. And the SEC would exercise in a much more vigorous fashion its oversight of proposed principles and standards and the operation of those already in place, exercising its right of pre-emption when necessary.
Congressman Moss also introduced a proposed amendment to the 1975 Energy Act directing the General Accounting Office to develop a uniform method of accounting for the petroleum industry. After strenuous efforts by representatives of the FASB, AICPA, and SEC, Congress adopted a revised version of the amendment that required the SEC to see that a uniform method was established within twenty-four months. The revised amendment explicitly recognized that the SEC might look to the FASB for this purpose.

The FASB met the two-year deadline only to be overruled by the SEC. The commission issued Accounting Series Release no. 253 calling for footnote disclosure of financial data on oil and gas reserves and announcing its intention to require the reserve recognition accounting method in the future. Under this method the changing current value of reserves is reflected directly in the financial statements. The FASB, which had elected a successful-efforts method in its FASB Statement no. 19 was left with little choice but to defer the effective date of compliance with the successful-efforts method. This was necessary to put nonregistrants on the same footing as SEC registrants.

Many supporters of the FASB saw these events as a serious threat to the body’s authority. In reality, these developments were more a reflection of the strong political pressures exerted by the independent oil companies, which bitterly opposed a change from full costing to successful-efforts accounting. In any event, the SEC went out of its way to reaffirm that it did not intend to depart from its long-standing policy of looking to the FASB to set accounting standards. Furthermore, on February 4, 1981, the commission decided to abandon its proposal to require adoption of a reserve recognition accounting method and to support the FASB’s effort to develop a comprehensive package of disclosures for oil and gas companies.

The FASB was also under pressure from another congressional panel: the Senate Subcommittee on Government Operations, chaired by Senator Metcalf, which conducted investigations in 1976 and 1977. In its final report, the subcommittee urged a number of actions to improve the standard-setting process and warned, “If the present standard-setting system is to become more responsive, the SEC must more vigorously oversee the systems on behalf of the public.”
Other Criticisms of the FASB

In addition to the attacks from the government, the board faced sharp criticism from all sectors of its constituents in connection with a number of its pronouncements. Anyone interested in the controversies that were generated by particular standards should read the board’s newsletters, as well as articles written in the financial press.

The board’s first, formative period came to an end on December 31, 1977, when Marshall Armstrong stepped down as chairman, although he would continue as a consultant through September 1979. Mr. Armstrong had performed the monumental task of establishing the board and dealing with all of its early problems. His critics felt that he had been too rigid and too concerned about protecting the jurisdiction of the FASB. If he was guilty of these charges, they were certainly understandable in light of all the threats that the board faced. On balance, his record was truly distinguished. Donald Kirk, who had served as a member of the board from its inception, became chairman on January 1, 1978.

Disclosure of Soft Information

During the mid and late seventies, the maturing FASB was faced with several particularly complex issues. One of these was the need for disclosure of “soft information.”

The Securities and Exchange Commission considered requiring a number of new disclosures, some of which could be considered “soft information” because they did not lend themselves to objective audit verification. Disclosure of forecasts and data on oil and gas reserves and the effects of changing prices were examples of soft information.

The FASB discussed requiring that these types of disclosure be made within annual financial reports but outside the defined parameters of financial statements. In effect, this would remove them from the scope of an independent audit of the financial statements. It would leave the AICPA Auditing Standards Board and the SEC with the burden of determining the extent to which independent auditors would be responsible for reviewing the
disclosures made outside financial statements. This approach also would exempt most small, closely held companies from compliance with the disclosures since they generally do not issue annual financial reports.

On February 23, 1978, the FASB added to its agenda a project to consider the establishment of guidelines that would require reporting entities to make some disclosures outside the defined limits of financial statements. The board had concluded that its charter authorized it to deal with the broad scope of financial reporting rather than just the narrower limits of financial statements.

Because AICPA rule of conduct 203 applied only to financial statements, the Institute was now faced with the question of whether any FASB disclosure requirements outside financial statements should be made enforceable. On the recommendation of the Institute's board, the Council passed a resolution on May 8, 1979, designating the FASB as the body under rule of conduct 204 to set standards for such disclosures. This action made the standards on disclosures outside financial statements enforceable for all AICPA members in public practice. Their responsibilities as independent auditors regarding such disclosures were to be defined in standards to be established by the Auditing Standards Board.

The Small, Closely Held Companies Issue

Another issue facing the FASB was the groundswell of objections from practitioners serving small, closely held companies. The costs of applying the newly established accounting standards and disclosure requirements to their clients seemed to exceed the benefits to potential users of the audited financial statements. Often, these practitioners were forced to justify fees that were unduly high because they were required to apply complicated accounting treatments that neither their clients nor their clients' creditors understood or wanted.

As early as 1974, the AICPA began addressing this problem, and an AcSEC task force was appointed to study possible solutions. The task force issued a discussion paper on the subject
on March 31, 1975, which was widely discussed by practitioners in every state and at various AICPA meetings.

The responses indicated that a considerable majority opposed the establishment of exceptions to accounting principles that would create what were pejoratively labelled "big GAAP" and "little GAAP." Many practitioners feared they would be viewed as second-class CPAs and would suffer a competitive disadvantage if lesser standards were required for their smaller, closely held clients. Others were concerned that competing practitioners serving closely held clients were not being disciplined for failing to comply with all the standards and were therefore able to perform audits for lower fees. On the other hand, a majority was clearly troubled by the problems of applying the more complex standards established to meet the needs of users of the financial statements of publicly traded companies.

After considering these conflicting views, the task force recommended that certain disclosure requirements should not be regarded as part of generally accepted accounting principles and, therefore, should not be required of companies not registered with the SEC. At a meeting on February 8, 1977, the task force urged the FASB to draw such a distinction in imposing disclosure requirements. It recommended, however, that the same accounting measurement standards should apply to all companies, without exception.

The FASB initially took no position on the task force's suggestions. When it seemed apparent that the FASB would not take action on the recommendations, a letter (dated June 24, 1977) was sent in behalf of the AICPA Board of Directors inquiring about the FASB's intentions. An inconclusive response from the FASB on July 6, 1977, buttressed the belief that it was generally unsympathetic to the task force's recommendations. This perception was supported in a subsequent speech by the chairman of the FASB and an indication in FASB Statement no. 14 that the board neither rejected nor accepted the recommendations of the task force.

In a meeting on November 7, 1977, the AICPA Board of Directors decided that more aggressive action was necessary to achieve a satisfactory solution. It authorized the AICPA chairman to meet with the FASB to discuss the matter. If the FASB then failed to act, a proposal would be made to the Institute's Council
in May 1978 to give the Accounting Standards Executive Commit­
tee authority to establish relief from disclosures for closely
held businesses. Such authority would be granted by an amending
resolution under rule 203 of the code of professional ethics.

This action apparently had its intended effect. The subject of
accounting principles for closely held companies was discussed
at some length at a symposium on financial accounting and
reporting held at Seaview, New Jersey, on November 19 through
21, 1977. Some of the FASB members who were present partici­
pated in the discussion.

In April 1978 the FASB issued statement no. 21, exempting
companies not registered with the SEC from compliance with
APB Opinion no. 15 and FASB Statement no. 14, which required
disclosures, respectively, of earnings per share and of financial
data on business segments. This major breakthrough persuaded
the AICPA Board of Directors that further action was unneces­
sary.

Considerable concern remained, however. Some practitioners
felt that relief should be granted from some of the more complex
measurement standards, such as those relating to the capitaliza­
tion of leases.

In November 1978 a special committee was appointed to
study the problems of smaller and medium-sized accounting
firms. In its final report, issued in October 1980, the committee
recommended consideration of a comprehensive basic accounting
method for small, privately held companies. In reporting on
financial statements that are based on such a method, independ­
ent auditors would refer to the defined, comprehensive, basic
accounting method rather than to generally accepted accounting
principles. As of 1981 the committee's suggestion was under
study, but no conclusions had been reached.1

The final word on this subject has not been written. The
profession has refused, at least so far, to adopt a policy of
exempting small and privately held companies from some of the
more burdensome measurement standards. The problem can

1. In a discussion paper issued on December 28, 1981, the AICPA Special Committee on
Accounting Standards Overload tentatively recommended that the FASB study the needs
of users of financial statements of small businesses and reexamine certain of its pro­
nouncements with a view toward simplifying GAAP to render them more cost-effective
to small, nonpublic businesses. The paper also presented a proposal for wider use of the
income tax basis of accounting in appropriate situations.
only get worse as the volume and complexity of accounting standards increase.

Accounting Standards for State and Local Governments

Yet another thorny issue that arose during this period involved accounting standards for state and local governments. The severe fiscal crisis encountered by the city of New York, along with threats of similar difficulties in other cities, alarmed members of Congress. Various legislators worried about the lack of regulation of securities sales by state and local governments and about the inadequacies of these bodies' financial reports. The lack of uniformity and the deficiencies in the financial statements of governmental units were also of great concern to the comptroller general and the U.S. General Accounting Office, which had responsibility to monitor the auditing of cities and states receiving revenue-sharing funds and other federal grants amounting to more than $80 billion a year.

Some accounting standards did exist in the form of the governmental accounting and financial reporting principles developed by the National Council of Governmental Accounting (NCGA), a group sponsored by the Municipal Finance Officer's Association (MFOA). These principles were contained in Governmental Accounting, Auditing, and Financial Reporting, often referred to as the "blue book," which was published in 1968. Also, the AICPA Committee on Governmental Accounting and Auditing had issued an industry audit guide, which incorporated the NCGA standards within its accounting recommendations. There was no mechanism for enforcing compliance with these standards, however, and studies by several of the national CPA firms revealed that they were not being consistently followed.

Senator Harrison Williams, a member of the Senate Banking, Housing and Urban Affairs Subcommittee on Securities, proposed legislation in 1978 to require cities and states that offered their securities for sale to the public to register with the SEC. This met with stiff opposition from state and local government officials, and the proposal was replaced in 1979 by a new one,
which would have established a federally financed governmental accounting standards board under the combined supervision of the SEC chairman, the comptroller general, and the secretary of the Treasury.

Meanwhile, the Financial Accounting Foundation Structure Committee suggested that the FASB should devote attention to this aspect of accounting standards. The FASB responded by commissioning Professor Robert Anthony to conduct a research study on accounting for nonprofit entities. After the study was completed in May 1978, the FASB developed a conceptional framework for accounting for nonprofit entities, which was adopted and issued as Statement of Accounting Concepts no. 4, *Objectives of Financial Reporting by Nonbusiness Organizations*. The statement left open the question of whether governmental units should be encompassed by such objectives.

The prospect of standards being set for state and local governments by either the FASB or a federally funded standards board met with strong opposition, particularly from government representatives. The SEC felt that Senator Williams' proposal did not provide sufficient enforcement. The General Accounting Office was silent about the proposed legislation, but Comptroller General Elmer Staats stated his support for reconstitution of the NCGA as an independent, private-sector standard-setting body. The National Association of State Auditors, Controllers, and Treasurers (NASACT), the MFOA, and the NCGA also opposed the FASB's assumption of this role. They thought that the FASB was too committed to applying a commercial accounting model to government. Government officials were convinced that a different model was necessary to deal with the unique characteristics of government.

The AICPA officers and Board of Directors viewed the controversy with alarm. They worried that a federal accounting standards board might lead to a government takeover of all accounting standards. Furthermore, they believed that the NCGA was too dominated by government representatives to be able to set objective accounting standards. As a consequence, the board urged the Financial Accounting Foundation to convene a study group composed of members of the various interest groups to develop a proposal that would have general support.

With some reluctance, Financial Accounting Foundation Pres-
ident Alva Way called a meeting on July 17, 1979, which was attended by representatives of the foundation, the FASB, the MFOA, the NCGA, the NASACT, the General Accounting Office, and the AICPA. The government representatives clearly would not accept the FASB's assumption of the standard-setting role. Instead, they shared a strong sentiment for a separate, small, full-time governmental accounting standards board sponsored by either the Financial Accounting Foundation or a similar private foundation.

After several more meetings, the group met with the foundation's board of trustees on February 12, 1980, to determine whether the foundation would agree to sponsor a separate standards board along the proposed lines. The foundation responded in a letter dated March 13, 1980, indicating unwillingness to sponsor a separate board but stating that it would consider supporting a structure that met certain criteria and that offered reasonable prospects for improved financial reporting by state and local governmental units.

A formal committee, the governmental accounting standards board organizing committee (GASBOC), was formed, and Robert Mautz, a professor at the University of Michigan, was persuaded to act as chairman. The committee included representatives of the MFOA, the NCGA, the NASACT, the General Accounting Office, the AICPA, and the Financial Accounting Foundation. Seven associations of state, county, and municipal officials sent representatives to the committee's meetings. By the end of 1980, the committee had completed a report recommending the establishment of a five-member, full-time governmental accounting standards board and a part-time advisory council under a new foundation, all of which would be virtually identical to the Financial Accounting Foundation, the FASB, and the Financial Accounting Standards Advisory Council. The report was published on February 16, 1981, in preparation for public hearings to be held in Philadelphia on May 4 and 5, 1981. It left unresolved the manner in which the FASB and the proposed Governmental Accounting Standards Board would coordinate their activities and deal with questions of jurisdiction (for instance, standards for private-sector and government-owned nonprofit entities, such as utilities, hospitals, and universities, that perform similar operations).
The issue of accounting standards for government is inescapably controversial. Many CPAs would prefer to see all accounting standards set by a single body, the FASB, but people in government have indicated that this would be unacceptable. Any attempt by the FASB to impose standards on government can be expected to meet with powerful opposition and to embroil the FASB in politics.

Future developments will determine whether the various groups with conflicting interests can successfully join forces to support an effective structure to set accounting standards for state and local governments.2

The AICPA's Audit and Accounting Guides

Finally, during the late 1970s friction again developed between the FASB and the AICPA, this time in connection with the AICPA's auditing and accounting guides. In 1978 a Financial Accounting Standards Advisory Council committee, appointed to study the activities of AcSEC, recommended that the FASB assume full responsibility for the accounting portions of the special-industry guides. This was partly inspired by an SEC recommendation, contained in the commission's 1978 report to Congress, that a means be found to make the guides enforceable. The SEC had been disturbed by the fact that some CPA firms were not complying with the guides.

Both AcSEC and the AICPA Board of Directors expressed serious reservations about the likelihood that the FASB would maintain the guides on a timely basis. Nevertheless, they agreed to defer to the FASB. In Statement of Financial Accounting Standards no. 32, issued in September 1979, the FASB announced its intention of assuming responsibility and declared that the accounting recommended in existing guides would be viewed as preferable to other alternatives until such time as the guides were modified by the FASB. Because of the provisions of Ac-

2. In a final report dated October 13, 1981, the GASBOC recommended that a separate standards board be established under the Financial Accounting Foundation (FAF). The FAF trustees endorsed the GASBOC recommendations with certain reservations regarding operating details, and, early in 1982, appointed an advisory committee to develop specific proposals for implementation.
counting Principles Board Opinion no. 20, the FASB's action enhanced the enforceability of the guides in those instances in which companies decided to change from one accounting method to another. By the end of 1980, the FASB had made only limited progress in reviewing the guides, and there were lingering doubts within the AICPA about whether the FASB would fulfill the responsibility it had assumed.

In the meantime, AcSEC had agreed to replace its Statements of Position with issues papers that would be submitted to the FASB for consideration. An uneasy truce was in effect.

The history of accounting standard setting during the 1970s was one of rapid and far-reaching changes in structure, a great deal of improvement in the quality of financial reporting, and continuing vigilance to retain the process in the private sector under the FASB. On balance, the FASB has been successful in the face of enormous difficulties, representing a unique experiment in self-regulation.
Prior to the 1970s, the AICPA Committee on Auditing Procedures defined the responsibilities of independent auditors in its Statements on Auditing Procedure. Even though the committee had been engaged in this work for more than thirty years, the flood of litigation against CPA firms in the early 1970s demonstrated that the appropriate role and responsibilities of auditors were by no means clear.

In many instances litigants and critics of the profession's performance did not distinguish between the adequacy of accounting principles and the responsibilities of auditors. As a result, much of the public's attention focused on the setting of accounting standards, leaving the SEC, the courts, and the profession to sort out what could appropriately be expected of auditors.

Nevertheless, by the early 1970s there was a growing belief that independent auditors were not performing their roles satisfactorily. Many users of financial statements considered an auditor's opinion a guarantee that the financial statements were fully reliable. This attitude was reinforced by frequent stories in the business press. Many of the articles asserted that auditors had a duty not merely to determine compliance with generally accepted accounting principles but also to evaluate the overall fairness of financial statements. Seldom was it recognized that well executed management fraud can be extremely difficult if not impossible to detect.

The Equity Funding Case

It was in this environment that the story of Equity Funding's collapse hit the headlines in March 1973. The huge losses by
investors in the company's securities, closely following a series of other business failures, dealt a shattering blow to the credibility of independent auditors. Everyone asked, "Where were the auditors?"

The AICPA Auditing Standards Division considered what actions to take to deal with this problem. Before the division reached a decision, however, SEC Chairman Bradford Cook summoned representatives of state insurance commissions, actuaries, life insurance companies, and the AICPA to a meeting in Washington on April 30, 1973, to discuss what went wrong at Equity Funding. Ernest Hicks, chairman of the auditing standards division and a partner of Arthur Young and Company, and I represented the Institute. During the course of the meeting, SEC officials pressured the AICPA representatives to reexamine auditors' responsibilities to detect fraudulent transactions. One commissioner expressed the view that independent audits are of little value if they cannot be expected to uncover the type of massive fraud that occurred at Equity Funding.

I concluded that we could not afford to leave the meeting without giving some assurance that the profession would take appropriate action. We agreed, therefore, that the AICPA would immediately conduct a study of the Equity Funding case to determine what, if any, corrective action the profession should take. The meeting adjourned with the promise that a follow-up meeting would be held within three or four months to determine what progress was being made to prevent similar problems in the future.

This was promptly reported to AICPA President LeRoy Layton, who fully agreed that a study should be conducted. At a meeting on May 4, 1973, the AICPA Board of Directors approved the appointment of a special committee to study the issue of whether auditing standards should be changed in the light of Equity Funding. The committee was specifically directed not to pass judgment on whether the auditors involved in the case had complied with the profession's standards; that determination was to be left to the professional ethics division, which would follow its normal due-process procedures.

Recognizing that the study's findings might be used in litigation, I notified the heads of the two principal CPA firms affected by the action being taken. While both would have preferred to
avoid a special review of the case, they fully understood the need for the AICPA to act immediately. They agreed to cooperate to the extent permitted by the advice of their respective legal counsels.

On May 7, 1973, the AICPA Council was advised of the board’s action, and the Institute issued a press release announcing the authorization of the special committee.

Marvin L. Stone, a former president of the Institute, was persuaded to chair the committee. Shortly thereafter, the following members were appointed to serve with him: J. T. Arenberg, Jr., a partner of Arthur Andersen and Company and an expert on insurance companies; Leo Burger, a partner of McGladrey, Hansen, Dunn and Company and a former member of the auditing procedures committee; Robert C. Holsen, partner of Ernst and Ernst and a former member of the auditing procedures committee; and A. E. MacKay, a partner of Main Lafrentz and Company, a CPA, and a lawyer. Assisting the committee were three members of the staff: myself; Donald Schneeman, the general counsel; and Donald Adams, AICPA director of computer services. The Institute’s legal counsel, David Isbell, a partner of Covington and Burling, also participated in the committee’s deliberations, as did Andrew Barr, retired chief accountant of the SEC and an AICPA consultant, and Robert Harden, the head of his own firm and an expert on audits of life insurance companies.

The committee did not seek to audit the financial statements involved in the fraud, nor did it examine the audit working papers of the CPA firms that had audited Equity Funding. It did, however, gather extensive information about the nature of the fraud from the auditors appointed by the bankruptcy court and from the trustee’s reports. The committee also interviewed key individuals, such as the conservator appointed by the court, and examined some of the records of the Equity Funding entities.

The committee concluded that the fraud could have been detected by the application of existing auditing standards and procedures. It also stated that, with minor exceptions, no changes in such standards were necessary in the light of the Equity Funding case and that the profession’s position regarding auditors’ responsibility to detect fraud was sound. Nevertheless, the committee urged that the standard relating to the detection of fraud be restated in more positive terms to avoid public misun-
derstanding. The existing standard specified that the audit of financial statements was not designed to detect fraud, although fraud might be uncovered in the application of auditing procedures.

True to its charge, the committee flatly denied having attempted to assess fault on the part of the auditors. By reaffirming the adequacy of auditing standards, however, the committee could not avoid calling into question the performance of Equity Funding's auditors. This dilemma made the committee's work especially difficult and controversial. Several AICPA members urged the board of directors to terminate the study without issuance of a report. Heated debates took place within the committee itself. Ultimately, two committee members dissented to the publication of the report prior to the end of litigation on the grounds that the rights of litigants might be unfairly affected. There was also concern that additional information might come to light during the litigation that would have affected the committee's conclusions.

On two separate occasions the board considered the objections being raised to the issuance of a report, and on both occasions the board reaffirmed its original authorization and charge to the committee. Final approval for publication was given on February 27, 1975, subject to clearance by the auditing standards executive committee (AudSEC) regarding any inconsistencies with its official pronouncements. This action followed appearances before the board by representatives of the two auditing firms involved and an oral report by Chairman Stone that the committee had completed its work and wished to be discharged. Mr. Stone stated that a majority of the committee believed that immediate publication of the report would be in the best interest of the public and the profession.

Clearance by the auditing standards executive committee was not completed until mid 1975, and in late June the heads of the two firms that had been the principal auditors of the Equity Funding entities again objected to publication of the report. Their letters to AICPA Chairman Philip L. Defliese asserted that a professional association should not engage in activities that would be detrimental to the interests of one or more of its members. They argued that the report was too late to accomplish any public good and could only harm the two firms.
The board concluded that the interests of individual firms should not be permitted to stand in the way of the greater good of the profession. As a result, the report was finally published.

The Institute's action was a courageous and appropriate response to the news reports and articles criticizing the effectiveness of independent auditors. It was, however, too little and too late to halt the adverse publicity or to reverse the erosion of public confidence in the profession. Something more had to be done.

The Commission on Auditors' Responsibilities

Concern about the profession's deteriorating image had led to a proposal that the AICPA Board of Directors meet with a group of the profession's leaders to explore what might be done to cope with the problem. President Layton convened such a meeting in Atlanta on October 12, 1973.

The discussion at the meeting covered a number of questions but focused mainly on the fact that public expectations of auditors exceeded what the profession considered appropriate. Ivan Bull, head of McGladrey, Hansen, Dunn and Company, suggested that a public commission be appointed to study the proper responsibilities of auditors. This idea gained broad support, and by the end of the meeting there was general agreement about the size and makeup of a proposed commission and the nature of the study to be conducted. The participants hoped that an impartial report would reduce the gap in understanding between the public and the profession about what independent auditors could reasonably be expected to achieve.

Following the meeting, a detailed proposal and charge was prepared. This was reviewed by the board on January 3, 1974, and a revised version was approved on February 20. The board agreed that the chairman of the commission should be a non-CPA, and it authorized Samuel A. Derieux, who had become the Institute chairman, to begin contacting potential candidates to serve on the commission.

The recruiting process proved to be more difficult than anticipated, and it was not until October that a full complement of three practicing CPAs, one academician, and three non-CPAs
was in place. Manuel F. Cohen, former chairman of the SEC and a partner of Wilmer, Cutler and Pickering, a Washington law firm, agreed to serve as chairman of what became known as the Commission on Auditors' Responsibilities. Serving with him were Walter S. Holmes, Jr., chief executive officer of C.I.T. Financial Corporation; LeRoy Layton, CPA, and head of Main Lafrentz and Company; William C. Norby, financial analyst and member of Duff, Anderson and Clark (investment researchers); Lee J. Seidler, CPA, professor of accounting at New York University; Kenneth W. Stringer, CPA, a partner of Haskins and Sells and a former member of the auditing standards executive committee; and John J. van Benton, CPA, head of George S. Olive and Company.

The commission spent its first several months interviewing representatives of various interests and defining the issues. It also engaged several researchers to gather and analyze facts and to prepare reports on a number of the more important questions relating to the performance of independent auditors.

In September 1975 the commission issued a paper, Statement of Issues: Scope and Organization of the Study of Auditors' Responsibilities. It presented a series of questions about the issues under consideration, and it invited individuals and organizations to submit position papers, research results, and other information relevant to the commission's study.

The study progressed slowly, partly because the commission had to await the results of the several research projects that it had initiated. It was not until April 1977 that a Report of Tentative Conclusions was published. The report served as a basis for public hearings held in Washington, D.C., beginning on June 21, 1977.

It was a great tragedy that Chairman Manuel F. Cohen died suddenly on June 16, 1977, and could not see the results of the project to which he had devoted so much time and effort. His keen interest and balanced leadership had contributed heavily to the success of a very difficult study. The profession is indebted to him for his willingness to undertake the task.

Professor Seidler, who had been deputy chairman, assumed Mr. Cohen's responsibilities for the duration of the study. He worked closely with Douglas R. Carmichael, the commission's research director, in drafting the commission's tentative and final reports.
The Report of Tentative Conclusions contained a long list of recommendations. Since these would all require a response by the profession, as well as by other groups, a special AICPA committee was appointed in March 1977 to consider just what actions should be taken by whom. Samuel A. Derieux acted as chairman of this project, and the eight other committee members included representatives of the key senior committees affected by the commission's recommendations.

At its first meeting, on March 28, 1977, the committee decided that the AICPA should not testify on its own behalf at the commission's public hearings in June but, instead, should await the commission's final report. The committee also decided to seek the views of AICPA Council members on the major issues at the spring meeting on May 10, 1977. In addition, the committee offered suggestions on how to respond to possible questions about the commission's recommendations that might arise during the course of U.S. Senate subcommittee hearings scheduled for June.

The committee divided the commission's conclusions into three broad categories: (1) recommendations requiring auditing standards executive committee study and implementation, (2) policy questions requiring decisions by the AICPA Board of Directors, and (3) policy questions requiring decisions and implementation by other organizations or, alternatively, by the AICPA Board of Directors.

In July 1977 the committee offered its conclusions about those policy questions requiring decisions by the AICPA board. At a meeting on July 21, 1977, the board considered the committee's recommendations and took several actions. First of all, it requested the auditing standards executive committee to give early consideration to the development of an improved auditor's report. It also approved the appointment of special committees to do the following:

- Develop appropriate guidelines for management reports on their responsibility for financial statements.
- Study the structure of the auditing standards executive committee and consider how auditing standards should be restructured to give more attention to the special needs of practitioners serving nonpublic companies.
Develop a model statement of conduct that could serve as the basis for corporate policy statements on employee conduct.

Develop criteria for the evaluation of internal accounting controls.

Study the circumstances under which names should be published in connection with disciplinary hearings and actions.

The board approved the appointment of a standing committee to develop analyses of types of fraud and methods of detecting them. It approved actions to inform non-CPA accounting educators about professional developments. And, also, it requested the accounting standards executive committee to study the feasibility of developing criteria for determining under which unusual circumstances the application of generally accepted accounting principles may result in financial statements that are misleading.

In addition, the board approved in principle the desirability of several new reports and services. These included management reports on their responsibilities for financial statements, reports by the management of SEC companies to their audit committees or boards of directors on systems of internal accounting controls, and a new service whereby auditors would review what management has done to ensure compliance with policy statements on employee conduct and report their findings to the audit committee or board of directors. The board approved in principle the periodic publication of statistical summaries of all disciplinary matters pending before the professional ethics division and the publication of the names of all AICPA members found guilty of charges by a disciplinary trial board. Similarly, it approved in principle actions to encourage the establishment of independent audit committees and the development of an ethical rule to prohibit both the recruitment of directors and the placement by CPA firms of former employees in such positions.

All of these decisions were in response to specific recommendations by the commission and were based on the suggestions of the special committee. Some of the commission's recommendations were not adopted, and others were implemented in modified form.

Overall, most members of the profession, including the AICPA
governing bodies, reacted favorably to the commission’s tentative report. Nevertheless, there was significant opposition to many specific recommendations. This apparent contradiction probably resulted from the fact that the commission’s report was not as critical of the profession as many CPAs anticipated it might be.

The commission completed its work in November 1977 and published its final Report, Conclusions, and Recommendations early in 1978. After considering a large number of responses to its tentative report and public hearings, the commission made few changes in its preliminary conclusions. Thus, the actions of the AICPA board remained unchanged.

On November 3, 1977, the board acted on the suggestions of the special committee regarding the remaining commission recommendations. It requested the accounting standards executive committee to consider whether financial statements should include a separate note on uncertainties and, if so, to request the FASB to require it. It approved the appointment of a special committee to develop models of reporting on litigation in financial reports. It requested the special committee on management reporting to deal with a requirement for publicly traded companies to disclose information relating to auditor changes similar to the requirement in SEC Form 8-K. Lastly, it approved the concept that auditors be approved by corporate audit committees or boards of directors and that auditors be present and available to answer questions at the annual meetings of shareholders.

In its final report, the commission stated that it had interpreted its charge “to be a mandate to study all aspects of the independent audit function and to provide recommendations to, and for the benefit of, all groups interested in [it], including users of financial statements, management, auditors, and regulatory bodies.” The commission fulfilled this charge, and it probably helped reduce the gap that existed between what the public expected of auditors and what auditors could and should reasonably expect to accomplish.

It would be unrealistic, however, to expect that the gap can ever be totally eliminated; the public is likely to always want and expect more than auditors can reasonably provide within practical limitations.

The report and testimony by the members of this prestigious, independent commission probably helped mollify the Senate
Subcommittee on Reports, Accounting and Management. Likewise, the commission's report was cited in proposals and statements by the SEC. Equally important was the influence that the commission had on the attitudes of public accountants and the fact that it caused the AICPA to take actions that it might otherwise not have taken.

The Institute had responded to a credibility crisis by the appointment of the commission. Three years later it had a report that was generally well received but that contained a number of recommendations with which it could not agree or that it could not implement by itself. Nevertheless, on balance, the exercise had been beneficial. It had blunted the more extreme criticisms of the profession and had moved the profession toward the assumption of additional responsibility.

Formation of the Auditing Standards Board

The commission's report included a suggestion that the AICPA Auditing Standards Executive Committee be restructured, presumably to speed up the standard-setting process and to make it more objective. Curiously, the report acknowledged that "the auditing standards-setting process has worked reasonably well" but went on to recommend replacing it with a smaller, full-time, compensated committee with a larger budget and staff. The report did not provide a rationale for the need for a change.

The AICPA Board of Directors appointed a special committee to deal with this proposal. It was composed entirely of former elected heads of the AICPA and was chaired by Walter J. Oliphant, former head of Arthur Andersen and Company. Serving with him were Ivan O. Bull, Philip L. Defliese, Samuel A. Derieux, and Louis M. Kessler.

The committee began its work on August 30, 1977. Following customary procedures, it sought the views of a wide range of individuals who had reason to be interested in the setting of auditing standards. Interviews were held, questionnaires were circulated, and public hearings were held in New York City on February 2 and 3, 1978. The committee also made an intensive study of how well the auditing standards committee had functioned in the past.

By late February 1978, the committee had reached tentative
conclusions and drafted a report. It recommended the retention of the part-time standard-setting body, but it suggested renaming the body the Auditing Standards Board. The board should comprise fifteen members, not all of whom should necessarily be members of the AICPA. The adoption of standards should require nine affirmative votes. Board members should be paid for their time if they devote at least 50 percent of their time to the work of the board. This reimbursement should be automatic rather than upon request. The committee also suggested the establishment of an advisory council, consisting of from twelve to eighteen members drawn from various interest groups, to monitor and provide suggestions on the work of the board. Finally, the committee urged that the auditing standards staff should be expanded, that it include a director of research, and that it be headed by a well paid executive director.

These proposals were reported to the AICPA Board of Directors on March 2, 1978. The board postponed any action until it could obtain the views of Council members at a series of regional meetings later in the month. Those meetings revealed strong support for most of the committee’s recommendations. The proposal to permit non-AICPA members to serve on the auditing standards board, however, was overwhelmingly opposed.

The Institute’s general membership reflected a diversity of opinion about the committee’s conclusions. Some members and a few of the large firms favored a full-time, paid board, while others preferred a full-time, paid chairman with part-time board members. In fact, at one point some committee members had favored a full-time chairman.

On May 6, 1978, the AICPA Board of Directors acted on the committee’s recommendations. It endorsed the committee’s report with a few exceptions: The Auditing Standards Board should comprise solely AICPA members; the advisory council should consist of not more than nine members, and the chief staff officer should be a vice president for auditing. Also, the board concluded that reimbursement for the time and expenses of Auditing Standards Board members should be under the existing Council policy for expense reimbursement and should be made only upon request.

The board sought the immediate approval of the Council at its meeting on May 10, 1978. The Council debated a resolution
to adopt the committee's report with the modifications proposed by the board. Amending motions regarding the size, voting, and compensation of the new Auditing Standards Board all failed, although the Council did adopt an amendment to restore the size of the proposed advisory council to between twelve and eighteen members, as recommended by the committee. The resolution was adopted, marking another major milestone in the profession's history.

Following the Council's action, the board adopted a policy of compensating members of the Auditing Standards Board for their time, up to a maximum of 1,000 hours a year, at $25 an hour. The board hoped that this would encourage members from smaller firms to serve on the standards board.

The committee's final report was published as an AICPA booklet in May 1978. Readers interested in the rationale underlying the recommended changes in the structure of the auditing-standard-setting process are referred to that report.

In August 1978 a committee was formed to nominate members to serve on the new Auditing Standards Advisory Council, and by January 1979 a fourteen-member advisory council had been appointed. The first chairman was Alan B. Levenson, a partner in the Washington law office of Fulbright and Jaworski and a former head of the SEC Corporation Finance Division. Included on the council were representatives of various interest groups outside the profession, as well as four CPAs engaged in public practice. It was the committee's belief, supported by the AICPA Board of Directors, that at least a few practicing CPAs should be included to provide expert knowledge about auditing matters.

The council was particularly influential in pressing the Auditing Standards Board to develop a proposal for a revised auditor's report. However, the proposal, issued as an exposure draft on September 10, 1980, met with overwhelming opposition, and no changes were made in the existing form of auditor's report.

It is too soon to judge whether the restructuring of the auditing-standards-setting process was sufficiently beneficial to warrant the effort. There is certainly reason to doubt whether changes were necessary. In 1978, though, the climate in Washington seemed to dictate that the AICPA should not completely reject the suggestions of the Commission on Auditors' Responsibilities on this matter.
Recodification of the Securities Laws

Over the years there have been few objections to the AICPA’s setting of auditing standards. The auditing standards division has maintained close working relationships with the chief accountant of the SEC, and any differences have been resolved without major confrontations. Few, if any, informed observers would assert that there are serious gaps in existing auditing standards. Any criticisms are generally directed at the performance of individual auditors rather than at the standards with which they are expected to comply.

Nevertheless, in 1973, when John C. Burton was chief accountant of the SEC, a serious attempt was made by him to obtain explicit statutory authority for the SEC to set auditing standards. This came about in connection with a proposed recodification of the federal securities statutes under the sponsorship of the American Law Institute (ALI).

The authority of the SEC to set auditing standards under the present securities statutes is unclear. The law explicitly grants the SEC authority to specify the required form of auditor’s report but is silent with respect to the auditing procedures to be followed. To clarify this matter, Mr. Burton convinced Professor Louis Loss, the person drafting the ALI recodification, to include explicit authority regarding auditing standards in the language of the proposed recodification. Provision was also made for the SEC to set requirements for practice before it by accountants.

The AICPA vigorously opposed these proposed changes since the provisions were obviously designed to give the SEC more direct control over the auditing function. AICPA personnel met during 1973 and early 1974 with Professor Loss, Mr. Burton, and A. A. Sommer, Jr., one of the SEC commissioners, in an attempt to persuade them to agree to deletion of the provisions. David Isbell of Covington and Burling, the AICPA’s legal counsel, was particularly helpful in these negotiations. Mr. Isbell presented the AICPA’s views at meetings of the American Bar Association and the ALI.

After extended discussions Mr. Sommer was persuaded that it would be better not to include the new language in the securities laws recodification. He apparently recognized that it would damage the generally constructive relationships between
the SEC and the profession and decided that it was unnecessary to be more explicit about the commission's authority to regulate auditors' performance.

Professor Loss acceded to this view and deleted the controversial language from the draft of the recodification. A footnote was included to explain the modification, indicating that the intention was to leave the SEC's existing authority unchanged. Thus, the SEC's control over auditing standards would remain unclear until it was tested in the courts.

The ALI recodification included other sections that would have a direct bearing on auditors' exposure to legal liability. One provision would limit the liability of experts, including auditors, under certain conditions. To monitor the proposed changes affecting auditors, the AICPA appointed a special committee composed of the house counsels of the large firms. This group conveyed a number of suggested changes to Professor Loss during his development of the pertinent sections of the recodification.

The recodification proved to be a long and difficult process. Not until late 1980 did the SEC reach tentative agreement with Professor Loss on various changes it believed were necessary. By then significant segments of the securities bar were saying the project's time had come and gone. Few people had any enthusiasm for a sweeping revision of the securities statutes. Legislation had not been introduced by early 1981, and the inauguration of the Reagan administration and a Congress dedicated to deregulation made the introduction of such legislation even more doubtful.

The Question of Audit Committees

Another matter involving auditing standards and the statutory authority of the SEC was the proposal to require all SEC companies to establish audit committees composed of outside directors. During the 1970s the SEC sought to improve corporate governance and accountability. In a May 11, 1976, letter, the SEC urged the New York Stock Exchange to impose an audit committee requirement on its listed companies, a requirement that the exchange adopted effective July 1, 1978.
Harold Williams, who became chairman of the SEC in 1977, sought to extend this mandate to other SEC registrants. He urged in congressional hearings in 1977 and 1978 that the profession make the existence of an audit committee a necessary condition for the issuance of an unqualified opinion on financial statements. A similar proposal had been made by Harvey Kapnick, head of Arthur Andersen and Company, who suggested that the AICPA adopt either an auditing standard or a rule of ethics on independence to impose an audit committee requirement.

The pressures from the SEC led to a proposal that the Institute appoint a special committee to consider the adoption of an audit committee requirement. On September 16, 1977, the AICPA Board of Directors authorized the appointment of such a committee to be chaired by Robert D. Neary, a top partner of Ernst and Ernst (now Ernst and Whinney). Two months earlier the board had adopted a policy statement, consistent with the AICPA’s recommendation adopted in 1967, urging Institute members to encourage corporations to establish audit committees.

The special committee began its work by distributing an issues paper seeking the views of all interested parties. It also held a public hearing on May 31, 1978. Most respondents, while favoring audit committees, believed that a requirement by the AICPA was unnecessary, and they questioned the Institute’s authority to impose such a requirement. The opinion of the Institute’s legal counsel was that the AICPA’s authority was dubious at best.

Virtually all CPA firms smaller than the eight largest were very vocal in opposition to the AICPA’s advocacy of audit committees. They felt that audit committees were causing companies to replace their smaller firm auditors with nationally recognized firms. Allegedly, a competitive disadvantage of the smaller firms resulted primarily from the outside directors’ belief that their safest course of action was to retain only the most widely known auditing firms for protection from criticism in the event of an audit failure.

The committee concluded that an audit committee requirement was not necessary either to auditor independence or to the conduct of independent audits. Since auditors could report directly to boards of directors, the existence of audit committees was not imperative. On September 21, 1978, the committee reported its conclusion to the board, and the board concurred.
When the AICPA informed the SEC of its decision, Chairman Williams expressed keen disappointment. He apparently had hoped that the profession would accomplish what the SEC might not have the legal authority to do through its own rule-making procedures under the securities statutes. Many observers believed that an audit committee requirement by the SEC would not withstand legal challenge.

Meanwhile, to counteract possible discrimination on the basis of size, the Institute's board issued a policy statement on July 13, 1978, urging audit committees and corporate boards not to use size as a principal criterion when selecting auditors. This action may have provided some comfort to the aggrieved CPA firms, but it did not solve the long-standing problem of displacement of smaller firms by larger ones. Nothing short of statutory authority for a governmental agency to appoint the auditors of corporations might solve the displacement problem, which continues to nag the profession. Such a cure would almost certainly be worse than the inequity it was intended to eliminate. In the end, the profession will probably have to become resigned to living with the discomforts of competition in a free enterprise system.

SEC Requirements Regarding Auditors

During the 1970s the SEC imposed other requirements related to auditors. Now, when a client changes accounting methods, the auditor must provide an opinion regarding the preferability of the new accounting method. This requirement is contained in Accounting Series Release no. 177.

The SEC also proposed that registrants should disclose certain types of information relating to auditors. Two such proposals, neither of which was adopted, would have required disclosures in proxy statements of auditors' fees and information regarding civil and criminal litigation and administrative disciplinary proceedings against auditors. One important disclosure requirement was imposed by the SEC beginning in 1971. It mandated that registrants describe, on SEC Form 8-K, certain disagreements about the application of accounting principles when there is a change in auditors. The former auditor must furnish a letter to
the commission stating whether he agrees or disagrees with the registrant's representations. This requirement was designed to discourage the practice of shopping for accounting principles. The rules, which were modified in 1974 and again in 1976, have generally worked well.

**Accounting and Review Services**

Another development of major significance to auditing had its origins in a 1975 letter from the Connecticut Society of CPAs to the Institute, recommending that a separate senior committee be established to set guidelines for engagements involving unaudited financial statements. Many smaller firms serving predominantly small, privately held clients believed that the auditing standards executive committee was too preoccupied with the problems of auditing the large, publicly traded companies registered with the SEC. As a result they believed that engagements involving unaudited financial statements were receiving too little attention and were being saddled with inappropriate standards.

The board was reluctant to authorize a separate committee because of the potential jurisdictional conflicts that might arise. Nevertheless, there was sympathy for the problems being raised, and on October 10, 1975, the board directed that a subcommittee of AudSEC be established to deal with unaudited engagements. The new unit was designated the accounting and review services subcommittee in order to avoid any confusion about the circumstances under which CPAs were associated with unaudited financial statements. We decided to seek a prominent CPA from a smaller firm who had no prior service with AudSEC to chair the new subcommittee. This would provide a clean break with past efforts to deal with unaudited engagements. William R. Gregory, head of a local firm in Tacoma, Washington, and later to become chairman of the Institute, fit the criteria and agreed to serve as chairman of the new nine-member subcommittee.

Beginning in 1976 the subcommittee defined two specific types of services involving unaudited financial statements: **compilation** and **review**. The committee developed specific procedures and accompanying accountants' reports for both types of engagements, and the draft of a first Statement on Standards for
Accounting and Review Services (SSARS) was exposed for com-
ment.

As might be expected, the new approach of providing differ-
tent levels of assurance on defined types of engagements involv-
ing association by CPAs with financial statements attracted a
great deal of attention and controversy. Bank lending officers,
through the Robert Morris Associates, objected to various aspects
of the proposals on the grounds that they would be confused
and shortchanged by the differing levels of assurance. Some
CPAs opposed the concept of limited assurance on the reliability
of financial statements. Other CPAs worried that clients would
substitute review engagements for full audits. Because of the
many comments and objections, a final statement was not pub-
lished until December 1978.

By that time the status of the subcommittee had changed. It
had become increasingly obvious that many local practitioners
strongly supported a separate senior committee status to deal
with accounting and review services. On July 21, 1977, the board
recommended to Council that a senior committee on accounting
and review services be established. This recommendation was
approved by Council on September 17, 1977.

The creation of the new senior committee presented the
potential for serious jurisdictional disputes between it and AudSEC.
Both committees dealt with the association of CPAs with unaud-
dited financial statements, depending on the nature of the client
and the context within which the financial statements appeared.
Predictably, disputes arose between the two committees almost
immediately. A joint task force succeeded in resolving some of
the issues, but others required decisions by the board of directors.
The board directed that association with unaudited financial
statements of any entity controlled by a publicly traded company
should fall under the jurisdiction of AudSEC.

As the date for publication of SSARS no. 1 approached, the
accounting and review services committee suddenly realized that
there was no provision for the enforceability of its standards
under the Institute's rules of conduct. To remedy this oversight,
the committee urged the board to endorse its designation by
Council resolution as the committee to promulgate technical
standards enforceable under rule 204 of the rules of conduct for
accounting and review services. This proposal was approved by
the board on March 1, 1979, and by the Council on May 7, 1979. Thus, members of the AICPA became subject to discipline for failure to comply with the committee's pronouncements on standards.

The committee published SSARS no. 2, dealing with comparative financial statements, in October 1979, and it had several additional matters under consideration during 1980. By early 1981, however, it was becoming apparent that the committee's task was limited. The need for more attention to nonaudit engagements had abated, and there was reason to question whether the committee would continue to be necessary in the future.

New Statements on Auditing Standards

During the 1970s the auditing standards committee and its successor, the AICPA Auditing Standards Board, addressed a great number of auditor-responsibility issues, many of which resulted in the publication of new Statements on Auditing Standards. Several of these issues demand at least limited discussion.

Lawyers' Representation Letters. One such issue involved lawyers' representation letters. The lawyers of audit clients became alarmed about their exposure to liability for representations made to auditors regarding their clients' contingent legal liabilities. After extended debate and negotiations between individual law and CPA firms, and between the AICPA and the American Bar Association, compromise procedures were developed. In January 1976 AudSEC issued SAS no. 12, Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments, describing procedures to be followed.

Responsibility of Auditors to Detect Errors and Irregularities (Fraud). Another issue involved auditors' responsibility to detect errors and irregularities. The report on the Equity Funding case caused AudSEC to issue SAS no. 16 in January 1977 to define more clearly the responsibilities of auditors for the detection of fraud.
Reports by Auditors on Interim Financial Statements of SEC Registrants. The SEC, in Accounting Series Release no. 177, adopted a requirement for certain large registrants to disclose selected quarterly financial data in notes to their financial statements in their filings with the commission. The release required independent auditors to review and report on the data, following proposed review and reporting procedures. The large CPA firms and the AICPA generally objected to this new responsibility. The SEC prevailed in its requirement but deferred to the profession's standards for review and reporting procedures. Those standards were contained in SAS no. 10, issued in December 1975, and in SAS no. 13, issued in May 1976. Both were superseded by SAS no. 24, Review of Interim Financial Information, published in March 1979.

Reports by Auditors on Internal Accounting Controls. Other standards involved auditors' reports on internal accounting controls. The Foreign Corrupt Practices Act of 1977 required SEC registrants to maintain systems that are adequate to meet certain specified objectives, and this requirement generated client requests for reviews of their internal accounting control systems by their independent auditors. A special AICPA committee developed proposed criteria for evaluation of internal accounting controls. In August 1977 AudSEC issued SAS no. 20, requiring auditors to report any material internal accounting control weaknesses detected during the course of audits to the clients' boards of directors or audit committees. Subsequently, in July 1980, AudSEC adopted SAS no. 30, which set standards for reviews and reports on systems of internal accounting control that are performed by auditors in connection with various types of defined engagements.

Supplementary Information Disclosures in Financial Reports. During the decade the SEC and the FASB imposed requirements for the disclosure of various types of supplementary information in the footnotes to financial statements and in financial reports outside the financial statements. These disclosures were covered in several pronouncements. Statements no. 18 and 21 dealt with footnote disclosures regarding, respectively, replacement costs and segments of a business. Statements no. 27 and 28 dealt with
disclosures outside financial statements regarding the effects of changing prices, and statements no. 27 and 33 provided guidance regarding oil and gas reserve disclosures.

Reviews by Auditors of Client Financial Forecasts. During the decade, the SEC reversed its long-standing policy prohibiting the publication of financial forecasts by registrants and began to encourage the disclosure of such information. The AICPA Accounting Standards Executive Committee developed recommended procedures for reporting, and the management advisory services executive committee issued procedures for the development of forecasts. Although AudSEC did not prepare auditing standards, it did issue a Guide for a Review of a Financial Forecast in the fall of 1980. The publication of financial forecasts and auditors' reports on reviews remains extremely rare even though the SEC provided legal liability safe harbor provisions in its release.

Without question, the responsibilities of auditors were significantly expanded during the decade. New duties were imposed in relation to such things as interim financial statements, internal accounting controls, opining on the preferability of accounting principles, and disclosures of a variety of supplementary financial information. Much of the pressure for these changes originated with an aggressive SEC, which was responding to a rash of major business failures and a consequent loss of confidence in financial reporting. Other pressures grew out of litigation against auditors and court decisions that tended to extend the responsibilities of the profession.

Because of the huge amounts of liability at stake, the profession moved deliberately if grudgingly to meet the public's rising expectations but resisted the more extreme demands for auditors to provide greater assurance on the reliability of financial statements than is reasonably possible. The trend of the 1970s toward more auditor responsibility is expected to continue because of continuing growth in the public's demands for accountability. Thus, the profession will have an opportunity to play an increasingly important role, providing it judiciously accepts the responsibilities that the public seeks to impose.
CHAPTER 6

Ethics and Enforcement

Prior to the 1970s the principal emphasis of the profession's disciplinary effort had been directed toward the restriction of what were viewed as unprofessional competitive practices. Rules such as those prohibiting advertising, solicitation, competitive bidding, engagement in incompatible occupations simultaneously with the practice of public accounting, and encroachment on the practice of other CPAs were based on the belief that such practices would erode the independence of CPAs acting as independent auditors. Other rules, such as the prohibition of the pirating of other CPA firms' employees, were intended to maintain harmony among practitioners in order to ensure a strong profession capable of fulfilling its responsibilities to the public.

Considerable emphasis was also placed on the independence of auditors.

Generally, the profession handled few complaints relating to compliance with accounting and auditing pronouncements. Indeed, the rules of conduct did not explicitly require AICPA members to follow the opinions of the Accounting Principles Board.

Drastic changes took place during the 1970s. Virtually all prohibitions against competitive practices were repealed under heavy pressure from the U.S. Department of Justice, and the enforcement of compliance with the profession's technical standards achieved paramount importance. Largely, the importance of these changes paralleled that of the developments in the setting of accounting standards. The shift in disciplinary emphasis was less visible to the public because it was mainly an intraprofessional matter; nevertheless, it was an important development because it represented a drastic departure from the
profession’s traditional beliefs about competitive practices, and portions of the internal turmoil caused by the changes were still present at the end of the decade.

Compliance With Accounting Principles and Practice in Corporate Form

The upheaval began in 1969 with the struggle to make compliance with generally accepted accounting principles enforceable under the code of professional ethics. The Institute’s membership voted on a new rule 202(e), which would have required compliance with Accounting Principles Board opinions.

On the same mail ballot was another provision to allow CPA firms to practice in corporate form under certain prescribed conditions. Professional corporations had become very popular because of their possible income tax advantages. As a result, there was considerable pressure within the public accounting profession to repeal the Institute’s prohibition of corporate practice. At the insistence of the Institute’s Board of Directors, the professional ethics committee developed a new rule 406 prescribing the circumstances under which practice as a professional corporation would be permissible.

The membership approved the proposal to allow CPAs to practice in corporate form but rejected the proposal to require compliance with opinions of the Accounting Principles Board. The latter proposal, actually, was endorsed by a majority of members, but it narrowly failed to receive the necessary two-thirds vote.

Revision of the Code of Professional Ethics

The Council did not authorize a second vote on the proposal because a complete review and restatement of the code of professional ethics was already underway. In 1965 Thomas Higgins, former chairman of the AICPA Committee on Professional Ethics, had described the code as one of the most poorly written pieces of professional literature and had called for a complete restatement in positive rather than negative terms. In October 1968 Thomas Flynn, who then served as chairman of the ethics
committee, responded by arranging for the appointment of a special committee to revise the code. I was appointed chairman, and Mr. Higgins served as a member of the study group.

The special committee labored on a complete revision of the code for over three years. A final version was approved in March 1973 by a mail ballot of the membership.

The new code included rules that explicitly required AICPA members to comply with the Institute's pronouncements on generally accepted auditing standards and with accounting principles promulgated by bodies designated by the Institute Council. These rules removed any doubt that the profession would enforce technical standards as part of its system of self-regulation.

The restated code also included other important innovations. It contained a forepart, "Concepts of Professional Ethics," which expressed the underlying philosophy for the rules of conduct that followed. The concepts of integrity, objectivity, and competence were specifically addressed. Peer reviews of professional practices were officially recognized and exempted from the restrictions relating to the confidentiality of client information. Prior rules on advertising and solicitation were combined. Finally, the code differentiated the applicability of the rules to members within and outside public practice.

Federal Antitrust Actions

Naturally, these innovations generated controversy. One major issue was whether the code should continue to include a rule prohibiting members from engaging in competitive bidding.

Several years earlier, in 1966, the AICPA was informed by the Department of Justice that ethics rule 3.03, prohibiting competitive bidding, would very likely be deemed to be in restraint of trade. Following the advice of legal counsel, the board had adopted a policy of not enforcing the rule, and a statement to that effect was included in the code of professional ethics.

Following this action the Department of Justice obtained consent decrees relating to similar competitive bidding rules from the American Society of Civil Engineers and the American Institute of Architects. Having achieved its objective with these two organizations, the Department of Justice once again turned its
attention to the AICPA and began an investigation early in 1971. A civil investigative demand required the Institute to make available all documents produced after January 1, 1967, relating to rule 3.03. By 1972 the department made it clear that it would carry out litigation against the AICPA unless the Institute entered into a consent decree not to enforce its ethical rule prohibiting competitive bidding.

The board was advised by legal counsel that, if the matter were litigated, the competitive bidding rule was almost certain to be found a per se violation of the federal antitrust laws. Counsel therefore recommended that a consent decree be entered into. Acting on this advice, the board authorized negotiations to obtain the best possible agreement under the circumstances. It concluded that signing a consent decree was the best course to pursue since a settlement resulting from negotiations might be somewhat less restrictive than what might result from litigation.

The board’s intentions were reported to the AICPA’s Council at a meeting in May 1972. At that time the Council was considering submission of the restated code of professional ethics to a vote of the Institute’s members. In view of the pending negotiations with the Department of Justice, the proposed code did not include a prohibition of competitive bidding.

This omission and the intent to enter into a consent decree gave rise to acrimonious debate at the meeting. The AICPA had long held that competitive bidding was unprofessional and would do serious damage to auditors’ independence, and the prospect of abandoning this position caused great alarm. The Texas Society of CPAs, among others, had obtained separate legal opinions to support its contention that the AICPA should litigate the issue all the way to the U.S. Supreme Court if necessary. Motions were made to insert a rule restoring restraints on competitive bidding; however, these failed to gain the approval of a majority of the members of Council.

At a special meeting on May 26, 1972, the board approved the signing of a consent decree whereby rule 3.03, on competitive bidding, was declared null and void and the AICPA was enjoined from any plan, program, or course of action that would prohibit its members from submitting price quotations for accounting services to any person seeking such services. The board issued a press release, which stated that the AICPA did not concede
the validity of the government's complaint, and pointed out the prior voluntary abstinence from enforcing a prohibition of competitive bidding.

The consent decree did not deal with other rules, such as those prohibiting advertising and solicitation, even though the Department of Justice had expressed concern about them during the course of the negotiations. The attack on these rules was destined to occur several years later.

After the adoption of the restated code of professional ethics, the Institute no longer had a rule relating to competitive bidding. This was the first step in the elimination, under threat of legal action, of all attempts by the AICPA to restrain competitive practices within the profession. Having conceded by implication that the profession was not exempt under the federal antitrust laws, the AICPA recognized that it would be only a matter of time before its other restrictive rules would come under attack.

During the years from 1972 to 1977, the Department of Justice turned its attention to the other professions, including lawyers and doctors. Lawsuits were filed, which in some cases were decided by the U.S. Supreme Court. The department established that private professional organizations were not exempt from the federal antitrust laws and that their prohibitions of advertising were in violation of the law.

Then, in 1977, the Department of Justice and the Federal Trade Commission simultaneously reopened the attack on the AICPA's rules of conduct. The Federal Trade Commission initiated a broad investigation of the profession in April 1977 by issuing subpoenas to the AICPA, state societies, CPA firms, and state boards of accountancy. Generally, it sought information relating to entrance requirements, as well as all other practices that might be viewed as attempts to restrict competition.

The approach of the Department of Justice was narrower in scope. In a letter to the AICPA dated May 3, 1977, it requested files and information relating to the Institute's rule 502, which prohibited advertising and solicitation.

Once again the Institute's outside legal counsel, now Wilke, Farr and Gallagher, engaged in a dialogue with the Justice Department in an attempt to defend the profession's prohibitions. Privately, they advised the AICPA's officers, board, and Council that they had almost no chance of successfully defending
rule 502 in litigation, particularly in the light of recent U.S. Supreme Court decisions.

The department was persuaded to delay filing a lawsuit until the Institute could take action to repeal rule 502. Accordingly, the board requested the professional ethics committee to prepare a proposed change in the rule, which, under the restated code, had combined the prohibitions of advertising and solicitation. The committee responded by proposing the following revised rule: "A member shall not seek to obtain clients by advertising or other forms of solicitation in a manner that is false, misleading or deceptive." In addition, the committee indicated its intention to issue an interpretation to the revised rule; interpretation 502-3 provided, in part, that "a direct uninvited approach by a member seeking to render services to a specific potential client is prohibited."

These proposals were placed on the agenda of the meeting of Council in Cincinnati on September 17, 1977. Proposals to modify rule 504, prohibiting incompatible occupations, and to repeal rule 402, prohibiting offers of employment to employees of other CPAs without prior notice, were also included on the agenda. These were in response to public statements by the Federal Trade Commission that it regarded these rules as restrictions on competition. Philip Defliese, former chairman of the AICPA and head of Coopers and Lybrand, moved that the proposed interpretation regarding solicitation be included in the revised rule itself. After considerable discussion, the Council added the following to the revised rule 502: "A direct uninvited solicitation of a specific potential client is prohibited."

This change had the effect of retaining a direct prohibition on uninvited solicitation of specific prospective clients. Although there was considerable doubt that the Department of Justice would find this acceptable, there was strong sentiment within the Council that failure to retain the limited restriction would greatly damage the independence of auditors.

After modifying the proposal to revise rule 502, the Council approved all three proposed rule changes for submission for ballot by the membership as required under the bylaws. The changes were approved and declared effective early in 1978.

Predictably, the Department of Justice was dissatisfied with the continued prohibition of uninvited solicitation contained in
the second sentence of revised rule 502. It again threatened to file suit against the AICPA and to include in its complaint rule 401, which prohibited encroachment by members on the practices of other members.

Once again the Institute's legal representatives carried on discussions with the department, and the department again agreed to withhold legal action on the promise that the AICPA board would seek the repeal of rule 401 and the second sentence of rule 502. While the board was not in sympathy with allowing uninvited solicitation, it was convinced that an attempted legal defense would prove futile. It would be a waste of funds and would foreclose even informal discouragement of uninvited solicitation.

The proposed changes were presented to the Council at its meeting on October 21, 1978, in San Francisco. By this time the Council members had lost all patience with what they viewed as the unreasonable demands of the federal government, and many spoke in favor of litigating the issue to the Supreme Court if necessary. This mood was enhanced by the argument of Philip L. Defliese that the prohibition should be legally defensible on the grounds that uninvited solicitation would destroy the independence of auditors, which is so vital to their role and distinguishes them from other professions. He failed to explain, however, how the prohibition could be made to apply only to audit engagements and not to other services for which independence is not essential.

By a vote of 106 to 103, the Council agreed to submit the proposal to a vote of the membership, but by a vote of 130 to sixty-nine it indicated its disapproval of the proposed deletion of the second sentence of rule 502. Since rule 401, prohibiting encroachment, had already been nullified by the permission to advertise, there was little opposition to its repeal.

To the astonishment of nearly everyone, the members, by a vote of 48,961 to 22,310, approved the repeal of the prohibition of uninvited solicitation effective March 31, 1979. Repeal of rule 401 was approved by a wider margin.

Meanwhile, the Federal Trade Commission's nonpublic investigation dragged on for three years. Finally, it announced on September 16, 1980, that its file had been closed without further action. The commission stated that it was generally satisfied with
voluntary actions taken by the profession to eliminate anticompetitive restrictions on CPAs.

Continuing Controversy Over Solicitation

The removal of the restraints on uninvited solicitation met with a high level of consternation among many practitioners, who believed that the traditional professionalism of CPAs would give way to unrestrained selling tactics and fee cutting. It became the prime topic wherever CPAs came together. Some practitioners saw the action as a conspiracy between the AICPA and the large firms to put the smaller firms out of practice, while others alleged that the wording of the mail ballot had misled members. Some CPAs even expressed the suspicion that the votes had been miscounted and the final result misrepresented.

At the Institute annual business meeting in Boston on October 4, 1980, the members present approved almost unanimously a motion to appoint a special committee to consider restoring a prohibition on uninvited solicitation. The committee was authorized to engage legal counsel of its own choosing to obtain a separate opinion regarding antitrust aspects.1

That is where the matter stood at the end of 1980. Despite the profession's strong opposition to uninvited solicitation, the Department of Justice was unlikely to permit the profession to turn the clock back without a legal struggle, and the best legal minds specializing in antitrust law doubted that the profession could prevail in litigation.

Within a few brief years after adoption, large portions of a restated code of professional ethics had become obsolete by the repeal of the traditional restraints on competition. As a result of the new freedom the long-standing friction between the large international CPA firms and the rest of the practicing profession had intensified. Although it is not clear what effect these developments will ultimately have on the profession's unity, income levels, and quality of performance, intraprofessional harmony suffered considerably during the decade. Nevertheless, at the

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1. See note 1, chapter 1.
end of 1980 the profession appeared to be reluctantly adjusting
to the new circumstances. Fear that unrestrained competition
will be fatal to professionalism fails to take into account that,
over time, CPAs are likely to exercise appropriate self-restraint
regardless of the lack of any formal rules of enforcement.

Reviewing the Quality of Audits

As formal rules regarding competitive practices were repealed,
the ethics committee was able to devote more of its attention to
surveillance of the quality of practice. New procedures were
developed to gain access to and review samples of audit reports
for compliance with accounting and auditing standards.

During the decade the ethics committee established a program
for reviewing the quality of CPAs' audits of federally assisted
programs. The General Accounting Office had conducted a
limited review of such audits and issued a highly critical report.
Clearly, the profession had to act.

Arrangements had been made as early as 1973 for federal
grant agencies to refer cases of substandard performance by
independent auditors to the Institute's ethics committee. For
various reasons, however, only a few such referrals were actually
made over a period of several years. More aggressive action
appeared necessary.

After meetings between AICPA personnel and representatives
of the General Accounting Office and twelve of the more active
federal agencies, arrangements were made for the ethics com-
mittee to draw samples of audit reports from the governmental
files. The committee would review the reports and, when it
discovered a substandard audit, would take appropriate correc-
tive action. This program was in the process of being imple-
mented at the end of 1980.

To complement this program, the Institute board authorized
the ethics committee to mount a similar effort at the state and
local governmental level in cooperation with the state societies
through the Joint Ethics Enforcement Program. This effort was
also in the early implementation stage at the end of 1980.
Audits by Governmental Auditors

Audits of governmental units performed by CPAs who were government employees proved to be another area of concern. Increasingly government auditors, as CPAs, were expressing standard audit opinions on the financial statements of governmental units. The profession certainly did not wish to discourage CPAs from serving as auditors within government, but there were serious questions about whether government auditors were sufficiently independent to warrant use of the standard auditor’s opinion. The AICPA Board of Directors considered this problem, and on March 2, 1978, it adopted a policy statement that prescribed the circumstances under which government auditors could use the standard auditor’s opinion. It placed great reliance on the criteria for independence that the General Accounting Office had established for government auditors in connection with audits of federally assisted programs.

Restructuring the Disciplinary Machinery

Not only did the focus of the profession’s enforcement efforts change during the 1970s, but the enforcement mechanisms themselves came under review. In 1970 the professional ethics division brought disciplinary actions against members of one of the large firms, and the head of the firm challenged the appropriateness of the procedures of the division and the trial board. The Institute’s Board of Directors reacted by appointing a special committee to review the operations and procedures of the two groups. The committee reported its findings in February 1971. A number of suggestions for improvements were made, but no serious deficiencies in the operations and due-process procedures of the ethics division and trial board were noted. Nevertheless, the incident illustrated the difficulty of imposing discipline on members when their firms interceded on their behalf.

In 1971, independently of the foregoing challenge to procedures, the AICPA restructured the professional ethics division to establish an executive committee and three subcommittees, each of which would handle all matters under a particular section of the code. The three subcommittees had jurisdiction over technical standards rules, independence rules, and all other
behavioral rules. Greater specialization, it was hoped, would allow subcommittee members to develop more expertise.

Attention was also given to the duplicate disciplinary machinery that existed within the state societies and the AICPA. To eliminate the duplication, the AICPA devised a plan to integrate the work of the ethics committees at the state and national levels and to establish a single trial board division that would deal with each case, in behalf of both the state societies and the AICPA, through a single hearing. In general, the state ethics committees would process cases involving less significant violations, and the Institute's committee would deal with violations involving technical standards or having national significance.

Eventually, state societies joined forces with the AICPA in what became known as the Joint Ethics Enforcement Program (JEEP). Although later modifications were made in the joint trial board structure and in the operating procedures of the ethics committee, the JEEP was functioning quite well by the end of the decade.

A new disciplinary element was introduced when the division for CPA firms was created in 1977. Both sections of the division provided for the sanctioning of member firms for failure to comply with membership requirements, and this again posed the prospect of duplicate disciplinary proceedings for the same offense.

The division for CPA firms and the professional ethics committee worked to minimize duplication under their overlapping disciplinary jurisdictions. They tentatively agreed that the ethics committee would defer action on cases being handled by the division for CPA firms pending their outcome and disposition under that body's disciplinary proceedings. Nevertheless, the ethics committee reserved the right to initiate subsequent proceedings against the individual CPAs involved.

In addition, the National Association of State Boards of Accountancy (NASBA) was urging its state boards to mount an aggressive surveillance and enforcement program under their authority to suspend or revoke CPA certificates issued under their jurisdiction. Some of the state boards were also beginning to impose peer reviews as sanctions in disciplinary proceedings. These developments promised that even more duplication would occur.
Concern that respondents to ethics violation charges would be subjected to multiple proceedings for the same offense led to the appointment in March 1979 of a special committee, which included representatives of the AICPA, NASBA, and the state societies. The committee was chaired by Marshall S. Armstrong, who had previously served as president of the Institute and as the first chairman of the Financial Accounting Standards Board. The group was directed to review all aspects of regulation of the profession and to recommend ways in which it could be made more effective.

After several months of deliberation and sharp debate, the committee issued a report on its conclusions on February 20, 1980. The report recommended that the AICPA, the state societies, and the state boards of accountancy should establish a joint program for seeking out substandard work for possible disciplinary action. Under the program, members and licensees in public practice should be subject to random selection for a review of the quality of their work. To further avoid duplication, NASBA should urge state boards of accountancy to rely on the JEEP to investigate all possible violations of rules of conduct, and the AICPA and the state societies should encourage the JEEP to refer cases warranting disciplinary proceedings to the state boards. The committee also recommended that disciplinary hearings should be open to the public and that hearing panels should include some public members. Finally, the report urged that membership in the AICPA and any state society should be revoked for any CPA in public practice who fails to meet continuing professional education requirements.

The report was submitted to the boards of the AICPA and NASBA for consideration. Early steps toward coordination between the JEEP and the state boards were expected, and adoption of an affirmative program of sample reviews was to be further explored. In view of previous actions by the Institute’s board and Council, implementation of the recommendations regarding continuing professional education and public disciplinary hearings appeared unlikely.

The suggestion that the profession’s disciplinary proceedings be conducted publicly had been made by the Commission on Auditors’ Responsibilities in 1977. A special committee appointed to consider this recommendation concluded in March 1978 that
notices of disciplinary hearings and the names of the accused should be published and that the hearings should be open to the public. In addition, the committee recommended that the names of all respondents found guilty by a trial board be published. Publication of such names should no longer be left to the discretion of the trial board.

Both the board and the Council declined to adopt these recommendations, although they did agree to the mandatory publication of the names of all members found guilty as the result of a trial board proceeding. Most members feared that the publication of allegations against a CPA before they had been proven in a disciplinary hearing would damage the CPA’s reputation irrevocably, even if a finding of innocence were subsequently published. Many members of the board and the Council also believed that a public hearing would inhibit the disciplinary process because of the tendency toward greater formality under such circumstances.

The proposal to conduct the profession’s disciplinary actions “in the sunshine” was thus squarely addressed and rejected in 1978. Nevertheless, if the profession’s system of self-regulation again falls under critical outside investigation, it is open to question whether the privacy of disciplinary proceedings can be successfully defended.

All in all, strenuous efforts were directed toward the development of a more effective system of regulation of the profession, with greater coordination between the various jurisdictions to avoid unnecessary duplication. The structure to sanction CPA firms as entities, the affirmative program to seek out instances of substandard work through sample reviews of audits in both the governmental and private sectors, and the proposals to combine investigations and disciplinary proceedings were separate actions under an overall program to meet the profession’s responsibility to regulate itself. Future experience will determine whether the initiatives were adequate to achieve effective self-regulation or whether additional actions will be necessary.
CHAPTER 7

The Division for CPA Firms

The Complaints of Small CPA Firms

During my first year as chief staff officer of the AICPA, CPAs from small firms bombarded me with complaints about the AICPA. In my service on Institute committees and Council, I had already become aware of the tensions that existed between the large, national firms and the rest of the practicing profession. I was alarmed, however, by the volume and intensity of the criticism being levelled at the Institute.

Many of the complaints were based on false perceptions, rumors, or a lack of knowledge about the AICPA’s structure and services. Still, many practitioners expressed legitimate concerns about trends that were making it increasingly difficult for smaller firms to compete with both the larger firms and nonlicensed accountants.

In an article, "The House of Accounting," that I wrote in 1973, I expressed my concern about the tensions among the various factions within the profession. I felt that the AICPA must openly address these tensions and take actions to alleviate them. Others, including prominent members of the staff, argued that the stresses had existed for many years and that their causes did not lend themselves to ready solutions; they warned that a search for improvement would produce only needless debates and anger. I was not content, however, to treat the profession’s internal problems with benign neglect, and during the next several years the AICPA took many actions aimed at achieving greater unity within the profession. Unfortunately, they were offset by events beyond the control of the AICPA, which contributed heavily to animosities within the profession’s ranks: The repeal of compet-
The Division for CPA Firms

itive prohibitions at the insistence of the Department of Justice, the growing burden of complex accounting and reporting standards, pressure from the SEC and Congress, and the large firms' increasing aggressiveness all took their toll.

In late 1973 I began urging that the Institute establish a committee of members from smaller firms to consider ways in which the AICPA might be of greater assistance. The Institute's chairman resisted this suggestion on the grounds that it had been tried before with little success. In fact, he had served on such a committee and was convinced that it had acted like a small private club rather than as a source of constructive ideas. Finally, he agreed, however, to hold an experimental seminar for a group of practitioners from smaller firms who would be invited through the state societies.

The seminar was held in Chicago on July 11, 1974, with twenty-five members in attendance from twenty-two states. The chairman and I led the one-day discussions, which covered a range of subjects known to be of concern to the smaller firms. The session proved to be highly successful. The practitioners became much less critical as they learned more about the AICPA's activities and the practical limitations that it faced. The Institute's officers gained a sharper understanding of the problems of smaller firms and what might be done to deal with them. Most of the participants were genuinely pleased to have had a session with the Institute's top officers, and they spread the word to CPAs back home that the AICPA understood and cared about the problems of the local practitioner.

The success of the first seminar encouraged me to adopt it as an annual, staff-conducted event. Each year thereafter, through 1980, three regional seminars were held at locations in the East, Midwest, and West. The program became very popular, and many practitioners were eager to attend each year. Without exception, the seminars proved to be an effective means of communication through which ideas for new and improved services were generated and at which local practitioners could express their interest in service on committees. The seminars did not completely solve the communications problem, because they reached only about seventy-five CPAs each year, but they did help to eliminate misunderstandings.
The Complaints of Larger CPA Firms

The smaller firms were not alone in their dissatisfaction with the Institute. The heads of the large firms were also restless. Some of them felt that the profession's progress was being impeded by the smaller firms' opposition to needed changes; others regarded the AICPA as impotent because it could do nothing to prevent individual firms from taking unilateral actions that affected the entire profession.

One example of unilateral action occurred in 1974, when the SEC proposed that independent auditors review and report on registrants' interim quarterly financial reports. Nearly all the large firms strongly opposed such a responsibility on the grounds that users of the reports would place more reliance on their accuracy than would be warranted. They also worried about the risks of legal liability and the fact that many companies regarded the proposal as a means for enabling their auditors to increase their fees.

The debate on this issue was at its peak when Philip Defliese became chairman of the AICPA in October 1974. Shortly thereafter, his firm, Coopers and Lybrand, issued a statement that it would begin accepting engagements to review and report on its clients' interim financial reports. Because of competitive considerations, this unilateral action effectively set the policy for the rest of the profession. Needless to say, this angered the heads of the other large firms. To make matters worse, a partner of Coopers and Lybrand, Kenneth Johnson, was appointed by Mr. Defliese to serve as chairman of the auditing standards executive committee, which was struggling with the issue.

I concluded that something had to be done to discourage firms from taking such divisive actions in the future. With the agreement of Mr. Defliese and the AICPA Board of Directors, I called a special meeting of the heads of the eleven largest firms to discuss how a better climate of cooperation could be achieved. Although the action of Coopers and Lybrand triggered my decision, it was preceded by a long series of similar unilateral public statements and policies on the part of other firms.

The meeting was held at the AICPA's New York offices on December 12, 1974. As might be expected, the discussions were
less than calm. The heads of four of the eight largest firms talked openly about establishing an organization of the large firms outside the AICPA. (Much later it was revealed that the four firms had already discussed the idea of a separate organization.) Others counselled that this would be disastrous for the profession and warned about the possible applicability of federal antitrust laws.

The session concluded with an agreement that similar meetings should be held in the future to seek a consensus on technical issues, relations with the SEC, and other matters. The Institute would engage special legal counsel, expert in antitrust matters, to attend each meeting and monitor the proceedings to ensure that the participants did not engage in any discussions that would violate antitrust laws. Stanley Robinson, a partner of Kaye, Scholer, Fierman, Hays and Handler, a New York law firm, was engaged to serve in that capacity.

Additional meetings were held during the early months of 1975, with Chairman Defliese presiding. If nothing else, they provided a forum where viewpoints could be exchanged and complaints aired.

**Meetings With the SEC**

Prior to these group meetings, I had been meeting regularly with the heads of the large firms, one at a time, to discuss their complaints about the AICPA. Despite the differences, and sometimes animosities, that existed between some of these individuals, they all shared a deep concern about liability suits and SEC efforts to expand auditors' responsibilities with regard to financial reporting. The chief accountant of the SEC, John C. Burton, was a favorite target of criticism, as was the commission's enforcement division.

This was an unhealthy situation because it was in the best interest of both the SEC and the profession to maintain a harmonious working relationship. The chairman of the commission, Ray Garrett, Jr., also worried about the worsening relationship with the profession. He agreed that periodic meetings should be held between the commissioners, the heads of the large CPA firms, and the AICPA's chairman and president.
The first such meeting was held on June 28, 1974, in the AICPA's Washington office. AICPA Chairman Derieux and SEC Chairman Garrett presided jointly over the proceedings. The heads of the eleven largest CPA firms were present, as were the SEC's commissioners, chief accountant, and director of the enforcement division. The discussions explored alternatives to existing forms of enforcement by the SEC and the question of whether the SEC could provide auditors with the results of its private investigations when the information was relevant to audit problems.

Succeeding meetings dealt with possible relief from legal liability, auditors' responsibility for detection of fraud, improper corporate payments, disclosures of current replacement costs, and similar issues. A total of seven meetings were held through February 1976.

At one point the eight largest firms signed a joint letter, initiated by John Biegler, head of Price Waterhouse and Company, taking issue with some of the informal views expressed by SEC staff members at a meeting at which the subject of improper corporate payments was discussed. Chairman Garrett was incensed by this action because the meetings were intended to provide a means for free expression without any pressure to hold to official positions. He threatened to terminate the meetings but was persuaded by the firms to continue them.

Chairman Garrett was also disappointed by the CPAs' unwillingness to examine the facts contained in the SEC's disciplinary files on completed cases against auditors. Such an examination would allow the profession to judge for itself whether the SEC's enforcement actions had become overzealous. The CPAs decided not to follow up on this offer because they feared that only a biased sample would be made available.

The meetings were discontinued after February 1976 because new federal legislation made it illegal for regulatory agencies to hold private meetings with private interest groups.

The meetings did not produce any striking changes in the policy positions of either side. They did, however, produce a better understanding between the SEC and a large segment of the profession practicing before it. The meetings also provided an opportunity for a unified expression of the concerns of the
major firms. In effect, the program was a forerunner of the SEC practice section of the division for CPA firms.

Suggestions for Restructuring the AICPA

In addition to arranging meetings of these two constituencies (large firms and small practitioners), the Institute was investigating how it could better serve the various interest groups within the membership. A special committee chaired by Marvin Stone, former president of the AICPA, had been studying the impact of accounting services by non-CPAs. This study had been inspired mainly by the growing number of banks providing computerized accounting services in competition with CPAs. The committee’s report, issued in February 1973, recommended that the Institute embark on a program to accredit specialists.

The board declined to act on that recommendation because of its belief that the proposal did not have the support of the membership. Instead, it agreed in May 1973 to expose for comment my alternative proposals, which would establish divisions within the AICPA along existing lines of specialization, such as accounting and auditing, tax, management advisory services, SEC practice, and general practice. The divisions would be governed by existing executive committees; they would issue publications and sponsor national conferences in their respective areas of expertise. Membership in the divisions would be voluntary and open to any member of the AICPA. A form of associate membership would also be available to non-CPAs employed by CPA firms.

Before these proposals could be acted upon, a new special committee was appointed to study the scope of services within the accounting profession and the restructuring of the AICPA in relation to those services. In view of this development, the board agreed in July 1973 to refer my suggestions to the new committee.

The special committee on scope and structure devoted over two years to its study and issued its final report in July 1975. The committee’s recommendations met with strong opposition, and its report did not result in structural changes in the AICPA.
The Five Advisory Groups

Yet another proposal was made to the AICPA Board of Directors in February 1975: that five advisory committees be appointed to represent constituencies within the AICPA. Advisory group A would represent all firms having less than fifty AICPA members; advisory group B would represent all firms having more than fifty AICPA members, except for the eleven largest firms; and advisory group C would represent the eleven largest CPA firms. The industry and government advisory group and the education advisory group would represent all members employed in those areas.

The proposal was approved, and by mid 1975 the advisory committees for each group had been appointed. Except for group C, each advisory committee originally consisted of fifteen members. The eleven firm heads who had been meeting periodically since December 12, 1974, became advisory group C, and an existing committee on management accounting became the industry and government advisory committee. The following were the initial chairmen of the advisory committees:

Group A—Glenn Ingram, Jr., of Glenn Ingram & Co.
Group C—Walter Hanson of Peat, Marwick, Mitchell & Co.
Education—Professor C. B. Stephenson of Ohio University

The role of the advisory committees was to monitor developments affecting the profession and to advise the AICPA’s governing bodies and senior committees of their viewpoints. They were supposed to act as conduits through which the views of their respective interest groups would be conveyed to the AICPA’s policy-making bodies. By giving the different groups the means of expressing their views, the AICPA leadership hoped to lower the profession’s internal stresses.

The establishment of the advisory committees gave rise to considerable controversy. One of the principal points of contention was how many firms should be included in group C. Several large firms felt that they would suffer competitively if they were
not included in that group. On the other hand, the largest firms did not want their ranks expanded to include firms whose practices were not substantially similar to their own. The committee was expanded to fifteen firms in May 1977.

Group A was also expanded at that time, from fifteen to twenty-one members, because of criticism that the original committee did not adequately represent the very small firms. The additional six members were all drawn from firms having from one to ten AICPA members.

Advisory group B was expanded in October 1975. Instead of representing fifteen firms with at least fifty AICPA members, it now included representatives of all such firms. In 1975 a total of twenty-two firms qualified, and there was benefit in having them all serve on the advisory committee.

The five advisory committees held meetings with varying degrees of frequency and effectiveness through mid 1977. The most effective of the advisory committees was group C, probably because it was composed of a small number of firms whose interests were almost identical. Although its members were often in sharp disagreement among themselves, the firms involved gave the group considerable influence whenever it spoke with one voice. The group played an active role in advising the Institute’s board and senior committees of its views on key technical issues.

Group A also had the potential for great influence because it represented thousands of CPA firms across the country. However, the large number and diversity of its constituency made it difficult to gain a consensus of viewpoints, and the committee never realized its full potential. The group was also handicapped because the committee members, being practitioners from smaller firms, could devote only a limited amount of their time.

The firms in group B were generally in the awkward position of having interests that were similar with those of both groups A and C. In general, they tended to identify their interests with those of group C, even though they had no love for the so-called big eight firms, which often acquired the group’s larger clients. Although advisory group B had difficulty in reaching a consensus on issues, it was at least partially successful in making its wishes known.

The most important achievement of the industry and govern-
ment advisory committee was a bylaw amendment to permit members not in public practice to serve as AICPA officers and trial board members.

The education advisory committee achieved very little, and the committee was eventually discontinued.

**Proposals Leading to a Division for CPA Firms**

Another suggestion for reorganization of the profession appeared in a *CPA Journal* article in July 1975. The author, Eli Mason, suggested many changes, including the restructuring of the AICPA and the standard-setting bodies (including the Financial Accounting Standards Board) and an increased role for the presidents of the state societies, the SEC, and the General Accounting Office.

Several features of the Mason plan met with strong resistance, particularly the suggested restructuring of the FASB so soon after its establishment. The most serious problem, however, was that federal legislation would be required for implementation of the proposal. At that point in time, the Institute was in the early stages of its long battle to ward off unwanted federal regulatory legislation, and Mr. Mason's suggestions were unwelcome. Chairman Defliese and I attempted unsuccessfully to dissuade Mr. Mason from pursuing his proposal through members of Congress. As recounted in chapter 3, he pushed his plan as a witness before congressional hearings. He also discussed his ideas with various individual members of Congress and federal agencies.

Despite its sharp disagreement with Mr. Mason, the AICPA Board of Directors directed that his article be distributed and discussed at the next meeting of the Council in October 1975. At that meeting several members expressed interest in various features of the plan. As a result, it was decided to appoint a special committee to consider once again the structure of the AICPA and the profession and to include the Mason proposal in its deliberations. The committee was chaired by Harry Mancher, head of S. D. Leidesdorf and Company, and consisted of representatives of small, medium, and large firms.
It was apparent that the developments in Washington required the new committee to act with considerable urgency. It began its work in December 1975, interviewed Mr. Mason and others, and presented its final report to the board in July 1976, setting a time record for a special committee on a major policy matter. The most important recommendation in the committee’s report was for establishment of a structure within the AICPA to deal with CPA firms as entities; however, the committee did not offer any details about such a structure.

Only individual CPAs were members of the AICPA, and the Institute had no authority with respect to the CPA firms within which the individuals practiced. Several individuals had been suggesting for more than a year that, in the reality of the 1970s, firms were responsible for audits of at least all publicly traded corporations.

In accepting the committee’s report, the AICPA Board of Directors requested me to develop the general recommendation more fully for later consideration. I had no enthusiasm for this mission because I saw no way short of legislation that the large firms could be persuaded to surrender part of their autonomy to a private regulatory body under the AICPA. All prior experience had indicated that they would not do this voluntarily, and support for a legislative initiative was out of the question. Therefore, I prepared a paper spelling out the reasons why the committee’s recommendation could not be implemented. That is where the matter rested for the next several months.

One year later the picture had changed dramatically. The Metcalf staff report, *The Accounting Establishment*, had been published; congressional hearings were underway, and the larger firms were under attack. The issue of improper corporate payments had arisen, and the SEC had begun imposing quality reviews on CPA firms as a disciplinary sanction. Even the most conservative among the heads of the large firms recognized by mid 1977 that the status quo could not be maintained. Advisory group C was aware of the growing danger of unwanted legislation, and there was renewed discussion about the establishment of a self-regulatory body.

The time was ripe for change. In May 1977 Chairman Chetkovich and I proposed that the AICPA establish two divisions
for CPA firms, one for firms with an SEC practice and another for firms with largely a private companies practice. The proposal won the immediate support of the AICPA Board of Directors.

Advisory groups A and C, with some modifications to their membership, served as ad hoc groups to develop charters and operating procedures for the two proposed divisions. The two groups quickly agreed on documents that were to serve as the constitutions of the two divisions. They were similar in their provisions, except that certain additional requirements were imposed for firms serving companies registered with the SEC.

If one person deserves to be singled out for his efforts on this project, it is George Catlett. A partner of Arthur Andersen and Company, he played a key role in the negotiations regarding the division for SEC practice.

Membership in the proposed divisions would be voluntary and open to all CPA firms that met certain requirements. For a firm to qualify, a majority of its members would have to be CPAs, and all partners be members of the AICPA. To retain its membership, a firm would have to comply with AICPA quality control standards. It would submit every three years to peer reviews of its accounting and audit practice in order to verify its compliance with quality control standards. Each professional staff member would have to complete a minimum of forty hours of continuing professional education per year. The firm would maintain specified amounts of accountants' liability insurance and pay its membership dues to the division.

Firms joining the SEC practice division would have to meet additional requirements. Each firm would file annually certain firm information, which would be open to public inspection. Partners in charge of SEC client audits would be rotated every five years, and every SEC client audit would receive a concurring review by a second partner. The firm would refrain from providing certain specified management advisory services to SEC clients, and it would report certain matters relating to management advisory services and accounting and auditing disagreements to the audit committees or boards of directors of its SEC clients.

Both divisions would be governed by executive committees of twenty-one members appointed by the AICPA chairman. Both would include peer review committees of fifteen members to
establish requirements for peer reviews and to administer the reviews. A five-member public oversight board would oversee all activities of the SEC practice division.

The executive committee would have the authority to impose sanctions on members, ranging from remedial actions to monetary fines and expulsion, for failing to comply with membership requirements.

The issue that proved most difficult to resolve was representation on the executive committee of the SEC practice division. The heads of the largest firms, especially the "big eight" firms, were adamant in their insistence that firms most involved with SEC practice should guide the destiny of that division. The combined practices of the eight largest firms included over 70 percent of all SEC registrants. They were subjecting their firms to a regulatory apparatus that could impose severe sanctions, and they had to convince their own partners that they were not assuming unnecessary risks in relation to their self-interest. Considering other firms' frequent expressions of anger at the big eight firms, there was good reason for caution.

A compromise agreement provided that all member firms having thirty or more SEC clients required to file under section 12 of the 1934 Securities Exchange Act would be represented continually on the executive committee. This meant that, initially, fifteen of the largest firms would have permanent seats on the executive committee, and additional firms might qualify for permanent seats in the future.

Establishment of the Division for CPA Firms

With the approval of the AICPA Board of Directors, Council members received detailed explanations of the plan, as well as other proposed changes, at one-day regional meetings held in August 1977. Because of the great number of items being proposed for adoption at the regular Council meeting on September 17, 1977, it was imperative to provide the members with an advance explanation of what they would be voting on and why the actions were deemed necessary.

Many Council members were concerned about the sweeping nature of the proposed changes and about the possible reactions.
of their constituents. Nevertheless, an overwhelming majority agreed that the actions were necessary and appropriate in view of the congressional investigations and threat of federal legislation. At its September meeting, approximately two-thirds of the members of Council voted in favor of the plan to establish the division for CPA firms, as modified by two significant amendments.

Instead of establishing two separate divisions, the Council voted to establish a single division for CPA firms with two sections, one for SEC practice and the other for private companies practice. This was simply a matter of semantics, but the concept of a single division proved to be more acceptable.

The second amendment provided that a nominating committee would be elected by Council each year from among representatives of the member firms of either section. The two committees would nominate firms to be represented on the respective executive committees. This was intended to prevent the executive committee from being self-perpetuating and was directed primarily at the SEC practice section. Several Council members had objected to the compromise agreement about representation on the SEC practice section executive committee, and the amendment was adopted as a partial response to this objection. As it turned out, the compromise later became the target of severe criticism during congressional hearings, leading to changes in the quorum and voting requirements and in the size of the committee to ensure that smaller firms would retain the same relative representation in the event that more firms qualified for permanent seats.

On Monday, September 19, 1977, following the Council meeting, the annual business meeting of the AICPA was held. Previous annual meetings had been routine affairs, but this one was different. Several members, including Eli Mason, rose to speak passionately in opposition to the action of Council. They moved that the matter be put to a mail ballot of the membership.

It was difficult for the members to resist the pleas for democracy by refusing to authorize a mail vote by the membership, but most were convinced that it was appropriate for the governing Council to have acted and that it would be unwise to incur any further delay. I pointed out that under the provisions of the bylaws nearly six months would be required to complete a mail
ballot, and there was a serious risk that federal legislation would be enacted during the interim. By a vote of 563 to 211, the motion was defeated. This decision was repeatedly challenged during the balance of the decade by many members, most of whom were opposed to the division for CPA firms.

Members File Suit Against the AICPA

Mr. Mason and seventeen other members filed a petition on January 6, 1978, with the New York Supreme Court seeking an injunction to prohibit continued operation of the division for CPA firms and to force a membership referendum on the issue. The petitioners’ brief alleged that a new class of membership had been established, an action that exceeded the authority of the Council under the Institute’s bylaws.

The AICPA Board of Directors was unanimous in authorizing the Institute’s law firm, Wilke, Farr and Gallagher, to defend the Institute’s position. The board had relied on the firm’s prior opinion that Council’s action did not violate the bylaws, and it saw no reason to concede the issue to the petitioners. The defense rested mainly on the flat rejection of the argument that a new class of AICPA membership had been created. The Institute argued that it was simply a sponsor of the division for CPA firms and that the Council could withdraw the sponsorship at any time. Furthermore, the members of the division were firms and had none of the rights of Institute members; they could not vote or serve on the governing bodies or committees of the AICPA.

Before the case was tried, the assigned judge discovered that he knew one of the petitioners, Mr. Mason, which might be viewed as a basis for bias. He disqualified himself, and the case was reassigned to a new judge, thus causing a delay. Oral arguments were finally heard on April 27, 1978.

The protracted period of uncertainty about the outcome of the lawsuit, combined with concerns about the attitudes of AICPA members, caused some board members to waver in their resolve. There were indications that the spokesmen for the petitioners might be willing to withdraw their petition if the AICPA would make some conciliatory gestures. To satisfy those board members who were having second thoughts, AICPA
Chairman Scott and I met with two of the petitioners, Eli Mason and Alan Brout. The two men refused to withdraw their petition unless the AICPA agreed to pay their legal fees and to hold a mail ballot on the division issue. This was reported to the board, which promptly rejected any further actions toward a compromise settlement.

The decision of the judge was issued on July 27, 1978, and entered on September 11, 1978. The judge declined to grant the injunction sought by the petitioners.

The findings were still subject to appeal, so uncertainty about the petitioners' intentions continued until October 22, 1978, when Mr. Mason called to inform me of their decision not to appeal.

The following day, at the AICPA's annual business meeting in San Francisco, Mr. Mason announced that the petitioners did not intend to pursue the lawsuit, after which he moved that a special committee be appointed to study the problems of smaller and medium-sized firms and to report its findings to the Institute's members within two years. The motion was adopted by an overwhelming vote, and a fifteen-member committee, chaired by Samuel A. Derieux, was appointed. The work of that committee will be described later in this chapter.

Public Oversight Board

In the meantime, while the lawsuit was pending, the division for CPA firms began to function. Candidates, largely drawn from the firms serving on advisory groups A, B, and C, were nominated and appointed to serve on the two executive committees, and initial meetings were held in October 1977. Committees were formed to develop the ground rules for meeting the quality review and continuing professional education requirements. Membership dues were established, and the division set the required amounts of legal liability insurance. Efforts were made to encourage as many firms as possible to join one or both of the sections.

High on the list of priorities was the appointment of a public oversight board (POB) within the SEC practice section. By January 1978 John J. McCloy, William L. Carey, and Ray Garrett, Jr., had agreed to serve on the board. Mr. McCloy, a prominent
New York lawyer and statesman who had served in various capacities under several U.S. presidents, agreed to serve as chairman. Mr. Carey was a law professor at Columbia University and a past chairman of the SEC. Mr. Garrett had only recently been the chairman of the SEC and was now practicing law in Chicago. A fourth member, Arthur M. Wood, a recently retired chief executive officer of Sears Roebuck and Company, was appointed in March. A fifth member, John D. Harper, recently retired chief executive officer of Alcoa, was appointed in July.

One of the public oversight board’s first acts was to adopt its own operating bylaws. Also, to avert criticism that the board members serve at the pleasure of the executive committee, the board insisted that it have the authority to appoint and discharge its own members and set its own compensation. The section agreed to this with the qualification that the advice and consent of the AICPA Board of Directors should be obtained in each instance.

The POB addressed the question of whether it should have line authority over the section, as urged by the SEC. It declined such authority in the belief that it was better to let the section’s executive committee take the initiatives toward self-regulation, leaving the POB to exercise oversight and to take exception when it deemed necessary. The SEC was not entirely satisfied with this decision, but it did not press the issue further.

The POB engaged in many activities during its first three years. It testified at the Moss and Eagleton congressional subcommittee hearings in 1978 and 1979. It studied the performance of management advisory services by auditors and its impact on their independence. It counseled the executive committee on procedures for dealing with major alleged audit failures, particularly those involving litigation. The POB urged the section to seek additional member firms and pressed for the publication of a membership directory; it exercised extensive oversight and review of the quality review program, and it published annual reports on its activities for the information of the SEC, Congress, and the public at large.

The POB was supposed to act as a neutral link between the SEC and the profession. Indeed, it acted as an honest broker between the SEC and the section when the SEC insisted that it be given access to quality review working papers. With its
authority to speak publicly on any aspect of the section's performance and its full access to all section records, meetings, and activities, the POB gave teeth to the self-regulatory program. The member firms practicing before the SEC would not want to risk public censure or the taint that would accompany resignation from the SEC practice section.

In its first three years, the POB fulfilled its responsibilities well; and much of the credit belonged to Ray Garrett, Jr. As vice chairman of the POB, he bore the brunt of the board's work. Unfortunately, he died very suddenly on February 3, 1980. After a series of delays, he was replaced by Robert Mautz, a professor at the Paton Accounting Center of the University of Michigan, a CPA, and a noted author and researcher on auditing and accounting.

The POB's real test will come if and when it concludes that the section is not acting responsibly on a particular matter. If this does happen, it will most likely involve the handling of a disciplinary matter in which a major audit failure has been alleged against a member firm. There was every reason to believe that the board would meet such a test.

Membership Directory

One of the nagging problems for both sections was the fact that firms were slow in joining. Some, no doubt, wanted more time to put their procedures in order before they were subjected to quality reviews. Others were opposed to the division for CPA firms or were concerned about the costs of membership. Still others had long histories of nonparticipation in the profession's programs.

The SEC repeatedly urged that steps be taken to have all firms practicing before it become members of the SEC practice section. By 1979 nearly 99 percent of the companies listed on the New York Stock Exchange and approximately 92 percent of all companies registered with the SEC were audited by firms that were already members of the section. Nevertheless, approximately six hundred other firms with SEC clients had not joined. Each of these firms had only a few SEC clients, and some of them had no partners who were members of the Institute.

In an attempt to pressure firms to join, the SEC practice
section executive committee proposed to publish a directory of member firms. This met with strong objections by the executive committee of the private companies section, which felt that firms not listed in the directory would suffer a serious competitive disadvantage. A compromise was reached whereby a division-wide directory would be published without designation of the section to which a firm belonged. Neither the SEC nor the POB was particularly pleased with this result, and they both registered their displeasure.

The question of a possible directory had been raised back when the Council was considering the proposal for a division for CPA firms. At that time the AICPA officers stated that there was no intention to publish a list of member firms. Therefore, when the sections proposed publication of a directory, they had to seek the consent of Council at its May 1979 meeting. Several members opposed the proposal, but in the end the Council authorized the publication of a directory by July 1980.

By the time of the May 1980 Council meeting, the proposed directory had become the focal point of discontent on the part of those firms that had not joined the division. The feelings were so strong and widespread that many Council members had second thoughts. Motions to prohibit a directory were made and amended and debated. By a vote of ninety-eight to ninety-one, the Council deferred the directory until July 1982 to give all firms additional time to prepare for quality reviews and to join the division.

Challenge by the National Conference of CPA Practitioners

In taking this action, the Council was aware of a March 13, 1980, petition by 269 members for a special meeting of the Institute to act on two proposals. One was to prohibit the publication of a directory of member firms, and the second was to prohibit the AICPA from using any of its funds to provide staff or other support to the division for CPA firms.

Nearly all of the petitioners belonged to firms that were members of the National Conference of CPA Practitioners (NCCPAP). This was an organization that had been established in the fall of 1978 by a group of AICPA members who had
opposed establishment of the division for CPA firms. Organized principally by Eli Mason, the NCCPAP was an outgrowth of an informal group of practitioners in New York City that had been meeting periodically to discuss AICPA actions. By mid 1980 the NCCPAP claimed over 500 firms as members.

The Institute Board of Directors scheduled the special meeting for July 11, 1980, at the Conrad Hilton Hotel in Chicago. It selected this central location to facilitate attendance by members from every section of the country. Chairman William R. Gregory presided, and, as expected, most of the time was occupied by speeches in opposition to the division for CPA firms and in support of putting the two proposals to a mail ballot of the membership. When the votes were counted, however, both proposals were defeated. Prohibition of a directory lost by 425 to 234 votes, and the barring of AICPA financial support for the division lost by 432 to 246 votes.

The AICPA was still in the process of responding to another NCCPAP initiative. The group had organized a petition proposing that the board and Council submit three bylaw changes to a mail ballot of the membership. The petition was presented to Chairman Cummings at the Institute's annual meeting on October 15, 1979. If adopted, the proposed changes would accomplish the following:

1. Permit 500 members to put any proposed change in the bylaws or code of professional ethics to a mail ballot of the Institute's membership without the consent of Council.
2. Eliminate life membership on the Council for past elected presidents and chairmen.
3. Change the manner in which the Institute's nominating committee would be appointed by requiring five of the seven members to be nominated and elected by the membership at large.

Whatever one thought about the merits of these proposals, it was apparent that the first one was aimed at eventually eliminating the division for CPA firms. The NCCPAP had apparently decided to try to accomplish internally what Mr. Mason and others were unable to do through their lawsuit against the AICPA.

The board had been aware that a petition relating to the
bylaws was being circulated. At its meeting on September 21, 1979, it concluded that a comprehensive review of the bylaws was overdue, since the last overhaul was in 1972. A special committee was appointed in October to conduct the review. John Meinert, a member in industry who had recently served on the board, was appointed chairman.

The committee concentrated initially on the three proposed changes contained in the petition. By February 29, 1980, it was able to provide an interim report on its conclusions to the AICPA Board of Directors. It recommended against adoption of any of the petitioner's three changes but suggested certain alternatives in the event that changes were to be made. The committee did, however, suggest a modification of a prior Council resolution regarding the manner in which the AICPA's nominating committee was appointed.

The board decided to await the reactions of Council members before reaching a final decision, since regional meetings had been scheduled for the following month. The attitude of most Council members proved to be that the AICPA was being harassed by a small number of members whose views were not representative of the general membership.

A considerable number of Council members did feel, however, that the bylaws should contain a referendum provision that could be employed if a significant number of members were seeking to take action on a particular issue. There were mixed views about how many members should be required to initiate a referendum without the consent of Council. Some felt that 5 percent of the membership was appropriate, while others believed this to be too high. A great majority, however, agreed that the petitioners' proposal of 500 members was far too low.

The views of Council members were mixed with respect to life memberships on Council and the procedures for appointment of the nominating committee.

It was at this time that the Institute received the NCCPAP petition for a special meeting of the membership. Council members expressed shock that under the existing bylaws only 200 members out of approximately one hundred seventy thousand could require a special meeting to be held. They strongly urged that this provision of the bylaws be changed so that 5 percent of the total members should be required.
The views of Council members were reported at a special meeting of the board on April 2, 1980. As a result, the board resolved to urge the Council to reject all of the petitioner's proposals and to authorize a mail ballot on two alternative changes. One would increase the number of members required to call a special meeting of the Institute from 200 members to 5 percent of the membership. The other change would provide that 5 percent of the membership could cause a proposed change in the bylaws or code of professional ethics to be voted on by the members by mail ballot without the consent of the board or Council. The board also recommended a modification of the procedures for appointment of the nominating committee. In the future the board would select the slate of candidates for the committee and its chairman for election by the Council.

These proposals were presented at the next official Council meeting on May 2 through 4, 1980. After extensive debate, the Council approved the board's recommendations, except that it provided in its resolution regarding the nominating committee that the Council would elect the chairman of the committee following receipt of the board's recommendation.

The proposed bylaw changes were in due course submitted to a vote of the membership, and in January 1981 they were declared approved by more than the required two-thirds margin.

Special Committee on Small and Medium-Sized Firms

The AICPA had rejected the NCCPAP challenge, and the division for CPA firms was functioning. Nevertheless, many of the tensions that had existed at the beginning of the decade—tensions that the two practice sections were partly designed to resolve—continued to disturb the profession. In late 1978, in a further attempt to resolve these problems, the Institute had appointed a special committee to study the problems of small and medium-sized CPA firms. The study was prompted partially by concern about the dwindling number of national firms. Two firms, J. K. Lasser and Company and S. D. Leidesdorf and Company, had recently merged into Touche Ross and Ernst and Whinney respectively. Two large regional firms, Wolf and Com-
pany and Clarence Rainess and Company, had split into smaller local entities, and there were dire predictions that the days of all such firms were numbered because it was impossible to compete with the eight largest firms.

The committee was chaired by Samuel A. Derieux, a local practitioner from Richmond, Virginia, who had devoted many years of service to the AICPA, as chairman and in many other capacities. Under his able leadership, the special committee made a diligent study of the pressures on small and medium-sized firms. After considering the results of dozens of interviews, public hearings, member discussion forums conducted by the state societies, discussions with Council members, and correspondence received from members, the committee prepared a report on its deliberations and conclusions. The report was summarized at the AICPA's annual meeting in Boston on October 6, 1980, and subsequently was published as the Report of the Special Committee on Small and Medium-Sized Firms.

The report focused primarily on the subjects of competition, staff recruitment, and the burden of applying accounting standards designed for publicly traded corporations to smaller, privately held clients. The committee recognized that each firm bears responsibility for its own success or failure, but it concluded that some factors are beyond the control of individual firms and should be addressed by the Institute and the state societies.

In general, the report was well received, and the board promised to consider each of the recommendations. By early 1981 it had begun assigning individual items to the appropriate standing committees for study and implementation.

The Situation in 1981

While these events were occurring, the division for CPA firms continued to make progress. The private companies practice section executive committee had become a cohesive and effective group that expressed its views with considerable success. It began holding annual conferences for its member firms, and it developed better communications with its constituents.

The SEC practice section struggled with procedures for dealing with major alleged audit failures and disciplinary proceedings,
and it established a special investigation committee. The section had backed away from its proposal to involve foreign affiliates directly in the quality review process, since foreign accounting groups had objected strongly. After extended discussions, the POB, the SEC, and the SEC practice section executive committee had agreed to a compromise on the issue of access by the SEC to the quality review working papers. Quality reviews of all the large firms had been completed by 1981.

By the end of 1980, the private companies practice section had 1,601 member firms, and the SEC practice section had 535 members. Five hundred thirteen firms were members of both sections. The division for CPA firms seemed to have become a permanent feature of the profession's structure. Nevertheless, some people still strongly opposed the existence of the two sections, and only time will reveal whether additional efforts will be made to eliminate one or both of them.

The internal stresses in the profession escalated sharply during the 1970s. This was partially the result of the increasing disparity in the size of the CPA firms, but of greater importance was the impact of external forces. The forced removal of restrictions on competition and the establishment of a division for CPA firms contributed greatly to the dissension that existed at the end of the decade. Few firms were enthusiastic about the prospect of quality reviews. Some CPAs believed that there should be a single division for firms, without two sections, and others were opposed to any structure for firm membership.

The division was a necessity. A self-regulatory structure for firms was vital to the profession's credibility. Two separate sections were necessary to avoid the imposition on the entire profession of requirements necessary for SEC practice. In addition, an attempt to combine the two sections carried the substantial risk that a separate structure for SEC practice might be established outside the auspices of the AICPA by the larger firms. If this were to occur, the AICPA might well be overshadowed, and a permanent split in the profession would be institutionalized.

From the outset, I knew of the risk that overt attempts to deal with internal problems might only make them worse. This possibility may have been a contributing factor in the early stages of the increased disharmony, but, if so, it was diminished by the effect of external pressures that were beyond the profession's
control. Nevertheless, it is human nature to personalize blame, and the Institute's officers were the targets of considerable criticism.

Unbridled competition and the existence of a standards overload problem are likely to continue to divide CPAs. With little prospect that these factors will be eliminated, the profession may well have to learn to live with sharp differences within its ranks. The whole profession would be the poorer, however, if these differences were to lead to a formal split based on firm size. Accommodation of all interest groups under the umbrella of a single organization, the AICPA, remains the best alternative available to the public accounting profession.

With the reduction in pressures from Congress and the SEC, and the diminishing volume of lawsuits and adverse publicity, perhaps the emotions of the seventies will subside. Also, the new president, Philip Chenok, who took office on July 1, 1980, will be starting with a clean slate to work toward greater unity.
Peer Reviews

Development of the Idea of Peer Reviews

The introduction of peer reviews of the quality controls of CPA firms was a long and difficult process. The notion first surfaced in the mid 1960s. An AICPA long-range planning committee presented a tentative proposal, which was explained by the Institute’s executive director, John L. Carey, in the CPA Newsletter of June 1967. The resulting outburst of opposition caused the Institute to drop the plan at that time.

After further study, a modified approach was developed, whereby firms desiring confidential reviews of their auditing practices could obtain them under the auspices of the AICPA for a fee. No publicity or accreditation would be involved. The revised approach, which entailed reviews of specific engagements relating to audited and unaudited financial statements, was presented to the Council in the fall of 1968. Later, the AICPA Board of Directors authorized a pilot program to be carried out in the summer of 1971.

Initially, only a few local firms availed themselves of the new program, but subsequently nearly fifty firms a year were seeking reviews. By 1976 approximately 300 firms had been reviewed.

Peer Reviews as SEC Sanctions

Meanwhile, the idea of peer reviews was being advanced in another quarter. John C. Burton became chief accountant of the SEC; as a member of the AICPA planning committee that had first suggested peer reviews in the 1960s, Mr. Burton had been one of the strongest advocates of the proposal. As chief accountant, he continued to push for the adoption of such a program.
Mr. Burton soon had an opportunity to promote the adoption of peer reviews. The commission’s injunctive actions against the large firms led to a substantial number of consent decrees, which in turn led to private liability suits. By 1972 the number of lawsuits and the amount of damages claimed had reached such proportions that the AICPA’s elected president, Walter Oliphant, urged the commission to consider adopting less draconian disciplinary sanctions; otherwise, liability insurance might become unavailable, and one or more firms might go bankrupt. Mr. Burton suggested as an alternative that peer reviews be imposed as sanctions under rule 2(e) disciplinary proceedings. Some commission and staff members were skeptical of the proposal, but Mr. Burton succeeded in gaining agreement to give it a try.

The first opportunity arose when one of the large firms, Laventhol, Krekstein, Horwath and Horwath, was subjected to disciplinary action under rule 2(e) in connection with an alleged case of audit deficiency. The firm entered into a consent decree, whereby it agreed under court order to incur a review of its quality controls by a team of CPAs provided either under the auspices of the AICPA or by direct SEC appointment. A report on the results of the review would be submitted to the SEC.

A request to provide the review team was conveyed to the Institute in August 1972. The initial reaction of many of the large firms, as well as some members of the Institute’s Board of Directors, was to reject the SEC’s request. Several members argued vehemently that the AICPA and the profession had no business allowing itself to become an appendage of the enforcement arm of a governmental agency by agreeing to participate in the review. On the other hand, several members worried that failure to participate might result in the SEC’s appointment of reviewers who might be biased or who would lack the experience necessary to make fair judgments. Some members felt that it would be unfair to the firm involved to refuse to provide reviewers.

As distasteful as participation might be, there seemed little choice but to explore the possibility. A special five-member committee was appointed for this purpose, chaired by Gordon Murray, a former AICPA vice president and a partner of Deloitte, Haskins and Sells.

The committee held several meetings with SEC staff represen-
tatives to discuss the many problems in need of resolution. There were no quality control standards with which to compare performance; the scope of the examination needed to be defined, and the type of report had to be specified. In addition, there were grave concerns about the reviewers' and the Institute's exposure to liability. Questions arose about the reviewers' responsibilities to report to the SEC on any deficiencies in audits of the firm's specific SEC clients that were discovered as a byproduct of the review. Another issue was whether the review should go beyond quality control procedures and include evaluation of individual audits and accounting judgments.

As they considered the work and responsibilities of a review team, the committee concluded that a superior approach would be a review conducted by another firm within the framework of a professional engagement. Responsibility then could be fixed on the reviewing firm, and the conduct of the review was likely to be more efficient.

The SEC, however, rejected the firm-on-firm alternative. The commission staff thought that such reviews would lack credibility.

In October 1973, after extended negotiations and consideration of the advice of legal counsel, the committee reluctantly recommended that the AICPA comply with the SEC's request. It provided the board with a tentative program spelling out the procedures and conditions that had been worked out with the SEC staff. The committee also provided a draft of a letter to the SEC, which the board might use as a basis for a meeting with the commissioners. It spelled out all the problems and expressed grave reservations about whether such quality reviews would in fact result in improvement of a firm's performance. The board decided against arranging such a meeting with the commission.

In agreeing to supply a review team, the board recognized that the support of the large firms would be necessary. Accordingly, a meeting with top representatives of the twenty-five largest firms was held on January 4, 1974. Although they had many reservations about complying with the SEC's request, nearly all the firms represented at the meeting agreed to supply names of partners who would serve as review team members. Only one of the eight largest firms declined to participate.

After this show of support, the board adopted a resolution to
provide a team to review Laventhol, Krekstein, Horwath and Horwath under the terms of a "Tentative Program for an Inspection of the Quality Control Standards and Procedures of an Accounting Firm." The board intended to consider subsequent SEC requests in the light of this review's results.

Haldon Robinson, a partner of Deloitte, Haskins and Sells and a member of the auditing standards committee, was appointed to head the review team. Despite being confronted with a new type of engagement, the team completed its work to the satisfaction of all parties involved.

Meanwhile there were indications that the SEC had initiated a considerable number of additional disciplinary actions against CPA firms. It was rumored that in due course all of the eight largest firms would be subjected to quality control reviews.

The rumors were mostly borne out. In 1974 the SEC issued Accounting Series Release no. 153, requiring the review of Touche Ross and Company, and in 1975 it issued Accounting Series Release no. 173, requiring the review of Peat, Marwick, Mitchell and Co. In addition, several small firms were caught up in SEC disciplinary actions that resulted in requests that the Institute supply review teams. The AICPA board acceded to each request, and in time it became apparent that there was no turning back.

The AICPA was less responsive when some state boards of accountancy became interested in imposing reviews as sanctions. The Colorado state board, for example, asked the AICPA to provide reviews upon request. On October 11, 1975, the Institute's board declined this request on the grounds that reports on the results of such reviews could not be kept confidential by a state agency. The board's action effectively ended any attempts by the state boards of accountancy to have the AICPA provide reviews.

**Voluntary Multioffice Review Program**

Even before the board's decision to participate in the first SEC-mandated review, several of the large firms were aware, through their settlement negotiations with the SEC, that they might be subjected to reviews of their quality controls. This no doubt
motivated several firms to begin urging, late in 1973, that the AICPA develop and implement a voluntary quality control review program for multioffice firms to supplement the already existing local firm program. Some believed that if the profession mounted its own reviews the SEC would be willing to defer to such a voluntary effort. This result would be preferable to the stigma that accompanied a review mandated by the SEC.

In view of this groundswell of opinion, President Derieux appointed a special seven-member committee to develop a program for review of quality control procedures of multioffice firms. The committee worked at top speed, reflecting the urgency felt by some of the members' firms, which were in negotiations with the SEC. On April 27, 1974, it presented a program to the AICPA Board of Directors. The board immediately approved the plan for implementation.

The new plan called for the appointment of a seven-member committee to oversee and administer voluntary quality control reviews. A firm requesting a review would provide the committee with a description of its quality control procedures. A team would then conduct field reviews to test compliance with those procedures. The team would prepare a confidential report, which it would present to the reviewed firm. According to the plan, the firm could make the report available only to regulatory agencies, such as the SEC.

While these events were taking place, the auditing standards committee took action to provide guidance regarding the nature of quality control in a CPA firm. The committee appointed a task force in 1973, and its work culminated in the issuance of Statement on Auditing Standards no. 4 in December 1974. The statement identified nine elements of quality control, which were used as a starting point in the development of various review programs, beginning with the multioffice plan adopted in April 1974. The elements included such internal administrative matters as the hiring and promotion of personnel and policies for acceptance and continuance of clients. Thus, SAS no. 4 provided the first tacit recognition that certain aspects of a firm's internal management should be subject to regulation. A few individuals regarded this step as a serious mistake, but their objections failed to gain acceptance.

The Institute's officers had decided not to issue a press release
about the new program because it seemed prudent to be sure of its success before calling attention to it. Nevertheless, Fred Andrews, a leading financial reporter, became aware of the plan and inquired frequently about its progress. When Peat, Marwick, Mitchell and Co. became the first firm to request a review, Mr. Andrews promptly interviewed the head of the firm, Walter Hanson, and wrote a newspaper story on the development. This raised objections from the committee responsible for administering the reviews, which felt strongly that publicity would create the impression that the first firms to pass reviews were superior to those that had not yet been reviewed.

Mr. Hanson rightly pointed out that such matters could not and should not be kept confidential, and he sought a ruling from the AICPA Board of Directors at its December 5, 1974, meeting. The board approved the committee's position, and as a consequence Peat, Marwick, Mitchell and Co. withdrew its request for a review.

Immediately thereafter the firm engaged Arthur Young and Company to perform a review similar to the one contemplated under the Institute's multioffice program. By November 25, 1975, that review had been completed, and a report had been issued. Meanwhile, the SEC mandated an additional review of the firm under Accounting Series Release no. 173, and the AICPA board agreed on July 24, 1975, to provide a team for that review.

Voluntary Quality Control Review Program for CPA Firms

Other developments late in 1974 would lead to the replacement of the multioffice program before it became fully operative. Having foreseen trouble in Washington, I had been considering, on a confidential basis, the alternatives available to the profession. One alternative was the initiation of federal legislation to obtain statutory regulatory authority for the AICPA, coupled with a limitation on the liability of independent auditors. Taking the initiative might be a better strategy than waging a defensive battle against the congressional attacks that appeared imminent. Because I feared that any public discussion might stimulate congressional action, I was very discreet in exploring the idea of
seeking legislation with the chairman of the Institute, individual heads of some of the large firms, small groups of Council and board members, and the Institute's legal counsel. While many of them agreed that taking the initiative might be the best strategy, most of the participants in the discussions opposed such a bold step. Some believed that drastic action was unnecessary, and others feared that only unneeded requirements would emerge from the unpredictable legislative process.

Nevertheless, Chairman Philip L. Defliese concluded late in 1974 that the whole system of self-regulation, including the possibility of seeking statutory authority, should be reexamined. A special eight-member committee was appointed in December 1974. Included on the committee were the heads of some of the large firms, as well as representatives of medium and smaller firms. The committee chairman was Sam Derieux, immediate past chairman of the AICPA.

The charge to the committee suggested that it address several distinct questions: Is the present system of licensing and regulation adequate to serve public needs in the present environment of public practice? If not, what changes should be considered? What new or improved forms of preventative machinery should be considered to ensure high levels of performance? Should the profession develop and implement a new system of self-regulation of firms? If so, what form should the plan take? If legislation would be required to establish effective self-regulation of firms, should additional provisions be sought that would deal with other problems? If so, what proposals should be considered?

Chairman Defliese and I attended the opening portion of the committee's organizational meeting to elaborate on the charge. We both urged the committee to address the necessity for some form of federal accountancy board to make possible a more effective system of self-regulation, particularly the regulation of firms. We also suggested that provisions for liability relief should be included if a proposal requiring legislation were to be pursued.

In spite of our pleas, the committee promptly rejected any legislative initiative. Instead, it concluded that the profession's best course was to establish a system of self-regulation of firms.

In view of this conclusion, I urged the committee to move quickly to minimize any damage to the profession's credibility that may have resulted from statements made to the press by
Peat, Marwick, Mitchell and Co. when it withdrew from the multioffice review program. I suggested that any plan developed by the committee be described as an adjustment to the multioffice program, which was encountering severe difficulties.

When the committee began discussing alternatives for the regulation of firms, it was informed about earlier discussions between the AICPA and the SEC. One proposal, rejected by the SEC, had been that firms be required to register with the commission and to file certain information on a regular basis, including a report that their quality controls had been reviewed by another firm. The committee immediately embraced a variation of this idea, whereby firms would register with the AICPA, which would serve as a repository of information about each registered firm. To register, a firm would file a letter of intent to undergo a review of its quality controls by a specified date and every three years thereafter. A review team, rather than another firm, would conduct the review.

This plan had two important advantages over the multioffice firm review program. Because all firms could register immediately without waiting for completion of a review, it would deny any competitive edge to the first firms to be reviewed. In addition, it would be considerably less cumbersome to administer.

The committee developed the details and exposed the plan in a preliminary report to the board on May 9, 1975, and to the Council the following week. There were many suggestions for changes, and discussions with Council members, advisory groups A, B, and C, and member forums conducted by the state societies led to several revisions of the plan.

Of considerable importance was the reaction of advisory group C, composed of the eleven largest firms, which audited the great preponderance of SEC registrants. Initially, three of the firms adamantly opposed any form of registration with the AICPA. They felt that any regulation of firms should be conducted by a new and separate body rather than by the Institute. After several discussions, group C, with the unanimous approval of its members, submitted an alternate plan, which would permit firm-on-firm reviews and under which firms would not initially register with the AICPA.

By February 9, 1976, the special committee had considered all
of the objections and suggestions and had submitted a revised proposal to the AICPA Board of Directors. Several changes had been made to the original plan. Since smaller firms generally objected to any plan that would include them, the program was now to apply only to firms that had an SEC practice or that desired to prepare for such a practice. To allay fears that firms would refer to themselves as “registered CPA firms,” the use of the term registration was dropped in favor of references to participants. To become a participant, a firm would only have to file a letter of intent with the AICPA. Firms could advise their clients of their participation and the results of their reviews. Participating firms could, at their option, file copies of review reports with the AICPA, which would be available for public inspection. Firms electing not to file copies of their review reports could not refer to themselves as “participants.” Also, the results of initial reviews would not be released until the end of a preliminary period, designed to provide time for all firms to be reviewed. Finally, the revised plan would permit firm-on-firm reviews.

The board approved the revised plan on February 19, 1976, and authorized presentation to Council. Finally, after nearly sixteen months of committee effort, the Council approved the revised plan with the proviso that a similar plan, modified to apply to smaller firms without SEC clients, be prepared for adoption at its October meeting. Many smaller firms had come full circle, from opposition to any plan that included them to a desire to be included because of a fear of otherwise being viewed as second-class firms.

The board concurred with Council’s instructions, and at the next Council meeting, on October 23, 1976, the plan was revised to provide for the participation of all firms. The name was changed to the Voluntary Quality Control Review Program for CPA Firms to make it clear that the program was not restricted to firms with an SEC practice.

A new standing committee, the AICPA Quality Control Review Committee, was appointed to administer the new program. The committee was chaired by Haldon Robinson, who had headed the review team that had performed the first SEC-mandated review. It conducted a survey of CPA firms to gain an
indication of the number that intended to participate. Also, task forces were appointed to carry out all the necessary activities to implement and administer the program.

Anticipating that standards would be necessary to implement the new program, the AICPA appointed a special committee in February 1976 to develop guidelines for quality control policies and procedures and for reviews of compliance with those policies and procedures. Chaired by Robert W. Burmester, a partner of Arthur Young and Company who had extensive experience with intrafirm quality reviews, the special committee held its first meeting on March 4, 1976.

The committee's task proved more difficult than anticipated, and first drafts of the two sets of standards were not completed until December 1976. Because the auditing standards committee had issued SAS no. 4 on the nine elements of quality control, the drafts were subject to that committee's review before exposure to the membership. This review began on January 18, 1977, and led to further delays. It was April 22, 1977, before a discussion draft, Quality Control Policies and Procedures for Participating CPA Firms, was exposed to all practice units represented in the AICPA. A final draft was presented to the auditing standards committee on August 8, 1977, to be issued as a guide rather than as an elaboration of SAS no. 4. By the fall of 1977 the special committee also completed initial discussion drafts of guides on Performing and Reporting on Quality Control Compliance Reviews.

It was late in 1978 before all the necessary guidelines were ready for use in connection with the new voluntary quality control review program. By that time the division for CPA firms had been established, and the division became the new focal point for regulation of firms and reviews of quality control. However, since not all firms would necessarily join the new division for CPA firms, the separate voluntary program was continued to provide nonmember firms with an opportunity to have quality reviews. On September 17, 1977, the Council elevated the status of the quality control review committee to that of a senior technical committee responsible for setting quality control standards as well as for administering the voluntary program. The panel, renamed the quality control standards committee, issued its first official pronouncement, Statement on
quality Control Standards no. 1, on November 1, 1979. The committee also provided consulting services to firms regarding their quality control programs to assist them in preparing for reviews, either under the voluntary program or through the division for CPA firms.

Peer Reviews by the Division for CPA Firms

If the reader is confused by the chain of events, it is understandable; most practitioners found it difficult to stay abreast of the profession's efforts to mount an effective quality review program for the regulation of firms. If nothing else, this history should provide a sense of the rapidly changing circumstances during this period and explain events that led to the adoption of peer reviews by the division for CPA firms in 1977. The emergence of such reviews was one of several truly new developments that would dramatically transform the profession.

During 1976 and early 1977—after the abortive multioffice program had collapsed, while efforts were underway to implement the voluntary quality control review program, and before the division for CPA firms was established—some of the largest firms felt for various reasons that they could not defer reviews until an AICPA program became operative. One firm, Price Waterhouse and Company, independently arranged for Deloitte, Haskins and Sells to perform a firm-on-firm quality review. The review covered the fiscal year ended June 30, 1976, on which a report dated October 7, 1976, was issued. The opinion paragraph from that report illustrates the scope of reviews being made at that time:

In our opinion, the system of quality control that was in effect with respect to your audit practice in the United States during your fiscal year ended June 30, 1976 was suitable to achieve its objective. Consistent with the purpose of our study, we express no opinion concerning the professional judgments that you exercised in the conduct of any particular audit engagement.

The evolution of firm-on-firm reviews was largely a product of disciplinary pressures being applied by the SEC. Those pressures, along with other factors described in chapter 7, helped make the leaders of the large firms more receptive to the establishment of a self-regulatory scheme for CPA firms.
The result was the birth of the division for CPA firms. A principal requirement of both sections of the division was that a member firm have either a team or a firm-on-firm review every three years. The reviews would measure compliance with quality control standards set by the AICPA Quality Control Standards Committee. Peer review committees of the two sections would set policies and procedures for conducting and reporting on the reviews and would administer the program. Reports on the reviews and the quality control documents of member firms would be included in the files of the AICPA and would be open to public inspection.

Beginning in 1978, implementation of peer reviews under the two sections virtually replaced all preceding quality control review activities. The sections’ two peer review committees did not start from scratch, however; they benefited greatly from the work of prior groups in developing their policies and procedures.

The SEC Practice Section

The peer review committee of the SEC practice section encountered a number of issues during the early period of its existence. One of these involved the objections of the SEC to firm-on-firm reviews on the grounds that they lacked the appearance of objectivity. The public oversight board shared the SEC’s concern, and the issue also was raised in congressional hearings.

To resolve this problem, the section agreed to appoint review panels to oversee the work of the reviewing firms in firm-on-firm engagements. The panels would consist of from one to three CPAs from other firms. They would issue their own reports, taking full responsibility for the reviews. This resulted in duplication of effort and added significantly to the costs of firm-on-firm reviews. Nearly all the large member firms agreed to incur this added burden because they believed that team reviews were less effective than reviews by firms. They hoped that a record of satisfactory reviews would eliminate concerns about firm-on-firm reviews, and the additional requirement for review panels could then be eliminated.

Another issue was the insistence of the SEC, supported by the public oversight board and members of Congress, that the
peer reviews be extended to foreign firms or affiliates whose audits of foreign branches or subsidiaries of U.S. parent companies were included in filings with the SEC. The large firms generally favored such a move because it would help them gain the agreement of their international associates to participate in intrafirm inspection programs. When the professional organizations in other countries learned of the proposal to extend peer reviews to firms in their jurisdictions, they raised immediate and strong objections, particularly in Western Europe.

While attending the AICPA’s annual meeting in San Francisco in October 1978, John Hough, executive secretary of the Institute of Chartered Accountants of England and Wales, discussed the matter with me. This was followed by a December meeting in New York attended by Mr. Hough; David Richards, president of the English institute; and representatives of the AICPA, including myself, Chairman Joseph Cummings, and Donald Neebes, chairman of the SEC practice section peer review committee. There was an exchange of viewpoints, but no agreement was reached at the meeting. I made it clear that the AICPA was not seeking to apply full reviews of overseas firms’ quality controls. All that was being asked was for such firms to permit U.S. peer reviewers to examine working papers on specific audit engagements included in filings with the SEC.

This so-called third-party access became the principal point at issue. The profession in England adamantly opposed such access, claiming that it would violate their national sovereignty and their duty to protect the confidentiality of client information. Even more important was the fear that it would lead the English government to impose peer reviews on the profession.

Since the English institute could not speak for the profession in other European countries, the AICPA arranged a group meeting to discuss the issue. The meeting was held in Amsterdam on March 5, 1979, and was attended by representatives of Canada, England, France, West Germany, the Netherlands, and the International Federation of Accountants. The AICPA’s proposal that the institutes urge firms in their jurisdictions to permit third-party access met with almost unanimous opposition, but the attendees agreed to discuss the matter with their respective governing bodies and to report their decisions at a subsequent meeting.
A follow-up meeting was held in Amsterdam on June 16, 1979. As expected, all the institutes represented declined to support the AICPA’s proposal. The meeting ended with the agreement that David Richards, as a representative of the group, would meet with the executive committee of the SEC practice section to negotiate something less than third-party access.

On September 19, 1979, Mr. Richards proposed in New York that peer reviewers confine themselves to reviewing the procedures used by a U.S. firm to satisfy themselves that they could rely on the work performed by its foreign affiliate. He suggested that the audit practices committee of the International Federation of Accountants should set the standards for reliance on the work of other auditors in international engagements and that peer reviewers should use such standards as the basis for judging a firm’s quality controls.

By this time it was clear that the AICPA could not achieve third-party access to working papers on engagements outside the United States. The AICPA had no power to impose such a requirement across national borders, and even the SEC’s power to do this was both dubious and limited by other foreign policy considerations. In fact, in a tour of Europe at that time, SEC Chairman Williams had backed away from a hard position when confronted with the angry objections of the profession’s leaders in the various countries. This effectively killed any possibility that the AICPA could achieve third-party access since its principal argument was that the SEC was adamant and was threatening to withdraw its support for the SEC practice section.

With these considerations in mind, the executive committee agreed in general with the arrangement suggested by Mr. Richards. It was tacitly understood, however, that U.S. firms would request that key portions of foreign working papers be sent to them and that the papers would be made available for inspection by peer reviewers. This is essentially the basis on which the matter was resolved after the peer review committee had met with the federation’s audit practices committee in January 1980.

Thereafter, both groups issued pronouncements on the standards, policies, and procedures to be followed. The SEC and the public oversight board no longer pressed the issue, and the large firms seemed resigned to waiting until a later time to seek a more extensive arrangement. The large firms seem unlikely to
have such an opportunity unless domestic pressures in other major countries force the profession to embrace peer reviews similar to those in the U.S.

The SEC practice section also was faced with the difficult issue of SEC access to peer review working papers. From the outset the SEC sought the means to satisfy itself that the peer review program was functioning properly; to do this, the commission insisted it must have full access to review working papers. It refused to rely solely on the oversight of the public oversight board.

The section's executive committee was equally insistent that the SEC not have access to the peer review working papers. The committee feared that the SEC would not just appraise the review process but would examine the workpapers for opportunities for investigation of specific SEC registrants. The committee also worried that clients would refuse to allow their CPAs to make the working papers on their audits available to peer reviewers. If this were to happen, the whole peer review program would collapse. Furthermore, direct access by the SEC violated the fundamental purpose of the public oversight board, which was to serve as the independent link between the profession and the government.

The public oversight board did its best to act as an honest broker and bring about a satisfactory compromise. In the end it urged the section to grant the SEC access to only that portion of the peer review working papers relating to the administrative aspects of the review. The views of both sides were unyielding, and for a considerable time it appeared that the impasse might endanger the success of the entire self-regulatory program. In its first two annual reports to Congress, the SEC cited the issue, making its solution a condition for the commission's continuing support of the profession's program of self-regulation. As a result, the SEC staff and representatives of the peer review committee held a series of exploratory discussions over a period of nearly three years. The dispute became the subject of a number of stories in the press, and by 1980 the need for a solution had become acute.

A compromise agreement was finally reached in July of that year, and the SEC delayed filing its July 1 report to Congress to remove the matter from the list of unresolved problems. Under
the agreement the SEC would receive access to the public oversight board’s oversight working papers, which contain memorandums summarizing review information and listing items noted for further consideration and investigation. This information would provide no clues to the identity of the reviewed firm’s clients. Thus, the confidentiality of client information would be retained. It was also understood that such access would apply only to the sixteen largest firms, beginning with reviews performed in 1981. The section hoped that after a reasonable period the SEC would discontinue its review activities and rely on the public oversight board’s oversight of peer reviews.

The resolution of this issue was extremely important because it was the last major hurdle standing in the way of the SEC’s unqualified support of the peer review program. Of course, the SEC probably will never express complete satisfaction and will reserve the right to be critical or to withdraw its approval in the future.

The Private Companies Practice Section

The peer review committee of the private companies section also experienced many problems during the first two years of its existence. Fearing the possibility of being viewed as second class, the committee adopted nearly all the same peer review policies and procedures as the SEC practice section. As a result, many smaller firms were discouraged by the prospect of preparing detailed documents describing their quality control policies and procedures. Also, the rumored costs of reviews were considered excessively burdensome, and the voluminous checklists of controls designed to apply to the large national firms were obviously not practicable for small, one-office firms or sole practitioners.

I was greatly concerned that the section’s peer review program was inappropriate for the great majority of local firms. I was even more concerned that not enough firms would join the section because the reviews, as designed, seemed unrealistic. I repeatedly urged the executive and peer review committees to adopt a sample engagement review approach similar to that of the original program for local firms begun in 1971. Such an approach would be less burdensome and more effective in
improving the performance of local firms. Furthermore, it would be more in keeping with the objectives of the private companies section, which was not intended to be regulatory.

The section's executive and peer review committees resisted these suggestions because they believed that any deviations from the peer review requirements of the SEC practice section would be unfairly exploited by the large firms. As time went on, however, there were increasing signs that smaller firms were reluctant to undergo systems-oriented peer reviews. As a result, the section agreed to modify its program to place greater emphasis on engagement working papers and less on documented quality control policies and procedures.

The section's peer review committee lagged behind that of the SEC practice section, and the first reviews of the private companies practice section did not begin until July 1, 1979. By the end of 1980 only ninety-three reviews had been completed, and surveys indicated that a very high percentage of the member firms intended to defer reviews until the third year, beginning in July 1981. This posed a severe problem since most of the reviews would be performed by teams. Arranging for a large number of teams would be extremely difficult because of the shortage of experienced reviewers, and it would require a major administrative effort. Clearly, the section would have to consider extending the time within which member firms must be reviewed.

Associations of CPA Firms

Throughout the evolution of peer reviews, beginning with the development of the Voluntary Quality Control Review Program for CPA Firms, there was a question of how to deal with associations of CPA firms. Associations are groups of firms that work together on such matters as shared technical manuals and training programs and engagement referrals. During the 1970s there were about a dozen of such associations, many of which required their member firms to have their practice reviewed periodically by other members.

When it appeared that the AICPA would begin sponsoring a quality control review program for all firms, the associations sought to have their internal reviews qualify for recognition. At
one point the planning committee agreed to this, but it deleted all reference to the issue before the voluntary plan was approved by Council in May 1976. Nevertheless, the discussion at the Council meeting indicated that the omission was not intended to preclude the acceptance of association-sponsored reviews.

The quality control review committee appointed to administer the program addressed the question during the course of its deliberations. After obtaining information about the associations and after extensive discussions with their representatives, the committee concluded that their reviews should not be accepted under the program. The committee believed that the relationships of the firms within the associations prevented them from being independent of one another; thus, reviews carried out within an association would lack credibility.

This was a disturbing conclusion for a number of reasons. The Institute was encouraging the formation of associations to provide smaller firms with access to greater resources, and the committee’s position was contrary to this objective. Firms within the associations were also alarmed about other damaging implications if they were viewed as not being independent of each other.

The AICPA Board of Directors sympathized with the desires of the associations and requested the committee to reconsider its position and to attempt to develop criteria that, if met, would permit recognition of association reviews. The committee concluded that this was not possible.

The associations were incensed, and they mounted a vigorous campaign to persuade board members to overrule the committee. The issue became so emotional that David Eiger, representing CPA Associates, advised me that his association had authorized a lawsuit against the Institute if the matter was not resolved satisfactorily.

Although I favored finding a way to honor association reviews, I told Mr. Eiger that neither I nor the board would be intimidated by the threat of legal action.

The board approved the appointment of a special committee to develop criteria for acceptance of association reviews, and on September 17, 1977, the Council affirmed its intent that such reviews were not to be automatically excluded under the volun-
tary plan. Finally, on March 2, 1978, the board approved criteria recommended by the special committee.

When the peer review committees of the division for CPA firms were established, the question arose once again. The private companies practice section promptly adopted the board’s position, but the SEC practice section deferred action because of the greater urgency of other matters. Despite some reluctance, the SEC practice section also eventually adopted the board’s position. The issue had finally been resolved, but it may well be reopened if experience indicates that association reviews are not sufficiently reliable.

Other Review Programs

The voluntary plan adopted in 1976 also provided that state-society-sponsored review programs would be recognized if they met the specifications of the quality control review committee. A number of state societies began organizing programs; but before they could be implemented, the division for CPA firms came into existence. As a result, the state programs were redirected to fit the requirements of the private companies practice section. The societies were primarily interested in meeting the needs of the smaller local firms and had little interest in the SEC practice section.

In 1979 the Wisconsin Institute of Certified Public Accountants began requiring all of its members in public practice to submit samples of their reports on financial statements periodically. This was an extremely ambitious program, and it will be interesting to learn how successful it proves to be.

A variant of this approach was being discussed informally within the AICPA during the latter part of 1979 and early 1980. We were concerned about the quality of the work of many smaller firms that were not members of the AICPA Division for CPA Firms, and we believed that some monitoring system was necessary. One idea was that all firms not subject to peer reviews should be subject to random selection for reviews of their work. Implementation of such a plan would require a change in the bylaws by a mail ballot of the membership, and there was considerable doubt that it would gain approval if proposed.
The Situation in 1980

At the end of 1980 the peer review program remained voluntary and largely under the aegis of the AICPA Division for CPA Firms. The profession had made great progress in implementing an idea that, just a few years before, had raised an outburst of objections from the overwhelming majority of CPAs.

The program to review the quality controls of a wide range of firms still faced many problems and was too recent a development for anyone to judge its ultimate success. There were fears that the first major allegation of substandard auditing by a firm that had passed inspection under a peer review would thoroughly discredit the program. In addition, the costs of reviews were substantial, and there were questions about whether successive reviews would yield sufficient benefits to justify fees that ranged as high as $500,000 for the largest firms. Equally disturbing were the administrative costs of arranging for teams to conduct reviews. Potentially, thousands of firms may elect to have team reviews, and the arrangements would require a huge staff. Members would very likely object to the existence of such a bureaucracy.

There is little prospect that the firms practicing before the SEC can retreat from periodic reviews, since the SEC is unlikely to allow that to happen. Nevertheless, continuing experience with peer reviews may lead to modifications, such as a lengthening of the period between reviews. The possibility that all CPA firms might volunteer to have peer reviews at regular intervals, however, seems remote. To make such reviews mandatory would pose staggering problems of logistics and costs. Even more basic is the question of whether a quality control systems approach is appropriate for the reviews of smaller firms.

In spite of these problems, there is little question that the profession should find a way to monitor the performance by CPAs in public practice. The peer review concept is sound, although a more practicable means of achieving it is still needed. One possibility would be to review the work of local firms selected in a random sample. This approach would impose psychological pressures on all firms, whether or not they were chosen for reviews, and the costs and administrative burdens could be kept within reasonable bounds. In addition, it might be better to evaluate the work performed by small firms rather than the quality controls employed by them. When all is said and done,
there is no better way of judging performance than by looking at a firm’s engagement working papers and the reports it has issued.

Peer reviews will remain an important part of the profession’s effort to meet its responsibilities, but the manner in which they are imposed and carried out is likely to be improved as a result of future experience.
CHAPTER 9

Licensing, State Accountancy Statutes, and the Uniform CPA Examination

One of the important concerns of the profession is the establishment and maintenance of the requirements to become a certified public accountant. During the 1970s the Institute dealt with a number of significant developments relating to the licensing of CPAs, which involves mainly two activities: the maintenance of state accountancy statutes and the production and administration of a Uniform CPA Examination.

In carrying out these activities, the Institute found it necessary to deal with other organizations whose objectives and actions sometimes differed from those of the AICPA. Two such organizations were the National Society of Public Accountants (NSPA), a national organization of mainly non-CPA practitioners, and the National Association of State Boards of Accountancy (NASBA), a private association of state boards of accountancy.

Efforts by the AICPA Committee on State Legislation to improve the state accountancy statutes and to protect them from dilution involved the periodic updating of a model accountancy bill and statements of the Institute’s legislative policies and the lobbying of state legislatures through the state societies of CPAs. The production and administration of the Uniform CPA Examination involved a different set of problems. While production and grading of the examination continued under the direction of the AICPA’s Board of Examiners, NASBA and others began taking a strong interest in the appropriateness and administration of the examination, which led to several reviews of all aspects of the process. In addition, difficult questions arose regarding requests to provide examinations in Spanish.

In all of these activities the Institute encountered one contro-
versy after another, within its own membership as well as with other interested organizations.

Controversy with the NSPA

A principal adversary of the CPA profession in its effort to maintain strong licensing laws was NSPA, based in Washington, D.C., with a 1970 membership of approximately 15,000. Beginning in the late 1960s that organization stepped up its lobbying activities in the state legislatures to amend the accountancy statutes to provide for the licensing of a second class of public accounting practitioners who would not be required to pass the Uniform CPA Examination. The typical NSPA member was an unlicensed accountant who engaged in public practice by providing bookkeeping and tax services to clients but did not perform opinion audits. Such practitioners sought licensing for the usual competitive and prestige reasons.

As might be expected, CPAs were virtually unanimous in their opposition to the creation of a second class of licensed accounting practitioners. The profession has been striving for years to achieve uniformity in the accountancy statutes, whereby grandfathered licensed public accountants would be a dying class and ultimately only CPAs would be permitted to express opinions on financial statements. This objective was generally referred to as "single-class regulatory legislation."

Despite the profession's efforts toward uniformity, there continued to be a broad range of differences in the accountancy statutes of the various states. Some regulated only the use of the title "certified public accountant" but permitted anyone to express opinions on financial statements (permissive statutes). Others provided for the continuing recognition of another class of practitioners, referred to by such titles as "public accountants" and "accounting practitioners."

The lack of uniformity threatened to become even worse when the NSPA mounted its aggressive campaign to amend the statutes in those states where the state societies of CPAs were believed to be politically weak or inactive. This alarmed the AICPA Committee on State Legislation, and in 1969 it began
fighting back. The committee engaged a consultant on state legislative affairs, Martin R. Haley, to gain expert advice on key-person programs, political action committees, and how to deal effectively with the state legislatures. In addition, it organized regional meetings of state CPA society representatives to discuss ways to protect and improve the existing accountancy statutes. Experience indicated that actions taken in one state legislature tended to spread to neighboring states, and it was believed that a regional "buddy" system would help head off undesirable legislative developments.

In reviewing 1956 and 1959 Council resolutions on state legislation, the committee discovered that there was no clear policy statement opposing the licensing of a second class of practitioners. To remedy this situation, the following statement was drafted and incorporated in a revised ten-point policy regarding the licensing of accountants: "The public interest does not warrant the licensing of a class of accountants to perform bookkeeping and other elementary accounting services." The policy statement was approved by the AICPA Board of Directors on March 2, 1970, and by the Council on May 5, 1970. Thereafter, the committee on state legislation moved aggressively to implement the policy by working closely with the state CPA societies. Lobbying efforts were organized in every state where the NSPA or others pushed legislation that ran counter to the Institute's stated objectives. Initiatives were also taken to amend the state accountancy statutes where they were deemed to be deficient.

At various times smaller state societies with limited resources sought financial assistance from the Institute to engage professional lobbyists to help them combat unwanted accountancy legislation. Over the decade the AICPA Board of Directors approved matching funds with those provided by the societies in the District of Columbia, Alaska, Rhode Island, Vermont, and New Hampshire.

In 1973, under the able chairmanship of the late Max Myers, head of his own firm in Missouri, the AICPA State Legislation Committee decided that an existing ten-point policy statement required revision to make it less repetitious and self-serving in tone and to reflect new objectives, such as a statutory requirement for continuing professional education. A new statement
was prepared, consolidating all of the policies under five points, and was approved by the board of directors and Council in October 1973:

1. The public interest warrants the licensing and regulation of persons professing expertise in accounting who perform professional accounting services, including the expression of opinions on financial statements and other information upon which the public necessarily relies.

2. There is no such compelling need for licensing and regulation of persons offering record keeping and elementary accounting services performed at the instance of and for the benefit of employers and clients. Nor is licensing required in connection with the preparation of tax returns because of regulatory and disciplinary authority presently possessed by the Internal Revenue Service and other taxing authorities.

3. The practice of professional accountancy should ultimately be restricted to certified public accountants who have demonstrated competency by passing the Uniform CPA Examination, by fulfilling educational and other requirements and by continuing to meet professional standards. State boards of accountancy entrusted with administration of public accountancy laws should be comprised of certified public accountants who are qualified to assess the performance of other certified public accountants.

4. The enactment of a regulatory accountancy law is not intended to deprive persons who are practicing public accounting as principals at the time of passage of the law of their means of livelihood and they should be permitted to register as public accountants and become subject to regulation. All further registration or licensing to practice public accountancy should be limited to persons demonstrating their competence as certified public accountants.

5. The accounting profession serves a broad public interest as evidenced by the similarity of accounting needs in all political jurisdictions. In order that it may serve this interest, uniform licensing and regulatory requirements should be established and unnecessary restrictions of a local character should be avoided.

One year later, on October 11, 1974, another action was taken at the request of the committee. The board approved a resolution to actively pursue a program to achieve single-class regulatory statutes in all those states having permissive laws at that time. This was not so much a change in policy as it was an expression of renewed determination to go on the offensive rather than simply to wage a defensive battle against the attempts of the
NSPA to dilute the accountancy statutes. The efforts to implement this resolution were successful in that seven states were converted to single-class regulatory status during the balance of the decade—a surprising result because the tide of political opinion during that period was flowing toward elimination of restrictive licensing laws in the hope of benefiting consumers.

On several occasions throughout the decade there were attempts on the part of the NSPA to discuss with representatives of the AICPA ways to avoid confrontation between the two organizations in the area of state legislation. On December 3, 1970, John Lawler reported to the AICPA Board of Directors on a meeting attended by him and President Marshall Armstrong at the request of the president and executive director of the NSPA, which was seeking to establish a joint group to carry on formal discussions on cooperation. The board concluded that little could be gained by giving official recognition to the NSPA in the absence of a radical change in its legislative approach and declined to authorize formal discussions to take place.

This pattern was repeated on July 19, 1973, when the board declined a new request of the president of the NSPA to meet with the Institute’s officers. However, when a similar request was received in 1975, Chairman Philip Defliese and I met with our NSPA counterparts. At that meeting the NSPA’s representatives expressed concern about competition and damage to the reputation of all accountants being caused by unlicensed accounting practitioners whom they considered to be unqualified and guilty of malpractice. They sought the support of the AICPA for state laws requiring the registration of non-CPA public accountants to combat what they believed to be a common problem of the AICPA and NSPA. This was ironic since CPAs felt the same way about the members of the NSPA as the NSPA felt about unlicensed practitioners who were not among its members.

Mr. Defliese and I gave the NSPA no encouragement but agreed to report the discussion to the Institute’s board on May 9, 1975, when the board again declined to approve any actions aimed at seeking an accommodation with the NSPA but authorized the staff to maintain informal communications with the NSPA for whatever benefits it might provide.

This proved to be the last serious attempt by the NSPA during the 1970s to reach a peaceful coexistence with the AICPA.
Meanwhile, it adopted the AICPA's Statements on Auditing Standards, as well as the AICPA Code of Professional Conduct, virtually intact and adopted an examination for admission to membership. On the surface these measures seemed to be commendable, but they were actually less than impressive since the organization lacked an effective means of enforcing the auditing standards and rules of conduct on its members and the quality of the entrance examination was subject to question.

The NSPA and AICPA clashed on another important matter: the U.S. General Accounting Office establishment of uniform criteria for the engagement of independent auditors by various governmental agencies to audit the increasing volume of government grant programs. The NSPA lobbied hard both in Congress and at the GAO to have its members included within the GAO's recommendations. The AICPA, however, supported the September 1970 GAO policy, which stated that after December 31, 1975, only certified public accountants and those public accountants licensed before December 31, 1970, should be engaged to audit federally chartered, financed, or regulated private organizations. In 1972 this policy was incorporated in the GAO's Standards for Audit of Governmental Organizations, Programs, Activities and Functions.

By appealing to Congress in 1975, and again in 1979, the NSPA moved the GAO to reexamine its policy. On both occasions the GAO concluded that its stance was appropriate and no changes were made—determinations due, in part, to AICPA-supplied information that refuted some of the NSPA allegations.

The relations between the NSPA and the AICPA continued to be adversarial. The struggle for the support of the state legislatures is likely to continue indefinitely since neither side seems disposed to change its position regarding the licensing of another class of accounting practitioners. It is unfortunate that this issue cannot be satisfactorily resolved to avoid the continuing expenditure of time and money, particularly since it is questionable whether the public interest is served by the ongoing dispute.

The Model Accountancy Bill

An important part of the AICPA State Legislation Committee's activities has been the periodic updating and publication of a
model state accountancy statute incorporating the Institute’s policy positions regarding the licensing of CPAs. One important change in the model bill occurred in July 1974, when the AICPA Board of Directors endorsed proposed language that would permit separation of the issuance of the CPA certificate from the license to practice. This change arose initially to facilitate the enforcement of mandatory continuing professional education requirements whereby practitioners failing to comply would retain their CPA certificates but lose their licenses to practice.

At that time, the two-tier approach to licensing was already in use in several states where many believed it to be the best way to deal with yet another controversy—whether experience should be a requirement for becoming a CPA. By adoption of a dual requirement, experience could be required only for the permit to practice and not for the issuance of the CPA certificate, consistent with a policy adopted by Council in 1969 urging state boards of accountancy to drop experience requirements for the granting of CPA certificates.

Another important issue arose in the committee’s 1977 model bill—whether review and compilation engagements as newly defined in SSARS no. 1 should be included among the services reserved for licensed CPAs. On December 6, 1979, the board of directors concluded that review engagements should be included because they provided a measure of limited assurance on financial statements. Compilation engagements, however, were regarded as falling within a legislative policy that held, in part, “There is no compelling need for licensing . . . of persons offering record-keeping and elementary accounting services . . . for clients. . . .”

The draft of the overhauled model bill was exposed for comment early in 1980, and on May 5 the state legislation committee chairman, Barry Findley, reported to AICPA Council on the proposed changes. A final version of the model bill was presented for approval of the Council on October 4, 1980.

At that meeting two amending resolutions were proposed and adopted. One directed the committee to include compilation reports as defined in SSARS no. 1 among the services reserved for duly registered members of the accountancy profession. The stated intent was to control the use of the compilation report and not to restrict the preparation of financial data by unlicensed
practitioners, an act that would be of dubious constitutional validity. The proposed amendment received strong support among Council members because they had encountered many instances in practice in which non-CPAs were issuing compilation-type reports in connection with financial statements. The Council appeared to view compilation as a professional service that required regulation even though this seemed to contradict its stated policy.

The second amendment adopted was to provide optional wording for use by those states desiring to retain an experience requirement. This carried by a vote of ninety-nine to seventy-six, reflecting the controversial nature of the issue. The resolution did not directly reverse the policy adopted by Council in 1969 to require five years of college education and to eliminate any experience requirement, but it certainly invited noncompliance. The policy had not received popular support in the ranks of CPAs, and most of the state boards of accountancy had retained an experience requirement for the granting of CPA certificates.

Whether these two positions will stand or be reversed remains to be seen. The AICPA's old adversary, the NSPA, will no doubt fight vigorously against any attempts to foreclose non-CPAs from compiling and reporting on financial statements, and its case will be strengthened by the fact that such engagements do not pretend to offer assurance of reliability to third parties. Indeed, the issue was already joined when, on October 29, 1980, two unlicensed accounting firms sued the Washington State Board of Accountancy to set aside its interpretation that compilations and reviews of financial statements by unlicensed accountants were prohibited under the state's accountancy statute.

The experience requirement is another matter. Many educators and other AICPA members will regard the Council's 1980 "optional wording" as a step backward, but it may facilitate change to a two-tier approach to state licensing. If so, it will be a welcome development and should lead to removal of an experience requirement to obtain a CPA certificate.

In addition to the development of a revised model bill, the state legislation committee sponsored a policy change regarding the inclusion of lay members on state boards of accountancy. In earlier years the profession had opposed such appointments, but as lay members became more prevalent, the AICPA Board of
Directors, with Council endorsement in May 1978, agreed to a proposed change whereby the Institute would neither object to nor encourage the state board inclusion of lay members.

Uniform CPA Examination and the NASBA

Almost as important as the state accountancy statutes in the eyes of most CPAs is the uniform examination that all candidates for a CPA certificate are required to pass. Any such examination is bound to be the subject of periodic criticism and intensive scrutiny, and the AICPA-produced Uniform CPA Examination is no exception.

The first review relating to the examination during the 1970s was conducted by a small ad hoc committee chaired by Herman W. Bevis, head of Price Waterhouse and Company. That committee, which was concerned exclusively about security procedures, grew out of some irregularities that came to light involving improper grade changes by one of the state boards of accountancy.

The committee reported its findings to the AICPA Board of Directors on July 13, 1970, and recommended that in the future the state boards be required to report all changes in grades from those proposed by the Institute’s advisory grading service. On the basis of a review by a professional security consultant, it was also recommended that the AICPA arrange to do its own printing of the examination. The board asked that the staff implement these recommendations as soon as practicable; however, for practical reasons, the examination continued to be printed outside the Institute under newly invoked stringent security measures.

Subsequent reviews of the examination process came about as a result of interaction between the Institute and the National Association of State Boards of Accountancy, which for many years had been provided with facilities and limited staff assistance in the AICPA offices. The NASBA’s 1972 appointment of William Van Rensselaer to serve as a full-time executive director was a budget expansion funded in part by contributions from the larger CPA firms under a five-year program. Eli Mason, representing New York in the membership of the NASBA, objected to this,
claiming it to be improper for the "regulated" to finance the activities of the "regulators"—a debatable charge, since the NASBA was a private organization without regulatory power. Nevertheless, the NASBA board answered by appointing a long-range planning committee to develop a future course for the organization. During that committee's deliberations it was suggested that the NASBA's operations could be funded by taking over the preparation of the Uniform CPA Examination, although the committee did not include such a recommendation in its final report. However, the fact that it had been considered caused the AICPA to reexamine its relationships with the NASBA. As a result the staff was directed by the Institute's board to seek ways to assist the NASBA in solving its financial problems.

At approximately this same time, the U.S. Department of Justice and the Federal Trade Commission questioned whether the CPA examination was being used as a device to restrict entrance to the profession and thereby restrain competition. Lay members on state boards of accountancy were also voicing doubts about the content of the examination and questioning whether the boards should prepare their own examinations. It became apparent that some form of continuing independent review of the examination process might be necessary to respond to these concerns. This coincided with the NASBA's need to develop a sound financing basis and led to a proposal that might satisfy both objectives.

In meetings between AICPA and NASBA officials it was agreed that the NASBA, through a task force composed of its current and past state board members, should conduct an annual review of all aspects of the CPA examination, for which the AICPA would pay a fee that would be sufficient eventually to eliminate the NASBA's need to obtain operating funds from the CPA firms.

The AICPA Board of Directors and Board of Examiners and the NASBA's board agreed to the proposal, and by early 1976 the review team began its preparations to review the May 1976 examination. Robert Ellyson, a partner in the Miami office of Coopers and Lybrand, chaired the review team and collaborated with Mr. Van Rensselaer, the executive director, in drafting the report upon completion of the review.

The report, over sixty pages long, was presented to the
Institute’s Board of Directors on July 21, 1977, by Messrs. Ellyson and Van Rensselaer and contained a philosophical treatise on the use of tests for licensing purposes, as well as a discussion of the purpose of state accountancy laws and the responsibilities of state accountancy boards.

The review team’s overall conclusion was that “the policies and procedures of the AICPA’s Board of Examiners and the policies and procedures of the state boards of accountancy are generally adequate and that they are appropriately observed.” In wording that seemed to damn with faint praise, it went on to state, “While there is room for improvement in the process by which the Uniform CPA Examination is prepared and administered, the present process is well conceived and conscientiously administered in the public interest,” and listed forty-four recommendations for improvement. The drafters of the report maintained that they had not intended severe criticism. However, the Institute’s staff and Board of Examiners believed that the tone of the report was unduly critical and was most unfortunate in view of the Department of Justice and Federal Trade Commission attitudes. They were particularly irritated by the fact that many of the recommendations were for actions already in process before the review began or were exhortations to achieve objectives that represented unattainable ideals.

The board was disappointed by this first experience, partly because the report seemed unfairly, even if unintentionally, to cast doubts on the examination process and partly because the NASBA’s fee had been largely dissipated in consultant’s fees to provide an unneeded treatise on examination theory. Although there was little enthusiasm for a repeat performance, the board agreed to engage the NASBA for a second-year review limited solely to the administrative and security aspects of the examination, which limitations were reluctantly agreed to by the NASBA’s board.

Other developments contributed to strained relations between the NASBA and the AICPA, including the NASBA’s development of its own model act for accountancy statutes and a model code of professional ethics, with little attempt to coordinate these efforts with the appropriate committees of the Institute. Thus, by January 1978 the relations between the two organizations had become even more troubled. Also, congressional hearings in 1977
questioned whether the Institute's provision of office facilities evidenced control of the NASBA. The AICPA's chairman, Stanley J. Scott, and I met with NASBA President James Bates and Mr. Van Rensselaer to explore financing plans and concerns about some of the NASBA actions, and it was agreed that Mr. Scott and I would be given an opportunity at the meeting of the NASBA board in Albuquerque early in July 1978 to review some of the issues of common concern and to urge efforts to avoid differences in legislative and ethics policies. We suggested at the subsequent meeting with the board that the NASBA had a legitimate interest in the CPA examination and should itself conduct reviews on behalf of state boards of accountancy rather than have each board conduct its own review and then proposed that the NASBA's ordinary operating expenses, including provision for its own office facilities at a separate location and for the costs of annual reviews of the CPA examination, be financed by an allocation of a portion of the CPA examination fees paid by the state boards to the AICPA.

The NASBA's board generally agreed with this proposal, and at a meeting on July 13, 1978, the Institute's board authorized its implementation. An agreement was subsequently signed by the two organizations, and full reviews of the CPA examination, including the security measures employed by the state boards, were resumed on an annual basis. And, while these events laid to rest, at least for the immediate future, the problem of financing the NASBA, as well as the Institute's concerns about retaining the preparation of the CPA examination, they were unsuccessful in avoiding disparate legislative and ethics policies.

The NASBA proceeded to issue its own model code of ethics and model act and urged their adoption by the state boards of accountancy. They contained significant differences from those of the AICPA, some of which were not warranted by the fact that the state boards were statutory regulatory bodies rather than professional associations. This lack of uniformity was clearly undesirable from the standpoint of the AICPA, but there seemed to be no sure way to avoid it. The prospects were that such differences will continue to exist regardless of how much effort is devoted to coordination. The outlook of CPAs who serve on state boards is different from those serving in a leadership capacity within the AICPA, and it is likely to remain so. Hence,
a degree of friction between the NASBA and the AICPA on a continuing basis is probably unavoidable despite the best intentions of both organizations.

Further difficulties caused by the overlapping interests came about on April 24, 1980, when the NASBA proposed that it centralize and automate the grade-reporting process for the examination then being handled individually by the state boards of accountancy. The NASBA was of the opinion that centralized computer processing would provide savings and convenience for the state boards and yield a by-product of national statistics on grades correlated to candidate characteristics.

Although the AICPA was also in a position to provide this service, the NASBA representatives argued that this might cause some people to perceive AICPA involvement as in conflict with the Institute's role as the preparer and grader of the examination. In this instance the AICPA's board decided not to take issue with the proposal, although it did not concede the point on conflict of interest. The proposal was approved in principle, and a confrontation on yet another matter of common interest was avoided.

A Foreign-Language CPA Exam?

Other aspects of the CPA examination process became difficult issues during the 1970s. The large influx of Cubans in the Florida area put pressure on the state's legislature to provide for licensing examinations in Spanish. The Florida legislature passed a law, which, by its provisions, made it necessary to administer a Spanish-language CPA examination.

In May 1975 the Florida State Board of Accountancy appealed to the AICPA to help it meet the new legal requirements by providing the Uniform CPA Examination in Spanish. The Institute's board declined this request on the grounds that CPAs practicing in the various states must be proficient in English and should, therefore, be required to pass the CPA examination in that language. The Florida board thereupon developed its own examination in Spanish to comply with the new state law, and those few candidates who passed were subsequently qualified to become members of the Institute by a 1977 resolution of the AICPA's Board of Directors.
The same issue arose again, however, in March 1979 when the Puerto Rico Society of CPAs sought a Spanish-language examination to comply with requirements of the Puerto Rican Constitution. This time the Institute's board was more sympathetic because of the constitutional requirement and because business in Puerto Rico is carried on in the Spanish language. After exploring the costs and feasibility of meeting the request, the board of directors authorized the board of examiners to provide a Spanish-language translation of the Uniform CPA Examination for use only in Puerto Rico beginning in November 1979. The circumstances in Puerto Rico were thought to be sufficiently distinct from those in the fifty states to warrant making the exception, and the Puerto Rico Board of Accountancy had agreed to assume the additional costs involved.

The NASBA Board of Directors was disturbed by this action because it was feared that some of the states would find it more difficult to resist demands for a Spanish-language CPA examination, which was opposed by the state boards. However, the NASBA's representatives were satisfied after receiving assurances from the AICPA that it would not provide such an examination to the states. As it turned out, a breach of security prevented the examination from being given in Spanish in Puerto Rico in 1979, and the matter was deferred until November 1980.

In view of the AICPA's favorable response to Puerto Rico, the executive director of the Florida Board of Accountancy again put forward a request in September 1979. This was declined by the AICPA in December 1979, for the reasons previously expressed, and again in May 1980, when it was asked to reconsider the matter.

The issue of providing a uniform examination in more than one language was a troublesome one that is likely to be raised again. At the end of 1980, however, there was no disposition on the part of the AICPA Board of Directors to respond favorably to requests from any of the states. To do so would involve accommodating the language requirements of any number of ethnic groups.

Licensing of Foreign CPAs

Another major issue that arose during the 1970s was the licensing of foreign accountants as CPAs. In 1970 the state boards of
accountancy were individually determining whether the qualifications of applicants were sufficient to permit them either to take the uniform CPA examination or to be granted a certificate on some other basis; and although there was no uniformity in the way the various boards were meeting this responsibility, the boards were generally granting certificates to chartered accountants from Canada, the United Kingdom, and certain other English-speaking, developed countries without requiring such candidates to take the full CPA examination.

The AICPA International Relations Committee proposed in October 1971 that an international qualifications appraisal committee (IQAC) be established on a one-year trial basis, to evaluate the educational standards of the colleges and universities and the qualifying examinations of the accounting bodies in the countries of foreign applicants for CPA certificates.

This proposal was approved by the AICPA Board of Directors on February 10, 1972, and a five-member committee was appointed to function within the Institute's Examinations Division. By May 1973 the committee had adopted standards to be used for evaluating educational qualifications, and it was agreed to enlist the assistance of the Office of Admissions and Records of the University of Illinois, which had extensive experience in appraising foreign educational programs.

After the committee was established, the state boards of accountancy began requesting advice on the qualifications of individual foreign applicants, and the committee developed procedures for responding to these inquiries. Also, the committee embarked on a program intended to evaluate the profession's qualifying requirements country by country and compare them with those in the United States to determine whether they were comparable. The first country selected for such a study was Canada. It was concluded that the requirements to become a Canadian chartered accountant were equivalent to those of a CPA in the United States.

The next country studied was the Philippines. This time a different conclusion was reached, even though the committee was unsuccessful in obtaining complete information about the examination and grading process used to become a CPA there. With certain exceptions, the committee found that the CPA requirements of the Philippines were not equivalent to those in the United States, which meant that many state boards of
accountancy would require CPA applicants from the Philippines to take the Uniform CPA Examination before granting them a CPA certificate.

Obviously, this review program was potentially troublesome for relations between the professional bodies of the countries involved, and it was not long before serious problems did indeed arise. The first difficulty was encountered when a comparable committee of the Canadian Institute of Chartered Accountants preliminarily found that the requirements in England were not equal to those in Canada. This finding was subsequently modified, but not before it caused considerable harm that did not quite threaten to bring down the Commonwealth but was nevertheless damaging to international professional relations.

As an observer of this unfortunate experience, I concluded that the feasibility and desirability of the IQAC's mission ought to be reexamined lest the AICPA fall into the same trap. In discussions with my Canadian and U.K. counterparts, it was concluded that continuance of the program to evaluate the requirements in individual countries was ill advised and should be discontinued. Other, less inflammatory methods of dealing with the foreign reciprocity problem would have to be devised.

The review of the activities of the IQAC led to a number of changes. Responsibility for the committee was transferred to the international relations division, which had more intimate knowledge of the profession in other countries. Also, new studies of other countries were deferred, and the content of letters sent to state boards regarding foreign applicants was modified to confine the representations solely to an evaluation of the applicants' educational qualifications.

These modifications were not in time to prevent a major problem, which arose in 1977 in California, where the state board of accountancy had been denying reciprocity to CPAs from the Philippines but extending it to chartered accountants from Canada, the United Kingdom, and other commonwealth countries. The Filipino applicants appealed to California's Department of Consumer Affairs, which, in turn, threatened to take legal action against the state board because of alleged discriminatory practices. The state board defended its actions but agreed to sponsor a study of the feasibility of determining the equivalency of licensing examinations in a number of countries, including the
Philippines. In a public hearing held on the matter it became apparent from the testimony of a representative of the IQAC that that committee’s negative conclusion about the qualifications of Filipino CPAs had been based upon incomplete evidence, which was very damaging because the state board had been placing reliance on the committee’s recommendations. Furthermore, the IQAC representative expressed the opinion that, with the exception of Canada, all foreign licensing examinations were inferior to the AICPA’s examination.

The California state board’s feasibility study was conducted in conjunction with the NASBA and with financial and staff assistance from the AICPA. The study group concluded that it was impracticable to determine equivalency of licensing examinations to the AICPA’s examinations, as urged by the Department of Consumer Affairs. In the meantime a suit was filed against the state board of accountancy in behalf of the rejected Filipino applicants.

The California Superior Court ruled that the state board of accountancy had “abused its discretion by denying waiver” of the Uniform CPA Examination to applicants “who were duly licensed as CPAs in the Phillipines during the period 1957 through 1977.” The board was ordered to “reevaluate” applications received from an estimated 500 Filipino accountants and to use “the same standard as was used in evaluating applicants from New Zealand, India and Australia” to determine whether to waive the examination.

This adverse development was a stark illustration of the difficulties entailed in granting CPA certificates to foreign applicants. The need for a workable solution was further demonstrated when in 1978 representatives of the Institute of Chartered Accountants of England and Wales expressed great concern to the AICPA about the fact that a number of state boards were rejecting applications from English chartered accountants on the grounds that they did not meet the necessary educational requirements. Spokesmen for the English Institute were advised that it would be counterproductive for them to press the state boards of accountancy for more favorable treatment. Instead it was suggested that they await the outcome of efforts by the AICPA to develop a satisfactory solution to the overall problem of foreign reciprocity. They agreed to follow this course for the time being.
At one point in the California controversy, members of the state board of accountancy appealed to the AICPA to develop a so-called mini-examination to be used as a basis for granting CPA certificates to foreign applicants. This approach seemed to have merit since it had become apparent that determining the equivalency of educational and examination requirements was virtually impossible, given the diversity of educational systems, customs, and legal frameworks in the various countries.

In response, AICPA Chairman Joseph Cummings appointed a seven-member subcommittee of the board of examiners, to be chaired by Michael N. Chetkovich, a past AICPA chairman, to

Recommend content specifications and administrative procedures for a special examination to test the competence of foreign licensed accountants applying to state boards of accountancy for CPA certificates.

A special examination was contemplated to test areas of knowledge peculiar to the United States, such as taxation and business law. The examination would be shorter than the Uniform CPA Examination and would be prepared and administered by the AICPA as an advisory service to state boards of accountancy. It was hoped that this, coupled with proof by a foreign applicant that he was licensed in good standing in his home country, would eliminate the need to establish the equivalency of educational and examination requirements. The resulting more objective basis for dealing with foreign applicants would foster uniformity among the state boards and avoid the kind of discrimination charges that had arisen in California.

The subcommittee began its work on December 20, 1978, amid strong objections from the NASBA, the AICPA’s International Practice and State Legislation Committees, and the California Society of CPAs. Some were opposed to a special examination because they believed it would be used as a means to gain licensing of a second class of accountants by the National Society of Public Accountants. Others were against providing reciprocity to foreign applicants because even U.S. CPAs often encountered difficulties in obtaining reciprocity from states other than the ones by which they were originally licensed. While most of the objectors were willing to be flexible about educational and experience requirements, they all believed that foreign ap-
Applicants should be required to take the full Uniform CPA Examination. This, of course, ignored the fact that it was not an acceptable solution to foreign applicants who were already fully qualified and recognized as skilled practitioners in their home countries. It ran the risk that the profession in other countries would retaliate by restricting the activities of American CPA firms in their jurisdictions.

The subcommittee was asked to develop the specifications and procedures for a special examination. It had not been asked for its recommendation regarding whether use of a special examination was a good idea; accordingly, it carried out its task in spite of the objections. On September 20, 1979, the subcommittee chairman made a preliminary report to the AICPA Board of Directors. Even though the board had received a resolution from the California society opposing a special examination, it authorized exposure of the subcommittee's report for comments. Before this could occur, however, an agreement was made in October with the California members of Council to delay exposure until the spring Council meeting to give them time to express their views to Council members.

By May 2, 1980, the board of directors had received a request from the California society that exposure of the report be limited to members of Council. The board approved this request, and on May 5, 1980, Mr. Chetkovich reported to Council on the results of the subcommittee’s efforts.

The attitudes of Council members regarding the exposure draft of the report were negative by a wide margin. As a result, the subcommittee recommended that no further action be taken, and the board of directors simply received a final report and placed it on file.

Clearly, little or no support would be given to the contemplated solution for dealing with foreign applicants seeking CPA certificates. Most CPAs were unfamiliar with the international aspects of their profession and had no present interest in practicing across international borders. When the issue of foreign applicants was raised, the domestic problem of dealing with unlicensed practitioners no doubt weighed far more heavily in CPAs' minds than the possibility of their being restricted internationally—an outlook that may prove shortsighted. Increasingly, other countries are attempting to restrict the operations of American CPA firms
within their borders; following a hard line in the United States with respect to foreign applicants is likely to accelerate this trend. The risks of foreign retaliation and the domestic danger of inviting the licensing of a second class of practitioner are both difficult to judge; however, they are the factors that must be weighed unless a new solution is devised that avoids a conflict between international and domestic interests.

At the end of 1980 most state boards had eliminated any concessions to foreign applicants because of the California court opinion in the Filipino CPA case. It remains to be seen what reaction this will generate abroad. Based on my conversations with the profession's leaders in other countries, particularly in Canada and England, the current state of affairs will not be viewed as satisfactory. All signs point toward a future confrontation over this issue and a renewed search for an acceptable solution.

A National CPA Certificate

Another important issue regarding licensing and the CPA examination cropped up in 1970 when the incoming AICPA president, Louis M. Kessler, a top partner of Alexander Grant and Company, urged that a program to issue national CPA certificates be considered to overcome the many reciprocity problems between the state boards of accountancy. As a result, a joint NASBA-AICPA committee was appointed to study all aspects of the profession's recognition and regulation. That committee completed its work and reported to the Institute's Board of Directors on July 19, 1973, recommending against a national CPA certificate at that time but suggesting the establishment of a national registry of disciplinary actions. This and other suggestions for a directory similar to that of the legal profession and the establishment of a national qualification information service were not acted upon when it was concluded that they would not prove economically sound.

Following these events the idea of a national CPA certificate lay dormant for several years but was revived when the state legislatures began reviewing whether state accountancy statutes should be renewed. These reviews were being conducted pur-
suant to the adoption of "sunset" laws by state legislatures, under which legislative approval was required for the continuation of specified state agencies and programs beyond designated cutoff dates. Among other things, the reviews of accountancy statutes were leading to the appointment of more non-CPAs to serve on state boards of accountancy. Also, in some states the board powers were diluted when boards were placed under the authority of umbrella licensing agencies covering a wide range of occupations.

So-called sunset reviews began to threaten the continuation of the accountancy statutes and the licensing of CPAs in several states during the late 1970s through 1981. In answer to this developing threat to the licensing process, the AICPA Board of Directors requested and subsequently approved a policy resolution on state sunset laws prepared by the state legislation committee. The resolution did not endorse sunset legislation but supported periodic reviews of governmental programs through the use of financial and program analysis with the assistance of the accounting profession.

The prospects that one or more states might discontinue their accountancy statutes and the licensing of CPAs were sufficiently serious that I suggested in several speeches that consideration be given to a program whereby the AICPA would begin issuing a national CPA certificate. A fail-safe was becoming necessary, and the Institute was in the best position to provide a national certificate. Numerous examples of a national approach were in operation in other countries, such as Canada and the United Kingdom, where the "chartered accountant" designation was conferred by the profession's national institutes.

It was suggested that all holders of state-issued CPA certificates would be issued a national certificate by the AICPA and that the Institute would conduct the Uniform CPA Examination for applicants from any state that discontinued its licensing of CPAs and would grant national certificates to successful candidates. To avoid conflicts with existing state laws, the AICPA's certificate title would have to avoid the words "certified public accountant." One suggested alternative title was "chartered auditor." If a program of this nature were adopted, the Institute could eventually seek for its certificate a federal statutory underpinning that might be accomplished through official recognition
by federal agencies, such as the SEC or the General Accounting Office, or by direct legislation.

The suggestion that such an approach be considered resulted in the appointment of a special committee on regulating trends, which had not completed its work at this writing.

The concept of a national certificate issued by the Institute may well be viewed as too radical a departure from reliance on a system of state licensing or too great a risk of inviting further regulation by the federal government. It might also be concluded that the prospects of losing licensing in one or more states are minimal, although there were near misses in at least three states by early 1981. Nevertheless, the licensing of CPAs is so fundamental to the profession’s status that the AICPA can ill afford to be without a well formed alternative in mind in the event that a state legislature decides not to renew its accountancy statute. Although the problems of reciprocity are probably not pressing enough to justify a national certificate, the possible loss of licensing in a state puts such a proposal in an entirely different perspective.

Summary

In summary, there was a lot of action on the licensing, examination, and state legislation front during the decade, but many problems still remain to be resolved. The NSPA is continuing its efforts to achieve licensing of non-CPA practitioners. The Institute’s relations with the NASBA were improved, but the potential for continuing disagreements about rules of conduct and model accountancy statutes remained. The treatment of foreign applicants is a problem that remained unsolved and was almost certain to erupt in the future. And, finally, no contingency plan was yet in place in the event that state licensing is lost in one of the states.

Most of these problems do not lend themselves to neat and quick answers, yet they all involve issues of vital importance, and nothing less than vigilance, ingenuity, and forward planning is required if the profession is to deal with them on a timely and satisfactory basis.
Almost from its inception, the profession provided advice to management on accounting and financial matters. Not until the 1950s, however, did the rapidly growing national firms develop extensive specialized management consulting capabilities and begin employing non-CPA specialists in significant numbers to provide a broad range of services. This expansion was accelerated by the emergence of electronic data processing and the growing demand by government and the business community for consulting assistance.

The Institute originally applied the label management services to all services of CPA firms that did not fall under accounting, auditing, or taxation. This was later changed to management advisory services (MAS) to stress the fact that the services were to be rendered only in an advisory capacity and should not involve the making of management decisions for clients. A management advisory services committee devoted much of its effort to defining the nature and role of MAS and developing descriptions of how various types of consulting engagements are performed.

The Issues Raised by Management Advisory Services

These developments resulted in two major issues that concerned the profession throughout the 1970s. One was the allegation that the audit independence of CPA firms is impaired by the performance of management advisory services; this issue will be covered in the next chapter. The second problem was the question of formal recognition of specialization within the profession. The
profession’s long-standing view was that a certified public accountant is competent to engage in all aspects of public accounting practice and that formal categories of specialization, therefore, are unnecessary. With the growth in the range and complexity of services, however, this position became increasingly untenable. Services relating to computer systems, executive recruiting, inventory and production control, compensation and benefit plans, and work measurement programs obviously required skills and expertise well beyond those of the conventionally trained CPA.

Although some CPAs acquired competence in one or more aspects of MAS through formal study and practical experience, most CPAs were too busy providing services in the traditional areas of practice. Even the largest firms found it difficult to develop their own MAS specialists from within the ranks of their CPA employees. As a consequence, the CPA firms, in competition with non-CPA consulting firms, recruited experienced consultants. In a few instances CPA firms acquired non-CPA consulting firms to gain expertise in particular fields, such as actuarial services.

The influx of non-CPA specialists into the CPA firms added a new dimension to the specialization problem. It put CPA firms squarely in competition with non-CPA consulting firms, which created pressures to provide some form of professional recognition and status for the non-CPA specialists within the accounting profession. Failure to do so made it more difficult to recruit and retain experienced consultants.

The CPAs who coordinated the services rendered to audit clients generally looked upon the new class of non-CPA employees with distrust. They were not keen about risking the loss of recurring audit engagements for the sake of consulting services that might go awry. It was human nature to be suspicious of services that required competence that was foreign to their personal knowledge and experience. To make matters worse, some of the non-CPA specialists proved to be operating with false credentials, and some were overly aggressive in selling their services, which clashed with the CPAs’ traditional constraints on advertising and solicitation.

The emergence of MAS also contributed to the widening gulf between the large, national CPA firms and the rest of the practicing profession. The smaller firms’ lack of resources made
it difficult for them to provide formal MAS on a competitive basis or to absorb the costs of employing non-CPA specialists. As a result, many of these firms looked with disfavor on the broadening scope of services offered by the larger firms. They naturally opposed any initiative to recognize specialization of services or to bring non-CPA specialists into the ranks of the profession.

The Proposal for Non-CPA Associate Members

It was under these circumstances that the Institute tried unsuccessfully to solve the specialization question during the 1970s. The effort began in December 1969, when the AICPA Board of Directors received a letter from a member requesting that it consider creating an associate membership classification for non-CPAs serving on the professional staffs of CPA firms. The board responded by directing that a committee be appointed to study the suggestion.

Before the new committee could begin work, representatives of the MAS committee met with the board on March 2, 1970, to discuss the need for recognition of specialists. They pointed out that the Institute of Management Consultants, recently organized by the non-CPA consulting firms, had started a program to accredit "certified management consultants." This would make it difficult for CPA firms to attract and retain non-CPA specialists unless the AICPA instituted some form of similar recognition. The MAS committee representatives (all CPAs) raised the fundamental question about the place of specialists in the profession and requested that a special committee be appointed to study the desirability of the formal recognition of specialists.

The board concurred with the request, and a new special committee was appointed to supersede the previously authorized committee on associate membership for non-CPAs. Ralph Lewis, a partner of Arthur Young and Company, was appointed chairman of the new committee.

Almost a year later, on February 25, 1971, Mr. Lewis reported to the AICPA Board of Directors on the preliminary conclusions of the committee. He stated that the committee favored the establishment of an associate class of membership for non-CPAs employed on the professional MAS staffs of CPA firms. An
associate member would have to satisfy certain qualifications relating to education and experience and would have to pass an examination.

The board agreed in principle with the proposal and authorized its exposure for discussion at the next Council meeting.

Accordingly, on May 10, 1971, Mr. Lewis addressed the Council and distributed questionnaires to gain the views of its members. Even before the meeting closed, it was clear that most members opposed the proposal for an associate class of membership. This was confirmed when the committee tabulated the questionnaire responses, which revealed resistance to the inclusion of non-CPAs within the ranks of the profession on any basis whatsoever. The comments were not just negative; they expressed vehement, emotional opposition.

In July 1971 the executive vice president, Leonard Savoie, urged the board to take a formal position on the issue. He reported that the committee had considered but rejected some form of separate but interlocking organization for non-CPA specialists as an alternative to associate membership in the AICPA.

The board reluctantly adopted a resolution embracing the position that non-CPA specialists should be brought into a professional relationship with the Institute. It directed the special committee to continue its search for acceptable ways to accomplish this objective.

The special committee completed its report in December 1971, recommending a bylaw change to provide for an associate class of membership. The board tentatively approved the substance of the report but requested that several editorial changes be made before its publication.

During the ensuing delay, the MAS executive committee voted to oppose the proposed associate class of membership on the grounds that it would be an inadequate solution to the problem of recruiting and retaining non-CPA specialists. Instead, the committee stated its intention of developing an alternative proposal for a separate organization affiliated with the AICPA. When it learned of the MAS committee's action, the board decided to table the proposed bylaw change.

This marked the end of the first round of the Institute's effort to solve the specialization problem.
The Special Committee on Scope and Structure

By the fall of 1972, I had replaced Mr. Savoie as executive vice president, and LeRoy Layton, the head of Main Lafrentz and Company, had been elected president of the Institute. We believed that it was urgent that the profession reach a formal decision about the present and future scope of accounting firm practice.

Wasting no time, Mr. Layton announced in his inaugural address in October 1972 the appointment of a special committee to study the scope of the profession's services. Louis M. Kessler, a top partner of Alexander Grant and Company and a former elected president of the Institute, became chairman of the new group. All fourteen committee members had played important roles in the Institute's activities and had reached prominent positions within their firms. Thus, a truly blue ribbon committee assembled early in 1973 to deliberate on the scope of practice.

That period—1973—was a time of intense activity, much of it related to specialization and scope of services. The AICPA Board of Directors was considering a comprehensive overhaul of the bylaws, which had been underway for over a year. One proposed amendment would give the Council authority to create an associate class of membership if it chose to do so in the future. When the proposed amendments were circulated to Council members for comment, their response to this provision was again overwhelmingly negative. As a result, the board agreed to drop the proposal, although it informed the Council that it planned to consider associate membership at a later date as part of a review of the Institute's organizational structure.

In another development, legislation to require the registration of management consultants was introduced in the California legislature. The bill would have established a state board of registration and would have required management consultants to meet education and experience qualifications and to pass an examination. Even though CPAs were exempted under the bill, practitioners feared that this exemption would be deleted in the legislative process. The bill was strongly supported by the Institute of Management Consultants, which intended to promote similar legislation in other states.

This presented a clear danger that CPAs in smaller firms
would be effectively prevented from providing management consulting services if there were no exemption for CPAs, and the California Society of CPAs aggressively opposed the proposed legislation. It also asked the AICPA to object to the bill, but the board concluded that it would be inappropriate to intervene.

The board, however, did oppose the registration of management consultants until such time as a common body of knowledge had been identified and standards for practice had been established. Accordingly, it instructed the MAS committee to work with the Institute of Management Consultants and the Association of Consulting Management Engineers to explore the feasibility of examination and accreditation of MAS consultants. Once again the Institute faced the question of specialization.

The MAS committee, after some initial deliberations, proposed that the Institute sponsor a $100,000 research study on the MAS body of knowledge. The board agreed with the general objective but was somewhat skeptical about the study. It authorized the project but reserved the right to cancel it at the end of the first phases described in the prospectus. The MASBOK study, as the project became known, was carried out by Edward L. Summers and Kenneth E. Knight of the University of Texas.

A third development that occurred in 1973 was the report of a special committee that had been appointed in 1971 to study the likely effects of the growing competition from non-CPA firms, particularly from commercial service bureaus and banks offering computer accounting services. On May 4 Marvin Stone, the committee chairman, reported the panel's conclusions to the AICPA Board of Directors. Among the recommendations was the suggestion that the AICPA develop criteria that would lead to the formal accreditation of specialists.

By this time the board had become extremely wary of promoting any proposals to provide status to non-CPA specialists, since the necessary Council support did not exist. The board declined to act on the Stone committee recommendation, pending consideration of alternative staff proposals to deal with the specialization issue. The staff, hoping to find a solution that would gain general acceptance, had provided the board with an outline of such a plan.

The staff plan called for the establishment of divisions within
the AICPA along the natural lines of specialization: accounting and auditing, taxation, management advisory services, general practice, and management accounting (for members in government and industry). The proposed structure was similar to that of the American Bar Association, which had succeeded in effectively relating to the special interests of lawyers. The governing bodies of each division would be senior executive committees, some of which already existed. Membership in the divisions would be voluntary, and modest dues would be required. Each division would hold periodic national or regional conferences, issue publications, and engage in other activities to keep members informed of new developments in the division's area of specialization. Non-CPA specialists meeting certain employment, education, and experience requirements would be permitted to become nonvoting associates of the divisions but not members of the AICPA.

The board authorized the plan's exposure to the senior committees and representatives of the state societies. The board also referred the tentative plan to the special committee on scope of practice, which was grappling with questions about specialization. It also expanded the name and charge of the Kessler committee to cover "scope and structure."

Eventually, some lukewarm responses trickled in from the senior committees. By that time, though, the special committee on scope and structure had assumed responsibility for considering the various alternatives.

On January 3, 1974, the special committee on scope and structure reported its tentative conclusions to the AICPA Board of Directors. After much soul searching, the committee had decided to recommend once again that an associate class of membership be established for non-CPA specialists.

The board was sympathetic, but it would do no more than allow the committee to discuss the proposal at the next meeting of Council. At the May 1 Council meeting the opposition was intense. Several members offered motions to prevent the establishment of an associate class of members, but the Council voted to table the motions pending receipt of the committee's final report.

In July 1974 the special committee released a discussion draft of its report and recommendations. The board authorized its
circulation to all Institute members so that it could be discussed at the annual meeting in October and at meetings sponsored by the state societies. The draft was published and distributed in September 1974.

The report argued against any artificial restriction of the profession's scope of services. It postulated that the common characteristics of CPA services, which provide the foundation for a cohesive profession, are the expression of opinions and the provision of advice and assistance on accounting for, or management of, resource use.

The report recommended that the Institute establish a program for the recognition of specialties. It urged that the appropriate senior committees should be directed to develop suitable qualifying processes, including examinations, for specialists in their areas, and that they inaugurate activities to serve the specialists' needs. The qualifying process for specialists would be open to non-CPAs employed in public practice who met certain additional requirements. After a period of experimentation, the AICPA would consider granting membership status to non-CPAs who successfully completed the specialist examinations and fulfilled the other requirements.

The discussions that followed publication of the exposure draft again revealed that a majority of Institute members opposed accrediting specialists or providing associate membership status to non-CPA specialists employed by CPA firms. In view of this reaction, the board urged the special committee to delete the recommendation regarding membership for non-CPA specialists. Indeed, the groundswell of opposition became so vocal that the board finally decided, on February 27, 1975, to release a statement to the effect that it would not seek approval of the recommendation for recognition of non-CPAs, although it did intend to seek Council approval of the committee's proposals on scope of services and specialization.

The committee's final report was published on July 24, 1975. All references to membership status for non-CPAs were deleted from the report. Also, the committee modified its recommendation on the accreditation of specialists to suggest merely that a new committee be appointed to conduct a full-scale study of specialization within the profession, taking into consideration the need for any program to ensure competence in the major
areas of specialization, the detailed operating procedures of any such program, and its possible impact on various elements within the membership.

The report urged that, by Council resolution, the profession formally commit itself to maintaining a broad range of services, with due regard for the constraints set forth by the committee. The Council passed such a resolution on October 11, 1975, bringing to a close the second major effort to deal with the issue of specialization.

The Special Committee on Specialization

The third effort began with the appointment of the new special committee on specialization in October 1975. Wilbur H. Stevens of Elmer Fox, Westheimer and Company agreed to serve as chairman of the eleven-member group. The committee was composed entirely of individuals who had served in leading positions both in AICPA activities and within their firms. For over two-and-one-half years the committee conducted extensive research on the experience of other professional groups and held meetings with state societies, membership groups, and others interested in the subject of specialization.

While this work was going on, the MASBOK research study neared completion. The researchers submitted their final report on February 19, 1976, and the board authorized its publication in book form. The report concluded that there was indeed an identifiable body of knowledge for management advisory services and that it would be feasible to base qualifying examinations on that knowledge. The MAS executive committee announced its intention to submit recommendations based on the research findings.

Approximately one year later, on March 3, 1977, the chairman of the MAS executive committee recommended to the board that a survey be conducted to determine the extent of interest in an MAS examination program based on the results of the MASBOK study. The board authorized the survey and, simultaneously, requested an estimate of the costs of an examination program. The board stipulated, however, that nothing would be implemented until it received the report of the special committee on specialization.
At the same meeting Mr. Stevens requested, on behalf of the specialization committee, that the board appropriate $55,000 to hire a research company to survey user attitudes toward specialization in the profession. The board declined this request because it did not believe that any useful information would be obtained. After all, the board was already aware of the lack of member support for an accreditation program. In addition, the board was by that time preoccupied with congressional hearings and was in no mood to initiate extensive new programs.

On November 3, 1977, Stanley Klion, chairman of the MAS committee, reported the results of the survey to determine the feasibility of an MAS examination. The results indicated that if non-CPAs were included there would initially be about 2,000 candidates to take the examination, at a cost of $100 each. Thereafter, approximately 700 candidates a year would take the exam, at a cost of $235 each. If the examination were restricted to CPAs, the comparable figures would be 600 initial candidates at $270 each and another 220 candidates each following year at $700 apiece. The board again deferred action, pending receipt of the specialization committee’s recommendations.

At that same meeting, on November 3, Mr. Stevens reported orally on his committee’s tentative conclusions. It had decided that there was a need for the formal recognition of specialists and that the AICPA should implement an accreditation program that would be limited to AICPA members. The committee also suggested that the Institute establish specialization sections, which members could join voluntarily if they met certain experience and continuing professional education requirements. Those members passing an examination would be accredited members of a section, and those CPAs not taking an examination but meeting the other requirements would be referred to as members of a section. The committee had defined eighteen specialties for which examinations would be administered.

The board did not approve of these recommendations. It was opposed to the establishment of sections and was overwhelmed by the prospect of providing the large number of examinations that would be required. Some board members questioned the need for accreditation, and others doubted that the public would be able to understand the subtle distinctions between proposed classifications of members and accredited members.
In effect, the board had already tacitly decided not to endorse a program for accreditation of specialists, no matter how well conceived it might be. Simply, the Institute’s members did not support such a program, and the board knew it. Even aside from that, the timing was all wrong. The AICPA was in the midst of dealing with congressional subcommittees.

Being reluctant to make an overt decision, the board instructed the committee to seek an opinion on the legality of restricting accreditation to AICPA members. Also, it requested an estimate of the proposal’s costs, and it suggested that the committee consider proposing a pilot program for one specialty rather than embarking on a complete accreditation effort.

On January 5, 1978, Mr. Stevens returned to the board with a revised report. A legal opinion had been obtained, and the committee now proposed accrediting, at least initially, only those MAS specialists identified in the MASBOK study. Once again the board decided that the proposals were too ambitious, and it declined the committee’s request to expose the draft of its report for comment. Instead, it requested the committee to prepare an alternative proposal, which would use the existing national technical conference programs as a starting point toward a recognition of specialization.

By this time the committee was becoming understandably frustrated. Nevertheless, it made a final effort by modifying its report in several respects. It proposed a pilot program for two defined specialties, one under MAS and the other under taxation. The program would be administered by a new senior committee on specialization, and approval of the board would be required for future accreditation of each additional specialty area. Accreditation would allow a member to use a descriptive title prescribed by the administering committee. The revised report contained no provision for membership in specialist sections.

Finally, on July 13, 1978, the special committee presented its amended report to the board for approval to expose it for comment. The board again declined the request and asked that the committee issue a final report, which it did in October of that year. After receiving the final report, the board decided against initiation of the proposed pilot program and thereafter discharged the special committee.

Thus, a third effort suffered the same fate as the preceding
attempts to deal with specialization in the profession. This time, however, it failed even though it was unencumbered by the non-CPA issue.

Prohibition of Self-Designation as a Specialist

No further efforts were made to recognize specialization within the profession, and the Institute clung to its position that no CPA can claim to be a specialist in any particular service. Indeed, ethics interpretation 502-4 expressly forbade AICPA members from billing themselves as specialists. It was this very prohibition that caused the Institute further trouble.

During the 1970s the U.S. Department of Justice reviewed the Institute’s rules of conduct, forcing the Institute to abandon its prohibitions on advertising by CPAs. During the course of the negotiations, the department’s representatives expressed concern about interpretation 502-4. They withheld action, however, pending the outcome of the study being conducted by the special committee on specialization.

By the fall of 1978, the department’s attitude had forced the professional ethics committee to consider the deletion of interpretation 502-4. I became concerned that such action would enable members to designate themselves as specialists even though their qualifications might be questionable. Because the Institute had refused to establish criteria to accredit specialists, the ethics committee would be left to judge whether such self-designations were false and misleading and therefore in violation of the modified rule 502, which prohibits false advertising. And, of course, no criteria existed for this purpose.

To deal with this possibility, the board approved the appointment of a special committee to develop general criteria for the guidance of members who might decide to designate themselves as specialists. The committee was chaired by Richard Guiltinan, a past chairman of the computer services committee and a partner of Arthur Andersen and Company. It began its deliberations in January 1979, and by December 6, 1979, it had submitted its report to the board. The committee indicated that it would have preferred to recommend a program to accredit specialists, but, true to its charge, it had prepared a set of broad criteria to serve
as guidelines in the event that self-designation as a specialist was permitted.

By the time the board received the report, the Department of Justice had discontinued its review of the Institute’s rules of conduct, and interpretation 502-4 had not been modified by the ethics committee. In reviewing the report, the board worried that its publication would appear to be directed toward urging members to engage in self-designation as specialists, which was not the board’s intent. Therefore, the board merely referred the report to the ethics committee for future use in the event that interpretation 502-4 was repealed.¹

In taking this action the board did not intend to endorse the recommendation of the special committee that members be permitted to designate themselves as specialists if warranted under the guidelines. It believed that further action should await a new challenge from the Department of Justice. Thus, the decade ended with yet another aborted action.

The Continuing Search for a Solution

The 1980s began without a solution to the twin issues of formal recognition of specialization and the place of non-CPA specialists in the profession. Many of the large, national CPA firms had long since sought a partial solution to the problem of non-CPA specialists by becoming active in the Institute of Management Consultants. A substantial number of CPAs practicing in smaller firms continued to oppose both accreditation of specialists and some form of affiliation for non-CPA specialists. No doubt they were motivated in part by the fear that these developments might give the large firms a further competitive advantage.

Whether the user public has any great need for the accreditation of specialists remains an open question. Certainly, there has been no public clamor for assistance in engaging specialists in the consulting field. Apparently, if government officials or business management have had bad experiences with consultants, they have been more inclined to negotiate a reduced fee and chalk the matter up to experience than to voice demands for accreditation.

¹. Interpretation 502-4 was withdrawn effective September 1981.
If there is no public need for accreditation of specialists, then the issue is an entirely internal matter within the profession. Although de facto specialization has existed for a long time, formal recognition is a highly sensitive political issue because of the possible effects on competition between the large and small firms. Given the internal frictions that existed, early solutions to the specialization questions were unlikely.

The right to advertise will lead inevitably to claims of specialization since this is inherent in the objective of informing users of one’s services. Indeed, references to specialization have already cropped up in the advertisements of CPA firms. If the professional ethics executive committee attempts to impose discipline for making such claims, its position may not survive legal challenge. If the prohibition of advertising that is not false or deceptive is illegal, then the prohibition of claims of specialization that are not false or deceptive may also be illegal.

Thus, there is good reason to believe that the Institute will be forced to revoke its prohibition against claiming to be a specialist. Either a test case or renewed pressure from the Department of Justice is likely to occur. The revocation of interpretation 502-4 might well open the floodgates to all sorts of dubious claims, and that development might finally produce general support for a program to accredit specialists in the accounting profession.

A form of membership status in the profession for non-CPA specialists is a more difficult matter, however. The issue involves the question of whether the profession should be comprised of multiple disciplines, which in turn affects preentry education and entry examination requirements. To serve as the test for entry to the profession, the CPA examination might have to be broadened to cover additional subjects, and postentry examinations might be necessary for the various specializations.

Clearly, the profession was not ready in the 1970s for such a substantive change in the concept of its role. But, at the beginning of the 1980s the signs pointed more and more toward a broadening of the profession’s role and responsibilities. If this takes place, there will be an increasing need to employ specialists in other disciplines, in addition to those that have already been brought into CPA firms. This would increase the pressures to
embrace such specialists as members and would lead to a more diversified profession.

No one can predict with complete confidence what the outcome will or should be. It will be extremely interesting, however, to watch future events unfold in the area of specialization. These developments will provide a clear indication of whether the profession intends to restrict or expand its role and responsibilities.
CHAPTER 11

Management Advisory Services and Auditor Independence

An issue that has troubled the profession over a period of nearly twenty years is the question of whether auditors' performance of management advisory services impairs their independence, either in fact or in appearance. In the early 1960s a number of articles were written, mostly by persons in the educational field, asserting that auditors should be prohibited from performing such services in order to protect their independence. Two of the writers, Abraham Briloff and Arthur Schulte, surveyed various groups to elicit their views on the issue; the results of these surveys suggested that the profession did have an "appearance" problem, although there were reasons to believe that the questionnaires had introduced a bias in the responses.

Early Responses to MAS Criticism

In response to these allegations, the AICPA Management Advisory Services Committee initiated a series of papers designed to clarify the nature and scope of management advisory services, the competence required for such services, and the role played by CPA consultants. The committee hoped that the papers would eliminate some of the apparent confusion.

Meanwhile, in October 1966 Manuel Cohen, chairman of the SEC, raised the issue in a speech before the AICPA's annual meeting in Boston:

However, a word of caution is in order with respect to . . . "consulting services which cannot be related logically either to the financial process or to broadly defined information and control
systems, [such as] market surveys, factory layout, psychological testing, or public opinion polls." And, I am disposed to add, executive recruitment for a fee. An accountant who directs or assists in programs of this kind raises serious questions concerning his independence when it comes time to render to creditors, to investors and to the public his opinion on the results of the programs. Public accountants should carefully reconsider their participation in these activities lest their continuation and extension undermine the main function of the independent accountant—auditing and the rendering of opinions on financial statements.

Chairman Cohen's remarks gave the issue a new urgency. Accordingly, the AICPA Executive Committee (Board of Directors) approved the appointment of an ad hoc committee to study and prepare a report on the subject. The five-member committee was chaired by Malcolm M. Devore, a top partner of Haskins and Sells, and included representatives of the three major areas of service and the professional ethics committee.

The ad hoc committee conducted extensive research, including interviews with user groups and the authors of articles on the subject. It issued an interim report on August 1, 1968, and a final report in 1969. The committee found no evidence that performance of management advisory services had resulted in the actual impairment of an auditor's independence, and it concluded that countervailing pressures would prevent any erosion of auditor independence. Many observers confused competence with independence, had distorted views of what management advisory services entailed, and failed to understand the role played by CPAs in providing such services. All in all, there was no sound rationale for proscribing certain types of management advisory services.

Nevertheless, the committee concluded that concern about the appearance of lost independence continued to exist, and CPAs should exercise great care in performing services that were not logically related either to the financial process or to broadly defined information and control systems. Also, CPAs providing management advisory services should avoid making management decisions. If in doubt about the propriety of an engagement, CPAs should consult with their clients' audit committees.

The committee was discharged in October 1969 with the hope that its report would clarify the issue, if not lay it to rest. Only
a few months passed, however, before a letter was received by the Institute, in March 1970, from Andrew Barr, chief accountant of the SEC, requesting a reexamination of the propriety of accounting firms' performance of executive recruiting on a fee basis for audit clients.

This led to the appointment of a new committee, composed of members of the AICPA Board of Directors, and chaired by Stanley D. Ferst, a top partner of Laventhal Krekstein Horwath and Horwath. The committee proceeded to prepare a white paper on the subject of executive recruiting for a fee. The paper described the CPA firm's function in the executive recruiting process and concluded that such services, properly practiced, posed no significant threat to the CPA's independence as an auditor. Procedures were recommended to ensure that CPAs did not in fact make decisions for management during the course of the recruitment process.

The Institute submitted the completed white paper to the SEC in February 1971. Within the next few months, the makeup of the commission and its staff changed, and the new group representing the commission did not pursue the issue.

Report of the Committee on Scope and Structure

Even though the SEC took no further action, the management advisory services independence issue was by no means resolved. Academics and non-CPA consultants continued to question the propriety of management advisory services performed by auditors. By the fall of 1972 a reexamination of the profession's scope of services was necessary, and President Layton appointed a special fourteen-member committee to study the present and future scope of accounting firm practice.

During its deliberations, the committee on scope of practice was heavily influenced by the Institute's restated code of professional ethics, which was developed and adopted during this period. The new code contained a dissertation on the subject of auditor independence and whether nonaudit services are likely to impair such independence. Readers interested in a full analysis of the concept of auditors' independence are urged to read the
pertinent portions of the "Concepts" section of the code. Certain passages in that document were especially cogent to the work of the committee on scope of practice:

When a CPA expresses an opinion on financial statements, the judgments involved pertain to whether the results of operating decisions of the client are fairly presented in the statements and not on the underlying wisdom of such decisions. . . .

The more important question is whether a CPA would deliberately compromise his integrity by expressing an unqualified opinion on financial statements which were prepared in such a way as to cover up a poor business decision by the client and on which the CPA has rendered advice. The basic character traits of the CPA as well as the risks arising from such a compromise of integrity, including liability to third parties, disciplinary action and loss of right to practice, should preclude such action.

Providing advice or recommendations which may or may not involve skills logically related to a client's information and control system, and which may affect the client's decision-making, does not in itself indicate lack of independence. However, the CPA must be alert to the possibility that undue identification with the management of the client or involvement with a client's affairs to such a degree as to place him virtually in the position of being an employee, may impair the appearance of independence.

The committee on scope of practice worked for nearly two-and-a-half years before issuing a final report in July 1975. The report was primarily a philosophical essay, which addressed all aspects of the profession's scope of services and their effects on the independence of auditors. It is difficult to summarize the report, but a few excerpts illustrate the committee's reasoning:

There seems little doubt that the profession is confronted with a crossroads decision about its future course: does it wish to remain a broad-gauged profession offering a wide range of services designed to benefit many users—including management, investors, creditors, governmental agencies, and the general public? Or should it adopt a more restricted view of its mission?

The latter option may be tempting. Since many of the new services involve matters of uncertainty and even controversy, they may expose the profession to criticism and possible additional legal liability. Moreover, if the additional responsibilities being assumed are not clearly delineated, a widening gap may develop between what the profession believes that it can feasibly do and what the public expects of it. Finally, as it broadens its range of services, the profession redefines its character—provoking, at least for a time,
confusion about its true identity. This, in turn, may generate friction among those engaged in practice as well as between the profession and others who offer similar services.

Despite these dangers, the committee on scope and structure is convinced that the profession must not adopt a narrow concept of its role.

The report went on to present the committee's reasoning and then to propose a basic rationale for the profession's scope of services:

It must be acknowledged, however, that the diversity of services provided by practitioners has raised the question of whether the profession is engaged in performing incompatible services and, if so, whether the result will be a diminution of the professional status of CPAs.

There have been several attempts to deal with this question. One of them resulted in a proposition that all matters having to do with information systems fall properly within the scope of services to be rendered by CPAs. This view implied the conclusion that professional status would not be endangered by engaging in at least some services other than the attest function. Although it endorses this implied conclusion, the scope and structure committee believes that there is a broader characteristic than information systems which provides a common base for the present and future services of a unified profession.

That characteristic is the expressing of opinions and the providing of advice and assistance on the accounting for, or the management of, the utilization of resources.

One final excerpt from the report is particularly pertinent:

The suggestion has also been advanced that one or more of the "peripheral" management advisory services, i.e., those which may appear to be only marginally related to the traditional accounting function, ought to be proscribed.

This may seem at first to be an inviting course of action.

The challenged services are presently performed by relatively few firms, and none of them constitutes a major part of the practice of any firm. A prohibition against one or more of these services would not inflict much of a hardship on the profession, but it would deprive the business community of convenient access to useful assistance. A decision to ban a particular service, however, cannot be justified if it is merely designed to silence those who question the propriety of that service. Such a gesture of appeasement, even if it proved effective in mollifying the critics (a dubious assumption), would set a dangerous precedent. If any proscription were to be
adopted, it ought to be the result of a clear determination, based on solid evidence, that the prohibited service was creating serious questions about the profession's independence in performing its attest function.

The committee's report induced the Council to adopt a resolution on October 11, 1975, in support of a broad range of services and an expanding role for the profession, with due regard for the constraints stated by the committee.

Unfortunately, the report of the committee on scope and structure attracted little attention. Critics who did read the report dismissed it as a whitewash, and practicing CPAs continued to hold mixed views on the issue.

Congressional Hearings and the Commission on Auditors' Responsibilities

In early 1976 the independence issue again began to heat up, this time in connection with congressional investigations and hearings. In anticipation of these hearings, I drafted a white paper on the independence of auditors, which was later approved by the AICPA Board of Directors as a basis for dealing with governmental agencies.

The AICPA testified on June 16, 1976, before the Senate Commerce Committee regarding Ralph Nader's proposal for the federal chartering of corporations. The proposal included a suggestion to require mandatory rotation of auditing firms to bolster their independence. The AICPA expressed its opposition to mandatory rotation by filing a copy of the white paper and testifying on the nature of the independence required of auditors.

No action resulted from the hearings, and the paper was relegated to the archives, both in Washington and at the AICPA. Once again, an effort to present the profession's stand on independence and scope of services received little outside attention and failed to dispose of the issue.

Then, in December 1976, the staff of Senator Lee Metcalf's subcommittee on reports, accounting and management published its report, *The Accounting Establishment*. The report included the recommendation, "Performance of management advisory services for public or private clients are ... activities which are particularly incompatible with the responsibilities of independent
auditors, and should be prohibited by Federal standards of conduct." This report and the congressional hearings that followed are described more fully in chapter 3. Suffice it to say that they reopened all aspects of the issue of accountants’ performance of management advisory services.

Fortunately, the AICPA-sponsored, independent Commission on Auditors’ Responsibilities released its final report in 1978. The scope-of-services question was among the issues studied by the commission, and the report concluded as follows:

There is no evidence that provision of services other than auditing has actually impaired the independence of auditors. However, the belief of a significant minority of users that independence is impaired creates a major problem for the profession. Decisions on the other services offered and used should be made by individual public accounting firms and boards of directors of clients.

Approximately eleven pages of the report were devoted to a discussion of the profession’s scope of services. The commission’s recommendations stopped short of suggesting the proscription of specific types of services.

Interestingly, the chairman of the Commission on Auditors’ Responsibilities was Manuel F. Cohen, the past chairman of the SEC who had questioned the propriety of the profession’s scope of services back in October 1966. He had also been instrumental in initiating the SEC’s subsequent request that the AICPA study whether CPA firms should be prohibited from performing executive recruiting services for a fee.

The report of the Commission on Auditors’ Responsibilities and the testimony of its members played an important role in the congressional hearings that were held from 1977 through 1979.

Renewal of SEC Interest

At the time the congressional inquiries got under way in 1976, Harold Williams became chairman of the SEC, and Clarence Sampson took over as acting chief accountant. Both men had doubts about the propriety of auditors’ performance of certain types of management advisory services. When congressional subcommittees began criticizing the SEC for not exercising adequate oversight of the profession, Messrs. Williams and Sampson
became especially concerned about the scope-of-services question. This led to the publication of rulemaking proposals and ultimately to the commission’s adoption of Accounting Series Releases no. 250 and 264.

The commission began by seeking comments in release no. 5869, dated September 26, 1977, which called for proxy statement disclosure of audit and other fees incurred by registrants. It also sought comments on several questions regarding the need to restrict the types of services that CPAs perform for their audit clients.

At that time the AICPA was establishing the division for CPA firms, and members of the SEC practice section believed that a few concessions would be necessary on scope of services in order to gain SEC support for the new program. As a result, the SEC practice section’s organizational document prohibited member firms from performing, for their SEC clients, psychological testing, public opinion polls, and merger and acquisition assistance for a finder’s fee. The section also indicated that certain aspects of marketing and plant layout engagements might be ruled out at a later date.

These steps did not deter the SEC from continuing to address the scope-of-services question. The pressures from Congress had apparently convinced the commission that it could not afford to rely solely on the profession’s response. It became evident that the SEC intended to consider responses to its release and then take further actions to discourage the performance of management advisory services by the auditors of registrants.

The executive committee of the new SEC practice section was greatly concerned, and representatives met with SEC Chairman Williams to request the commission to delay further action until the section could develop a new proposal and carry on discussions with the commission’s staff regarding the scope of services. Chairman Williams encouraged the section to pursue this course.

The section then appointed a committee to prepare a position paper. The committee, which was chaired by Russell Palmer, head of Touche Ross and Company, developed a proposed amendment to the section’s constitution that would prohibit consulting engagements involving skills not related to accounting or auditing. It went on to rule out certain specified aspects of engagements involving executive recruiting, marketing consult-
ing, plant layout and design, product design and analysis, insurance actuarial computations, and employee benefit plans.

These proposals caused lengthy and often heated debates within the executive committee of the SEC practice section. In the end, the executive committee reluctantly agreed to the proposals.

This attempt to develop criteria that could be applied in resolving the scope-of-services issue did not satisfy the SEC’s chairman and staff. Chairman Williams publicly expressed the view that the proposed accounting and auditing skills test was too broad to be acceptable.

At this point the executive committee requested the section’s public oversight board to study the issue. It was recognized that this would become necessary at some point in any event, and it was hoped that the board’s views would gain greater acceptance by the SEC. The board accepted this request and began immediately to conduct a study, guided principally by the vice chairman, Ray Garrett, Jr.

In June 1978 the SEC adopted and released Accounting Series Release no. 250. The release required proxy statement disclosure of the various services furnished by a registrant’s auditor during the year, the percentage relationship of the total fees for nonaudit services to the audit fee, and the percentage relationship of the fee for each nonaudit service exceeding 3 percent of total fees. It also indicated that the commission had not decided whether to limit the scope of services and would await the public oversight board’s conclusions before taking further action.

On July 1, 1978, in the commission’s oversight report to Congress, the SEC identified the scope-of-services issue as one of three unresolved questions.

The Report of the Public Oversight Board

These actions set the stage for the report of the public oversight board. The board held public hearings on August 17 and 18, 1978, and conducted a comprehensive review of all that had been written on the subject. It then wrote a draft of its report, which it reviewed with both the SEC and the SEC practice section executive committee to elicit their comments. SEC Chairman
Williams and Chief Accountant Sampson expressed general satisfaction with the board's conclusions and recommendations. This was reported in due course to the SEC practice section, and it appeared that the issue was finally going to be settled without further SEC action to impose more stringent restrictions on management advisory services.

Unfortunately, through a failure in communications, it was not made clear that Chairman Williams intended to issue some form of statement to cause registrants and CPA firms alike to be more sensitive to the need to consider the independence issue in each nonaudit engagement. This proved to be the cause of some very bitter feelings on the part of the CPA firms when the commission subsequently issued Accounting Series Release no. 264.

The board's report was issued in March 1979. Like the other groups that previously had studied the scope of services, it found no evidence that the performance of management advisory services had in fact impaired auditor independence. It suggested that any possible problems would become evident through the disclosures required by Accounting Series Release no. 250. In the meantime, the board recommended against any specific proscriptions of services and rejected the validity of the proposed accounting and auditing-related skills test developed by the Palmer committee. The section's specific proscriptions of services should be rescinded, except for those relating to executive recruiting.

The board also recommended that members of the SEC practice section should be required to comply with the AICPA's management advisory services standards and code of professional ethics. Member firms should report their annual gross fees for nonaudit services as percentages of total audit fees, and this information should become part of the section's public files. Peer reviews should be expanded to determine whether management advisory service engagements had complied with appropriate role restrictions. Finally, the board recommended that auditors should provide only supplementary actuarial advice to insurance companies that they audit.

The report was favorably received by the SEC practice section's executive committee, which proceeded to amend the section's constitution to conform with the public oversight board's recommendations.
Accounting Series Release no. 264

Unfortunately, this latest attempt to deal with the scope-of-services issue did not end the matter. The SEC was aware that a Senate subcommittee chaired by Senator Thomas Eagleton had a strong interest in the scope-of-services issue. Questionnaires had been sent to the AICPA and a number of CPA firms in April 1978, and John Chesson, author of *The Accounting Establishment*, had become a member of the subcommittee's staff. His concerns about management advisory services were reflected in the questionnaires and the subcommittee's announced intention to hold hearings at some future date. Thus, the SEC was under continuing pressure to take a more aggressive position on scope of services. In addition, Chairman Williams and Chief Accountant Sampson truly believed that both CPA firms and their clients should be made more sensitive to the potential for impairment of auditor independence.

As a result, the commission issued Accounting Series Release no. 264 on June 14, 1979. The release contained the following summary:

In this interpretative release the Commission states its views concerning certain factors which accountants should consider in assessing the possible effects upon their independence of the performance of nonaudit services for publicly-held audit clients. In addition, . . . the Commission also sets forth certain factors which audit committees, boards of directors, and managements should consider in determining whether to engage their independent accountants to perform nonaudit services.

The release also included a statement of the commission's belief that the report of the public oversight board did not "adequately sensitize the profession and its clients to the potential effects on the independence of accountants of performance of non-audit services for audit clients." It went on to state, "While the Commission is not proposing proscriptive rules at this time, it believes that continued surveillance of the potential effects of such services on independence is essential." The commission stressed such matters as the magnitude of revenues from management advisory services, the need to ensure that auditors do not assume a managerial role, avoidance by auditors of review of their own work, and the economic benefits involved. It specifically rejected as a valid test the accounting- and auditing-
related skills concept previously proposed by the Palmer committee. The release concluded with the following warning:

This release is not the end of the examination of the scope of services issue. The Commission . . . will continue its oversight of this area, principally through staff monitoring of the disclosures required under ASR No. 250 and of the profession’s response to both the views expressed in this release and to the Public Oversight Board’s recommendations. The Commission’s staff will also continue to examine particular cases in which questions arise concerning the independence of accountants who practice before the Commission, and compilations of such inquiries will be published from time to time.

Although the commission had implied in its July 1978 report to Congress that it would take a position after receipt of the public oversight board’s report, the issuance of ASR no. 264 caught the profession by surprise. The SEC practice section believed the commission to be satisfied with the board’s report, and it expected that no further releases on the scope-of-services issue would be forthcoming.

Thus, when ASR no. 264 was issued, without prior warning or discussion with the AICPA, there was an immediate and angry outcry from the CPA firms. The negative tone of the release and the implied threat of staff inquiries regarding specific filings with the SEC were seen as a clever attempt by the commission to proscribe management advisory services indirectly, even as it expressed the decision not to do so directly. Several CPA firms reported that SEC releases no. 250 and 264 were having a very chilling effect on their clients and that prospective management advisory service engagements were being lost. A few firms seriously considered bringing legal action against the commission on the grounds that it had effectively proscribed management advisory services without the due process required by the Administrative Procedures Act.

The AICPA’s officers shared the belief that ASR no. 264 would do great damage to the profession’s scope of services and that strong objections to the release were in order. Accordingly, a special committee, chaired by Henry Gunders, chairman of the management advisory services executive committee, was appointed to prepare a letter of comment to the SEC.

The resulting letter, dated August 3, 1979, was one of the most sharply worded communications ever conveyed by the
AICPA to the commission. The tone was characterized by the following sentences:

In our opinion, ASR 264 will have, and was intended to have, a chilling and depressing effect on the use of a CPA firm’s management advisory services by the firm’s audit clients.

By issuing ASR 264 [the commission] attempts to substitute the rule of men for the rule of law.

The letter, which had the full approval of the AICPA Board of Directors, urged the commission either to withdraw the release or to issue a clarifying release "to assure that it does not achieve what would otherwise require compliance with the Administrative Procedures Act."

Neither of these actions was subsequently taken by the commission, despite a number of additional verbal protests that were made in the following months.

At approximately this same time the long-promised public hearings of the Senate Subcommittee on Governmental Efficiency and the District of Columbia, chaired by Senator Eagleton, were scheduled. One of the principal subjects covered during the hearings was scope of services. Senator Eagleton expressed grave doubts about the propriety of the auditors’ performance of such services, and he was visibly irritated when SEC Chairman Williams did not fully support his views. However, Ray Garrett, Jr., representing the public oversight board, later seemed to have a calming effect on Senator Eagleton when he provided an explanation of the board’s conclusions on the subject.

A report on the hearings was never issued. Shortly afterward Mr. Chesson left the subcommittee’s staff for other employment, and Senator Eagleton turned his attention to more urgent problems. This left the profession and the SEC to deal with the issue on their own, although the specter of further congressional interest remained.

Because there were indications that the SEC would not attempt to clarify ASR no. 264 at an early date, the AICPA Board of Directors authorized the publication of a brochure aimed at audit committees and boards of directors. The AICPA hoped that, by explaining the SEC’s positions in more positive tones and by making the case in support of management advisory services performed by auditors, it could mitigate some of the damage caused by ASR no. 264.
During this same period, John Biegler, head of Price Waterhouse and Company, appeared on the same speakers' platform with SEC Chairman Williams at the annual meeting of the American Accounting Association. Mr. Biegler used the occasion to blast the SEC for failing to provide definitive guidance on the scope-of-services issue. When this apparently failed to goad the SEC into action, Price Waterhouse and Company published a proposal, *Breaking the Deadlock Over Management Advisory Services*.

The proposal, which came as a surprise to the AICPA, urged adoption of the concept that "the development of information systems for audit clients, as well as marshalling and analyzing specific information for management decisions with respect to economic alternatives, are permissible areas of activity and raise no independence issues." It further recommended that a list of permissible management advisory services, grounded on the proposed concept, be developed by the AICPA. It also suggested that auditors provide their clients with written representations regarding their independence to demonstrate that the scope-of-services question had been fully considered. The authors hoped that such a "positive tack" would resolve the scope-of-services issue.

The AICPA appointed a special committee to consider these proposals and to monitor the impact of ASR no. 264 on the profession. That committee rejected the Price Waterhouse proposals, primarily on the grounds that they were not substantially different from concepts that had been proposed previously, and it offered little hope for resolution of the issue. The committee also opposed the preparation of a list of permissible services, which would, by implication, rule out all other services. The committee had no objection to a representation of the auditor's independence, although it observed that independence was already implied by the auditor's issuance of an unqualified auditor's opinion.

Nothing further came of the Price Waterhouse proposals, and the SEC continued to defer any clarification of ASR no. 264. Even a letter from the public oversight board to the effect that the SEC had partially misrepresented the board's conclusions failed to bring about a new statement from the commission.

As time went by, CPA firms became less vocal about the issue, and some even feared that a clarifying statement by the SEC might do more harm than good. The actual damage was
proving to be less than initially anticipated, and some firms told SEC Chairman Williams in private conversations that they had not suffered serious losses of management advisory service engagements following the issuance of ASR no. 264.

Finally, on January 3, 1980, Chairman Williams publicly stated that the commission had not intended to proscribe the performance of management advisory services by CPA firms. His comments were obviously meant to clear up any misunderstandings caused by ASR no. 264 and to allay the fears of accountants and their clients. The speech was not as satisfactory as a formal statement by the commission, but it served to quiet the already muted controversy.

The profession's initial belief that the SEC was attempting to proscribe management advisory services indirectly was probably wrong. More likely, the commission failed to realize that the tone and wording of ASR no. 264 might result in an overreaction on the part of the profession's clients. This interpretation is more consistent with Chairman Williams' often expressed agreement that the profession's auditing capability might suffer if CPAs were precluded from performing management advisory services.

By the end of 1980 the SEC staff was doing no more than monitoring the disclosures under ASR no. 250. Then, in 1981, there were changes in the members of the commission, and John Shad became the new chairman. In August 1981, in keeping with the new federal program for deregulation, the commission announced that it was rescinding releases no. 250 and 264. There is no indication that the issue will flare up again in the near future.

It is not likely, however, that the issue has been permanently resolved. There is still no agreement on a conceptual basis for proscribing particular types of services. Even the public oversight board's conclusions were less than consistent in their supporting logic and seemed to be more influenced by practical considerations than by any underlying conceptual guidelines.

This is not a criticism of the board but simply a recognition that, except where services are legally reserved for other groups, no valid basis exists for restricting CPAs' services. Surely, the forces of competition in the marketplace are capable of preventing any profession from straying too far from the mission that provides the overwhelming portion of its revenues. Even if other
services were to become predominant, such a development would indicate a significant public need that ought to be fulfilled.

It is significant that most suggestions for the proscription of CPA services have come from people who offer such services in competition with the profession. One cannot help suspecting that such critics may be motivated more by self-interest than by a desire to protect the public interest. Because such individuals will continue in their efforts to impose limitations on CPAs, the scope-of-services issue is almost certain to arise again and again. The profession would be foolish not to resist these attempts to impose artificial restrictions and would be well advised to resist the temptation to satisfy its critics by agreeing to piecemeal prohibitions.

In the end, the profession's best defense will be to diligently maintain a position of strict objectivity and integrity in the performance of the whole range of its services.
The Establishment of International Organizations

During the 1960s many American corporations expanded their operations by establishing facilities and subsidiaries in other countries. The rapid emergence of huge multinational companies made it necessary for auditors, in turn, to expand their operations worldwide.

This created an urgent need for the profession to organize internationally in order to develop uniform accounting and auditing standards and to cope with national barriers to international practice. Because the United States was in the forefront of world trade, the AICPA had to assume a leadership role. Accordingly, during the 1970s the AICPA, in cooperation with the institutes of other countries, devoted a great deal of effort toward establishing new organizations to achieve international harmonization within the profession.

The Report of the Working Party

The international organizations that were formed in the 1970s had their genesis in a working party that was established at the Ninth International Congress of Accountants in Paris in 1967. The working party was organized to consider the international needs of the profession and to present recommendations to the Tenth International Congress of Accountants to be held in Sydney, Australia, in 1972. Serving on the working party at its first two annual meetings were representatives from France, Great Britain, the Netherlands, the United States, and Australia; representatives from India and Mexico were added to the group for the 1970 and 1971 meetings. The AICPA was represented by
Clifford V. Heimbucher, a past president of the Institute, and Leonard M. Savoie, the Institute's executive vice president.

One of the principal issues discussed by the working party was whether a permanent secretariat should be established to help speed up international cooperation and the harmonization of auditing and accounting standards. The AICPA was very much in favor of this, but other members objected strongly. The English institute felt that the main emphasis should be on the development of standards within each country; eventually, the most appropriate standards would gain international acceptance. It argued that the main role of the working party and any successor body should be to encourage and assist the development of regional professional organizations.

The AICPA position reflected the fact that many American companies had expanded their operations worldwide and were struggling to cope with the variety of accounting practices in different countries. The English position, on the other hand, reflected that institute's desire to achieve a leadership role in the Union Européenne des Experts Comptables, Economiques et Financiers (UEC). The UEC was a European regional accounting group. For years the English institute had been indifferent to the UEC, but its interest had increased now that the United Kingdom was joining the European Economic Community (EEC or Common Market).

The working party presented its conclusions and recommendations in a final report to the Tenth International Congress of Accountants in October 1972. The report largely reflected the position taken by the representatives of the English institute. It recommended against a secretariat, urged the strengthening of existing regional organizations, and suggested that the international congresses concentrate on ways to harmonize auditing and accounting standards.

The report did, however, take a small step toward creating an international professional organization. It recommended that the working party be restructured and renamed the International Coordination Committee for the Accountancy Profession (ICCAP). The new body would consist of five members serving for fifteen years and an additional five members serving for five years and eligible for reappointment thereafter. The ICCAP would select the host country for international congresses, maintain
liaison with all bodies participating in the congresses, and monitor
and assist the progress of regional organizations. The body would
recommend changes for widening or amending its work, and it
would continue to review the need for an international secretariat.

The leaders of the congress did not request a vote on the
report, and none was taken. Since there was no groundswell of
objection from the delegates, it was presumed that the recom-
mandations had their approval.

One delegate, Walter J. Oliphant of the AICPA, did rise to
urge more aggressive action toward the international harmoni-
zation of auditing and accounting standards. Mr. Oliphant com-
plained that the report did not go far enough toward setting up
an effective international organization.

The congress, without a vote, established the new body and
approved the composition that the working group had suggested.
The fifteen-year members were Australia, France, the Nether-
lands, the United Kingdom, and the United States. The first five-
year members were Canada, West Germany, India, Mexico, and
the Philippines.

The delegates of the Japanese Institute of Certified Public
Accountants insisted that Japan should be included as a member
of the new ICCAP. Japan, after all, had become a leader in world
trade, and its accounting profession was developing very rapidly.
Although no action was taken at the congress, subsequently, at
its first meeting, the ICCAP voted to seat the Japanese delegation.
The Japanese representatives participated in the balance of the
meeting, and the ICCAP became an eleven-member body.

The ICCAP would continue to function through October 1977.

The Formation of the International Accounting
Standards Committee

The other important event that occurred at the Tenth Inter-
national Congress of Accountants was not part of the official
proceedings. Sir Henry Benson of the United Kingdom invited
delegates from the Canadian and American institutes to meet
with him regarding a very important proposal for setting inter-
national accounting standards.

The five institutes in England and Wales, Scotland, Ireland,
Canada, and the United States had previously formed a group known as the Accountants International Study Group (AISG), which worked for several years to achieve greater uniformity in those countries' accounting standards. This body had issued nineteen publications on accounting and auditing matters over the period of its existence. It was a natural starting point for any new initiative in the field of international accounting standards.

At the meeting, Sir Henry suggested that, because of its limited membership, the AISG was not adequate to meet the urgent need for the international harmonization of accounting standards. He proposed that a new body be created to set "basic" international accounting standards. The new body, as he envisioned it, would be composed of representatives from the United Kingdom, Ireland, Australia, Canada, France, West Germany, the Netherlands, and the United States.

It later became apparent that the proposal was motivated at least partially by a desire to gain greater influence over the standards to be set by the EEC, which would become mandatory for its members, including the United Kingdom. At that time the West German institute was generally recognized as being the leading influence in the EEC deliberations of accounting, and English practitioners feared that the standards adopted by the EEC would be incompatible with their own procedures.

At the meeting President Leroy Layton and I represented the AICPA. We had several reservations about the proposal. For instance, we pressed for an explanation of what Sir Henry meant by "basic" standards, but we received no clear answer. Also, the proposed membership seemed to be designed to allow England to dominate the organization: The Common Market countries would control four of the seven votes, and two of the other three votes would go to Canada and Australia, both members of the Commonwealth. More important, we believed that any truly international standard-setting body should include representation from Asia and Latin America. Japan and Mexico were obvious candidates, and we pressed for their inclusion; Sir Henry grudgingly agreed to include Mexico but resisted any further expansion. Finally, we insisted that the proposed standard-setting body should be established as a part of the ICCAP, albeit with complete autonomy in the development of standards.

Sir Henry would not hear of placing the new body under the
He believed that this would guarantee failure because it would subject the standard-setting body to all the conflicting political pressures of the larger organization. The ICCAP represented more than ninety different groups, among which the degree of professional development differed widely. Sir Henry maintained that the profession in the advanced countries should agree on "basic" standards, which would then very likely be adopted by accountants in the rest of the world.

Despite these differences in opinion, everyone agreed that we should hold another meeting to develop a more detailed plan. Leroy Layton and I recognized that U.S. interests coincided with those of the United Kingdom in regard to the type of accounting standards that might be mandated by the Common Market. To avoid a potential collision between the standards of English-speaking countries and those of the Common Market, we were prepared to recommend that the AICPA support the proposal for a new body.

The AICPA Board of Directors agreed. It authorized us to seek Japan's inclusion as a member, to press for the location of the secretariat in New York City, and to continue arguing that the new body should be established as a part of the ICCAP.

The participants at the Sydney meeting assembled again in London on December 3, 1972. A major portion of the discussion was devoted to reviewing and modifying a proposed constitution, which had been prepared by Douglas S. Morpeth and Sir Henry Benson in behalf of the English institute. We reached agreement on most issues with little difficulty, but the three AICPA proposals were hotly debated. Finally, we agreed on a compromise, whereby the Japanese institute would be invited to join the new International Accounting Standards Committee (IASC), the secretariat would be permanently located in London, and the constitution would include language that acknowledged the IASC to be a part of the ICCAP but not under its control. Clarification of this ambiguous relationship was left for future consideration.

None of the parties represented at the meeting were happy with all aspects of the compromise, but we all agreed that the IASC should be established. By the end of January 1973, the institutes in Canada, the United Kingdom, and the United States had approved the tentative proposal, and a meeting was sched-
uled in London for March 19 to explain the plan to officials of the institutes in Australia, France, West Germany, Japan, Mexico, and the Netherlands.

The participants at this meeting strongly supported the proposed IASC, but they were skeptical about how the new body's pronouncements might be enforced. Most of the participants indicated that their institutes would not initially be able to enforce international standards that were at variance with their domestic standards. I pointed out that the AICPA was unlikely to assign the IASC pronouncements a status higher than that of the Financial Accounting Standards Board. Sir Henry, however, insisted that each institute should require its members to demand that variations from international standards be disclosed in financial statements, or to make such disclosures in their audit reports, when international financial reports were involved.

This was a fundamental issue that could not be resolved in a short time. To get around this hurdle, language was adopted whereby the member institutes would pledge:

(i) to ensure that published accounts comply with these standards or that there is disclosure of the extent to which they do not and to persuade governments, the authorities controlling securities markets and the industrial and business community that published accounts should comply with these standards;

(ii) to ensure that the auditors satisfy themselves that the accounts comply with these standards. If the accounts do not comply with these standards the audit report should either refer to the disclosure of non-compliance in the accounts, or should state the extent to which they do not comply;

(iii) to ensure that, as soon as practicable, appropriate action is taken in respect of auditors whose audit reports do not meet the requirements of (ii) above.

On this basis the institutes represented at the meeting agreed to establish the IASC. In due course all the arrangements were made, and an agreement and a constitution were signed in London on June 29, 1973, followed by a press conference and press releases in the nine founding countries.

Joseph P. Cummings was appointed as the AICPA's first voting representative on the IASC, to be accompanied by Robert Sempier, the Institute's director of international relations. Mr.
Cummings was the deputy senior partner of Peat, Marwick, Mitchell and Co. and had previously served for several years on the Accounting Principles Board.

At the suggestion of the Canadian representatives, the AICPA was asked to provide the first secretary of the IASC. Paul Rosenfield, a member of the AICPA's technical staff, agreed to serve in this capacity for a two-year period and immediately took up residence in London.

It was unanimously agreed that Sir Henry Benson should be the first chairman of the new body. He believed passionately in the need for international accounting standards, and under his leadership, which some people viewed as autocratic, the IASC made rapid progress. Sir Henry remained chairman until June 1976, when he was succeeded by Joseph P. Cummings of the United States. Mr. Rosenfield was replaced as secretary in 1975 by John Brennan, a Canadian accounting professor; thus, the terms of the chairman and secretary were staggered to avoid the disruption that would be caused by simultaneous changes in both positions.

Other changes also took place as time went on. The AICPA appointed Eugene Minahan, an officer of Atlantic Richfield Company, to serve as one of the two U.S. representatives on the IASC, reflecting the Institute's belief that its members in industry should participate in the development of accounting standards, since they were responsible for the issuance of financial statements.

A revised agreement and constitution were signed in Munich in 1977, at which time the original standard-setting committee was redesignated the International Accounting Standards Committee Board. The purpose of this change was to permit supporting bodies to become members of the IASC even though they might not be voting members of the standard-setting body.

The IASC made remarkable progress. By the end of 1980 it had published thirteen International Accounting Standards and had issued exposure drafts for eight additional standards. Many observers were pleasantly surprised that agreements were reached with a minimum of nationalistic intransigence.

Although the standards were gaining recognition by the end of the decade, there continued to be no effective means of enforcing compliance with them. Fortunately, there were few
differences between the IASC standards and the domestic standards of the major developed countries. Thus, for the time being, a confrontation had been avoided.

When it became apparent that IASC had become well established there was no longer a need for the Accountants’ International Study Group (AISG), which included Canada, the United States and the United Kingdom. By mutual agreement it was discontinued in 1976 after having produced a series of excellent studies of the standards differences in the participants’ respective countries.

The First Meeting of the ICCAP

At the same time that the IASC was being established, the new ICCAP was also getting under way. Since West Germany had been selected as the host country for the next congress in 1977, the new president of its institute, Dr. Reinhard Goerdeler, had the task of chairing the ICCAP. At his instigation the first meeting of the ICCAP was scheduled for April 26 and 27, 1973.

Prior to the meeting, the AICPA appointed Michael Chetkovich, head of Deloitte, Haskins and Sells and the chairman of the AICPA International Relations Committee, to serve as its voting representative on the ICCAP. He would be joined at the meeting by Robert Sempier, the AICPA’s director of international practice, and by me.

The AICPA decided to push immediately for the establishment of an international organization with a more formal structure and greater substance. We visualized some form of an international institute to achieve an organized profession on the international level. To further this end, Mr. Chetkovich requested that the agenda for the first meeting provide for discussion of a broader role for the ICCAP. The secretary of the English institute suggested that it would help to know specifically what the AICPA had in mind, so we developed an outline of a proposed international institute and sent the outline to all ICCAP members.

When the first meeting of the ICCAP convened on April 26, Douglas E. Morpeth, representing the United Kingdom, vigorously opposed the AICPA’s proposal. He urged that the role of
the ICCAP should be limited to encouraging regional organizations and overseeing the international congresses every fifth year. All the other members supported the general concept of an expanded international organization, but they had varying views about the nature and timing of the changes to be made. Realistically, they recognized that progress would be difficult unless the United States and the United Kingdom could reconcile their fundamental differences.

Adding to the problem were sharp differences of views about the nature of the relationship between the ICCAP and the IASC. The United Kingdom preferred mere recognition that close cooperation was desirable. All other members felt that the IASC should be a part of the ICCAP structure, although most agreed that the IASC should be free of any interference in the setting of accounting standards.

For a time it appeared that the opposing viewpoints could not be reconciled; but, to the great credit of Chairman Goerdeler, a way was found to break the impasse. A working party was appointed to reconsider the role and structure of the ICCAP and to determine a reasonable timetable for implementing any proposed changes. Serving on the working party would be Australia, Canada, the United States, France, the Netherlands, the United Kingdom, and West Germany. In addition to taking this action, the delegates adopted the following resolution without dissent:

- ICCAP endorses the endeavors that have resulted in the formation of IASC.
- ICCAP formally invites IASC to be part of the world attempt to develop the accountancy profession.
- ICCAP requests IASC to recognize in its charter that it is part of the ICCAP organization although it is autonomous in its issuance of exposure drafts and recommendations.
- ICCAP further agrees that IASC's basic charter shall not be reviewed until the end of 1976 without the agreement of IASC and ICCAP.

A paragraph containing the substance of this resolution was subsequently included in the IASC constitution. The words part of remained subject to interpretation, however, since no structural ties existed between the two organizations other than sharing of the same group of sponsoring institutes.
The Evolution of the International Federation of Accountants

Although these actions prevented a total breakdown in the discussions, a fundamental conflict between the United Kingdom and the United States remained. Their basic differences were the subject of continuing discussions during the next four years. Six more plenary meetings of the ICCAP, two meetings of the ICCAP Working Party on the Future Role and Structure of ICCAP, six meetings of a subcommittee on future organizational structure, and numerous unofficial meetings between key representatives of the United Kingdom and the United States were held between 1973 and 1977. Slowly and painstakingly, differences were reconciled, and the International Federation of Accountants (IFAC) evolved from the discussions and negotiations at these meetings.

The working party appointed at the ICCAP meeting held its first session in Paris on August 9 and 10, 1973. The group concluded that the ICCAP should adopt a formal statement of objectives and that ICCAP committees should be appointed to deal with ethics, education, regional organizations, and promotion of the ICCAP. Another committee should study the need for a formal international body with a written constitution. The preparation of background papers on each of these subjects was assigned to individual members of the working party. The United Kingdom and the United States were given joint responsibility to develop proposals regarding a constitution.

The results of these assignments were reviewed by the working party on the day preceding the next ICCAP plenary meeting in October 1973. The American and English delegates had jointly prepared a summary of the working party’s conclusions in the form of a report to the ICCAP, to which the other papers could be attached. This approach won the approval of the working party, and the report was presented on the following day.

The report urged the ICCAP to appoint the committees agreed upon at the Paris meeting. It also recommended that a constitution for an international federation of accountants be developed and submitted at the next international congress in Munich in 1977. An outline for such a constitution, prepared by the American and English delegates, accompanied the report.

The ICCAP approved the recommendations without dissent
and appointed the suggested committees. The new subcommittee on future organizational structure, cochaired by the delegates from the United Kingdom and the United States, included delegates from Canada, France, West Germany, and the Netherlands; this subcommittee bore the brunt of the planning and negotiations that led to the establishment of the International Federation of Accountants.

The subcommittee spent 1974 preparing and reviewing successive drafts of a constitution for the International Federation of Accountants. Robert Sempier, Douglas Morpeth, Philip Carrel (director of overseas relations for the English institute), and I drafted the original document at meetings in London and New York. The subcommittee and the ICCAP held meetings to resolve details of the proposed constitution. Everything went quite smoothly because the decision to establish a formal federation in 1977 seemed to have unanimous support.

Unfortunately, at a subcommittee meeting in New York on January 24, 1975, the apparent consensus fell apart. The Canadian representative, Gordon Cowperthwaite, expressed the belief that the constituent bodies would not agree to establish a federation unless the ICCAP had produced some solid achievements by 1977. Otherwise, there would be little enthusiasm for paying dues to a new organization. He also worried about the lack of progress being made by the other ICCAP subcommittees. If the member institutes could not complete the work assigned to them by the ICCAP, then they would have trouble performing the many chores needed to establish the new organization. With these problems in mind, Mr. Cowperthwaite prepared a paper proposing that the ICCAP engage a small staff. He suggested raising the necessary funds by seeking contributions from the large CPA firms, which had the greatest interest in international developments.

The English representative, Mr. Morpeth, responded with a swift, firm rejection of the proposal. More significantly, he also reported that the United Kingdom institutes had reconsidered the need for a federation and were no longer prepared to provide financial support for such a body.

This announcement threw the meeting into disarray. The session ended, however, with an agreement that Canada and West Germany, in consultation with the United States, would
develop a more complete proposal for an ICCAP staff. The participants still hoped that somehow the United Kingdom could be convinced to change its position since all the other members of the ICCAP solidly backed the concept of a strong federation.

The AICPA’s representatives supported the proposal to engage a staff before 1977, and on February 6, 1975, I sent a letter to the heads of the large firms seeking funds for this purpose. The response was mixed. A few firms agreed to provide funds; some took a wait-and-see position, and one firm stated its opposition to a new federation. Given this response and a vigorous campaign mounted against the proposal by the large British firms, it was clear that funds for an interim ICCAP staff could not be raised from the firms.

Thus, in their definitive proposal, Messrs. Cowperthwaite and Goerdeler stated that funds for the staff would have to come from the member institutes. The proposal was mailed to the subcommittee on April 9, 1975.

The reaction of the United Kingdom was almost immediate. On April 30 Mr. Morpeth sent a long letter to the subcommittee, with copies to all the other members of the ICCAP. He repeated the British opposition to a strong, central body and urged that virtually all international harmonization efforts should be carried on through regional organizations. He did, however, support a federation with a £30,000 (approximately $60,000) annual budget and a role confined to coordination of work by other bodies and oversight of the international congresses. The letter stated emphatically that the United Kingdom institutes would not provide funds for an interim staff and argued that the lack of a defined work program for a central body and the minimal achievements of the ICCAP demonstrated that a strong federation was not needed.

The message left no room for doubt. The United Kingdom would support only a federation with little substance, and the stage was set for yet another confrontation on the fundamental issue that had been argued since the international congress in 1967.

On June 11, 1975, the subcommittee met in Amsterdam to discuss the paper that had been circulated on April 9. The discussion was acrimonious, and in the end the subcommittee
agreed only to report to the ICCAP that it supported the recommendations but that the United Kingdom remained opposed.

The ICCAP met on the following day. The meeting began with a discussion of the subcommittee's report and the Morpeth letter. All the pro and con arguments were aired in a tense session. Feelings of betrayal and anger were expressed by the delegates, none of whom supported the position of the United Kingdom representatives. Since no progress was being made toward breaking the impasse, Chairman Goerdeler adjourned the discussion until the next day, when a more dispassionate atmosphere might prevail.

I decided that a private discussion with Mr. Morpeth might produce a compromise on the diametrically opposed positions of the United States and the United Kingdom. In a candid exchange over breakfast the following morning, we both conceded that our constituents distrusted each other's motives. We agreed that effective progress could not be achieved on an international level unless the United Kingdom and the United States were in agreement. Either country could block effective action simply by refusing to agree.

Mr. Morpeth explained the British perception that the United States would want to spend large sums on a federation. Many people feared that the United Kingdom would be asked to pay more dues than it could comfortably afford. He cited the large budget of the Financial Accounting Standards Board as the basis for this concern.

An additional worry seemed to be the U.K. desire to retain the situs of the IASC in London. Apparently, the United Kingdom feared that the United States might urge that the IASC be moved to New York.

With these considerations in mind, I made a very frank proposal. The secretariat of the proposed federation would be located in New York, and that of the IASC in London. The two countries would jointly provide staff for the two secretariats so that there would be mutual surveillance. The United States would agree that the ICCAP should not hire a staff before 1977 and would do its best to confine the budget of the proposed federation to only what was necessary to carry out substantive projects at the international level. In return, the United Kingdom would
agree to support a stronger federation with a secretariat begin­ning in 1977. Mr. Morpeth agreed to these proposals.

When the ICCAP meeting resumed that morning, a more harmonious atmosphere prevailed. The members unanimously adopted motions authorizing the subcommittee on future organizational structure to prepare an interim report to all the constituent bodies represented by the ICCAP seeking approval of the establishment of an International Federation of Accountants (IFAC) and a secretariat in 1977. Included in the report would be a proposed constitution, a proposed work program for the IFAC, a proposed method of financing the IFAC, a recommendation on the location of the secretariat, a definition of the relationship between the IFAC and the IASC, a definition of the roles of regional bodies and their relationship to the IFAC, and a timetable and program for presenting the federation proposal to the congress in 1977.

When the meeting closed, the effort to create a new federation was back on track. The delegates departed with the hope that the ICCAP’s primary objective finally would be achieved.

The period from July 1975 through March 1976 was devoted to preparing, reviewing, and revising drafts of an interim report. Although there were debates about many of the details, the only serious disagreements were in regard to the relationship between the IASC and the IFAC.

Defining the relationship proved particularly troublesome. Most delegates urged that the IASC be a “part of” the IFAC as an autonomous committee with authority to issue pronouncements in its own name. A few delegates insisted that both bodies should share a single secretariat at one location. The United Kingdom’s delegates argued that the IASC should be a separate body with its own membership, financing, and secretariat but closely related to the IFAC.

Representatives of the ICCAP met with the chairman and other representatives of the IASC in an attempt to reach agreement on a definition of the relationship. Even though the principal sponsors of the IFAC and the IASC would be identical—the institutes from the major countries—it was believed that obtaining the agreement of the individuals serving on the IASC would avoid any bruised feelings. The IASC constitution stated that it was a “part of” the ICCAP; the strict constructionists now
said that the ICCAP had no right to assign this relationship to a new federation without the IASC’s consent. Others suggested that this was nonsense because the principal sponsoring bodies were identical and were in effect dealing with themselves.

The issue was temporarily resolved when a final version of an interim report was approved in February 1976. The report included the following wording:

ICCAP believes that its existing relationship with IASC should be carried forward to IFAC on the same general basis and recommends that IASC should continue as the body designated to have responsibility and authority to issue, in its own name, pronouncements on international accounting standards. As such, IASC would be autonomous and have its own constitution, secretariat and system of financing its activities.

ICCAP recognizes that the objectives of IFAC and IASC are interdependent. The closest relationship is clearly to the advantage of both IASC and IFAC particularly since some member bodies of IASC will also be members of IFAC. Therefore, arrangements should be made to establish and maintain a continuing liaison between the two bodies.

This wording was mirrored in a revised IASC constitution, which was adopted on October 10, 1977. The description was sufficiently ambiguous to allow agreement, but in fact there continued to be little substance to the concept that the IASC was a “part of” the IFAC. The issue would arise again at a later time.

The interim report requested the constituent bodies to respond, stating whether they would join the proposed federation and providing their reactions to the provisions of the constitution. A large number of responses were received, and the subcommittee and the ICCAP held several meetings during the months preceding the October 1977 congress. A final report and constitution were drafted, agendas were prepared, and all the necessary arrangements were made to launch the IFAC at the congress. Agreement was reached to nominate Dr. Goerdeler as president and Mr. Cowperthwaite as deputy president of the new federation. It was also agreed that the secretariat would be located in New York, that the AICPA would provide office facilities at no cost to the IFAC, and that Robert Sempier would be employed as the executive director.

The final ICCAP report was mailed to the constituent bodies in March 1977. The heads of delegations to the congress approved
the report on the morning of October 7, and that afternoon a founding meeting of the IFAC constituent assembly was convened to approve and sign the constitution.

The assembly then elected four countries to serve on the council along with the eleven countries designated in the constitution. The fifteen countries that composed the initial council were Australia, Brazil, Canada, Denmark, West Germany, France, India, Japan, Mexico, the Netherlands, New Zealand, Nigeria, the Philippines, the United Kingdom (and Ireland), and the United States.

The newly formed council held its first meeting on October 8. Officers were elected, auditors were appointed, a budget was approved, standing committees were appointed, and Mr. Sempier was appointed executive director. The two elected vice presidents were Gabriel Mancera of Mexico and B. L. Kabra of India. The budget for the first year projected expenditures of $145,500.

The conclusion of the council meeting marked the culmination of five years of effort to establish a formal international organization. It had been a difficult struggle at times, but in the end there was broad support for the federation. A total of sixty-three bodies from fifty-one countries had signed the constitution.

The Relationship Between the IFAC and the IASC

The second meeting of the IFAC Council was held in May 1978, and on the agenda was the matter of how to implement the provision in the constitution whereby "the closest relationship should be maintained between IFAC and IASC." IASC Chairman Joseph Cummings addressed the meeting on May 3. He urged the appointment of a small joint committee to develop a plan for merger of the two bodies. He expressed the view that eventually the duplication of secretariat, funds, and membership should be resolved.

This immediately rekindled the United Kingdom suspicions that the Americans were determined to consolidate all international activities into a single secretariat located in New York. Past wounds were reopened, and the ensuing negotiations continued into 1981.
At the IASC meeting in Perth, Australia, in June 1978, IFAC President Goerdeler discussed the subject of merger with representatives of the two bodies. They agreed to hold an informal meeting in London on November 6 to explore the merger issue further.

The London meeting was attended by the president, deputy president, and executive director of the IFAC and the chairman and staff of the IASC. John Grenside, a past president of the English institute and a member of the IASC, also attended. The participants agreed that they should continue to act as a joint working group to examine the problems and benefits of merging by October 1982. It was also agreed that the AICPA representatives should be added to the working group and that the two staffs should jointly prepare a draft proposal for the next meeting.

During the next year the individuals serving on the IASC began to raise objections to a possible merger with the IFAC. They feared that such action would hinder them from bringing other interested parties into the standard-setting process. This was viewed by some as necessary to gain the recognition and support of the Economic and Social Council of the United Nations and the Organization for Economic Cooperation and Development, which were threatening to set their own accounting and financial reporting standards for multinational corporations.

The members of the joint working group expected these concerns to prove troublesome at its next meeting in June 1979. Early in the meeting, however, I proposed a series of parallel amendments to the constitutions of the two bodies that would effectively integrate them without disturbing the autonomy of the IASC in the setting of accounting standards. The proposal quickly won unanimous agreement, and the two staff heads were instructed to draft the necessary documents for presentation to the IASC and the IFAC Council. Agreement had been reached in less than two hours of discussions.

The euphoria was short-lived, however. After reviewing a joint draft, Mr. Chetkovich and I were troubled by the ambiguity created by the continuation of a separate IASC constitution. We believed that this strongly implied that the IASC was a separate body rather than a division of the IFAC. To correct this problem, we suggested an alternative approach consisting of the following documents: an agreement of integration to be signed by the
members of both organizations, "Terms of Reference and Operating Procedures" to be appended to the agreement of integration, and an amended IFAC constitution. (The word integration had been substituted for merger in the discussions of the joint working group because it was believed to be less objectionable to opponents of a merger.)

The suggested alternative was adopted, and subsequent drafts were prepared in the form of a preamble, an integration agreement, and amendments to the IFAC constitution. These were circulated to members of the joint working party, modified on the basis of comments received from them, and then incorporated in a report to the IASC and the IFAC Council.

Neither body found the report acceptable. IASC members had various objections to the proposed integration, and a majority of the IFAC Council expressed dissatisfaction that the proposal did not provide for a forthright merger of the two bodies. In addition, at the urging of Washington SyCip of the Philippines, the council suggested that membership on the IASC board should be subject to rotation so that the nine founding countries would not have perpetual representation. Such a change would bring the IASC into harmony with the provisions of the IFAC constitution.

The joint working group met to consider objections that had been raised. After extensive discussions, agreement was reached in principle on the changes to be made in the proposed integration documents. A revised draft was mailed to members of the IASC board and the IFAC Council on January 7, 1980. It was hoped that by June 1980 both groups would approve the report for distribution to their respective constituent bodies.

These plans did not materialize. The Consultative Committee of Accountancy Bodies of the United Kingdom issued a letter urging delay in integration until questions about certain financing procedures and outside representation on the IASC were resolved. This position was reiterated by the United Kingdom representatives at a meeting of the IFAC Planning Committee in Bermuda on February 17, 1980. At the same meeting the Netherlands representatives expressed their opposition to the integration proposals. It came as no surprise, therefore, when the IASC board decided to defer further consideration of the proposed
integration agreement pending exploration of whether outside parties could be brought into its activities.

The integration discussions resumed on May 14, 1980, at a meeting of the IFAC Council in London. IASC Chairman Hans Burggraaff reported on the action of his board and expressed the hope that a revised agreement could be reached by the spring of 1981. Other informal discussions were also held, which revealed that the United Kingdom representatives were very upset with the provision that would permit but not require the rotation of all IASC members. They believed that the principal developed countries should be guaranteed membership on the standard-setting body.

During the succeeding months Mr. Cowperthwaite, who had succeeded Mr. Goerdeler as president of the IFAC, had informal meetings with representatives of the IASC in an effort to develop a revised agreement that would gain acceptance. Despite these efforts the IASC board indicated at a meeting in November that the rotation issue was still a stumbling block. Also, the IASC had received a legal opinion on the proposed integration agreement and had been advised to recast the document in the form of mutual commitments. In the meantime the IFAC Council reconfirmed its desire to allow rotation of all IASC members. Once again it appeared that negotiations had reached an impasse.

On January 14, 1981, the joint working group met in Toronto to make yet another effort to achieve an acceptable proposal for integration. Time was running out; if action was not taken at the 1982 congress, a delay until 1987 would likely result. The group agreed to recast the relationship between the IASC and the IFAC in the form of mutual commitments, as suggested by the IASC’s legal counsel. This formally recognized that there were two separate bodies, which effectively negated any pretension that a merger would be consummated. Nevertheless, the IASC would make two concessions: Rotation of all members would be permitted after 1987, and the IFAC Council would nominate the members to serve on the IASC board. All other features of the mutual commitments would be essentially the same as those included in prior drafts of an integration agreement.

In February 1981 the IFAC Planning Committee gave its approval to the compromise. An explanation of the revised
proposals was sent to the IFAC Council and the IASC board, urging their approval. At the date of this writing it appears that both bodies will approve the proposals and that the terms will be ratified at the congress in Mexico City in October 1982. If this occurs, the existence of two separate bodies will be institutionalized, but more substantive ties will be created.

It remains to be seen whether being a separate body will make the IASC more vulnerable to pressures to divorce it from any control by the accounting profession. If the American experience with the FASB is any guide, it can be expected that eventually the international accounting profession will be forced to surrender all controlling ties to the standard-setting body. It was precisely for this reason that the AICPA's representatives resisted a separate status for the IASC. The AICPA's representatives supported the participation of outside parties in standard setting but believed that the profession should retain control over the process as long as possible. We believed that a takeover by government seemed unlikely at the international level. We were more concerned that a body with separate status unnecessarily increased the chances that other interests would gain a controlling influence.

The setting of financial accounting and reporting standards internationally is perhaps less critical than on a national level since there is no effective means of enforcement across national borders. Nevertheless, uniform standards are being adopted by the Common Market countries, and the United Nations is expected to seek actions by member nations to adopt a common set of international standards. Further evolution can be expected as the national economies become increasingly interdependent. For all these reasons, the battle over the relationship between the IFAC and the IASC was not an academic exercise.

Other International Activities

Throughout the 1970s the AICPA pursued other international activities more limited in scope. These included membership in two regional organizations, the Conference of Asian and Pacific Accountants (CAPA) and the Interamerican Accountants' Association (IAA). The activities of these bodies consisted principally
of holding periodic conferences devoted to technical subjects. The AICPA also invited the presidents and executive directors of various institutes to attend its annual meetings as guests of the Institute. Reciprocal invitations were also extended to representatives of the AICPA to attend similar meetings in other countries. As might be expected, the relationships with the Canadian and Mexican Institutes were especially close and cordial. In addition, the AICPA’s chairman and president periodically attended various meetings in England, Scotland, Ireland, France, West Germany, the Netherlands, Australia, and New Zealand.

These visits often entailed expensive and time-consuming travel, but they helped build understanding and cohesiveness. It will be in the best interests of the AICPA and its members to continue such a policy of active involvement in professional developments around the world. All signs point toward increasing interdependence of business activities across international borders, and the profession must continue to adapt to these changing circumstances.

At the beginning of the 1980s much remains to be accomplished before the profession can become truly harmonized internationally. Technical standards, entrance requirements, rights to practice, and ethical restraints are far too disparate among the well developed countries and are too poorly developed in others. The barriers of national sovereignty guarantee that achieving uniformity will be a slow and painful process.

Nevertheless, a solid foundation for working toward this long-range goal was laid during the 1970s. It was a period of difficult negotiations and compromise. Out of the controversies emerged a keener understanding that the profession’s interests will be better served by setting aside national pride. The establishment of the IFAC and the IASC were impressive accomplishments, and it behooves the profession’s future generations to build on this good beginning. The profession has an opportunity to set an example by transcending nationalism for the common good.
CHAPTER 13

Professional Education

Every profession must take an interest in the content and quality of the education available to its future members, and the public accounting profession is no exception. During the 1960s and 1970s it paid a great deal of attention to the preentry education of future CPAs.

The Beamer Report

As early as 1963 the AICPA, together with the Carnegie Corporation of New York, sponsored a commission to study the common body of knowledge for CPAs. The twelve-member commission, chaired by Elmer G. Beamer, a Cleveland partner of Haskins and Sells, served in an advisory capacity to the study's director, Robert H. Roy, dean of the Johns Hopkins University School of Engineering Science, and the associate director, James H. MacNeill, chairman of the department of accounting of the Fordham University School of Business Administration. The directors conducted three years of research and reported their findings in a 1967 publication, Horizons for a Profession.

The report contained recommendations for the common body of knowledge for beginning CPAs. These were grouped under the categories of accounting, the humanities, economics and behavioral science, law, mathematics, statistics, probability, and the functional fields of business. The report was well received, and it provided the foundation for most of the succeeding developments in accounting education.

To follow up this report, the AICPA appointed a committee
on education and experience requirements for CPAs, which was also chaired by Elmer G. Beamer. On May 6, 1969, Mr. Beamer presented the committee’s conclusions and recommendations to the Institute’s Council and moved adoption of a ten-point policy statement on the education and experience requirements for entry to the CPA profession. The committee endorsed *Horizons for a Profession* as the authoritative guideline for the common body of knowledge for CPAs. It recommended that the education requirement to obtain this knowledge should be at least five years of college study, and state boards of accountancy should adopt this requirement by 1975. Candidates meeting the five-year education standard should not be required to meet an experience qualification. The committee also recommended that the accreditation of academic programs should be the responsibility of the academic community.

During the Council debate a motion to retain a one-year experience requirement for CPA candidates was defeated by a vote of ninety to seventy-three. The Council then adopted what became known as the Beamer report, and the policies that it presented served as a reference point throughout the 1970s.

Enunciating policies was one thing, but persuading the state boards of accountancy and the profession’s general membership to implement them proved far more difficult. Indeed, almost immediately after the Council adopted the Beamer report, an earlier standing committee on accounting education, composed of representatives of the American Accounting Association (AAA), the Institute, the American Assembly of Collegiate Schools of Business (AACSB), and the National Association of State Boards of Accountancy (NASBA), was reactivated. The committee concluded that coverage of the common body of knowledge should be emphasized rather than a five-year time period. It also proposed that holders of master’s degrees, with a concentration in accounting, from AACSB programs should be presumed to have acquired the body of knowledge. These recommendations were approved by the Institute Board of Directors on December 9, 1971.

The state boards did not rush to adopt a five-year education requirement; by the end of 1980 only three states had complied, and even in these cases the effective dates were delayed. Equally unpopular to the membership rank and file was the elimination
of a qualifying experience requirement to become a CPA. Many state societies actively opposed implementation of this policy by the state boards.

The Institute could not persuade the state groups to implement these two policies; and in regard to the third major policy issue, that the accreditation of academic programs should be solely the responsibility of the academic community, the Institute later reversed itself. Council decided that the AICPA should participate actively to promote the establishment of professional accounting education programs and schools.

Professional Schools of Accounting

By 1970 the practicing wing of the profession began to display a great deal of interest in accounting education. Horizons for a Profession and the Beamer report did much to stimulate this interest, but the most important factor was CPA firms' growing dissatisfaction with the preentry education that their new recruits had received. The firms were finding it necessary to conduct intensive training programs to teach new employees how to perform their beginning duties, a necessity that led many practitioners to question how well the academic community was preparing students for entry into the profession.

This concern, along with the desire for enhanced recognition as a profession, revived earlier calls for professional schools of accounting similar to those that existed in the fields of law and medicine. Pressure for the establishment of professional schools led the AICPA Board of Directors to explore the appointment of a joint committee with the American Assembly of Collegiate Schools of Business, which was engaged in the accreditation of business schools, and the American Accounting Association. The committee would consider the feasibility of establishing professional schools of accountancy. When a major university began, in late 1971, to consider the establishment of a school of accounting, the board expressed its general support. The board also considered a staff paper recommending endorsement of the concept of professional accounting education programs.

The board deferred action on that recommendation pending receipt of a report of a joint AICPA and NASBA committee
studying all aspects of professional recognition and regulation. The committee was known to be considering the desirability of professional schools of accounting.

When it reported its conclusions to the board on July 19, 1973, the committee recommended the establishment of schools of professional accounting at qualified colleges and universities. It also proposed the appointment of a committee to develop standards and a program for such schools.

At that same board meeting, Guy W. Trump, vice president for education, reported that the AICPA Education Executive Committee had proposed adoption of a policy statement on schools of professional accounting. He explained that the committee’s major concern was that colleges and universities offer strong professional programs in accounting and that the establishment of professional schools would be one way of achieving that objective.

The board decided that it was time to adopt a formal policy statement on the subject. Accordingly, it adopted a resolution that included the following paragraph:

The Institute strongly endorses any action which provides ... strong professional programs. As one way, and perhaps the preferable way of achieving an increased emphasis on the professional dimension of the discipline, the Institute endorses and encourages the establishment of schools of professional accounting at qualified and receptive colleges and universities.

The Board on Standards for Schools of Professional Accounting

The first move toward implementation of this policy was the appointment of a Board on Standards for Schools of Professional Accounting. The board, as its name implies, was to establish standards for the evaluation of accounting programs and to develop procedures for applying the standards to colleges and universities. The twelve board members were appointed by the AICPA Board of Directors from among candidates nominated by the presidents of the AAA, the AACSB, the NASBA, and the AICPA. Chairing the new board was Herbert Miller, a partner of Arthur Andersen and Company and widely known as a strong
proponent of schools of professional accounting since his earlier career as a prominent professor of accounting.

While the board was drafting proposed standards, the Institute received requests for funds from two major universities: one for a newly established professional school of accounting and the other for a doctoral program in accounting. The directors concluded that the Institute would not be able to meet such requests, since it was to be expected that many more of equal merit would follow. Even though the AICPA declined to provide financial assistance to establish professional schools and programs of accounting, it was hoped that the CPA firms would help fill this need.

The new board drafted proposed standards, which were exposed for comment in February 1976, and a final report, published in June 1977. The standards board did not construe professional status as being confined to the practice of public accounting. Rather, it treated the accounting profession as embracing a variety of career paths, including employment in industry and government. This was a concession to the academics, who had significant interests in the preparation of large numbers of students for careers in accounting outside public practice.

Whether accounting education should differ for different career paths was a question of great importance. The standards board stated its belief that a single set of standards was equally relevant to all accounting career alternatives but left the determination to accounting organizations other than the AICPA. It was clear, however, that the standards board expected the professional programs and schools to serve a broadly defined profession and that all accounting organizations would participate in the accreditation process.

Understandably, many practitioners felt that professional status should be confined to public practice and that professional education should be devoted solely to preparing students for such careers. This view was unrealistic, however, since the majority of accounting students did not choose careers in public practice. Nevertheless, in accepting the final report, the AICPA Board of Directors stated that it understood that the use of the term professional accounting education was not intended to define the term accounting profession.
The AICPA Seeks Accreditation of Programs

When it approved the standards board's report for exposure, the AICPA Board of Directors also requested that a proposal for accreditation of programs and schools be prepared. Acting on this request, Messrs. Miller and Trump contacted the AAA and other interested organizations to determine whether they would join in the development of an agency to accredit programs of professional accounting. It was clear at that time that the AACSB, which accredited schools of business, was unwilling to establish an accreditation program for professional programs and schools of accounting.

When a status report was received on April 30, 1976, the board of directors affirmed its full support for the establishment of an appropriate accreditation process and expressed the hope that other organizations would join the Institute in bringing this about. The board was subsequently reminded, however, that official Council policy, dating back to the adoption of the Beamer report, was that the Institute should leave responsibility for accreditation to the academic community. To remove this obstacle, the directors approved a resolution, to be proposed to Council, which contained the sentence, "Therefore be it resolved, that the AICPA should encourage the development of quality professional programs and schools of accounting and participate in their accreditation." The word participate was used because it was not contemplated that the Institute would carry out accreditation by itself.

The Council unanimously approved the resolution without debate on October 23, 1976.

Participation of the American Accounting Association

The AICPA board expected that the AAA would immediately agree to cosponsor the establishment of an accreditation agency, but this proved not to be the case. Before the final report of the AICPA's standards board was issued, the AAA Committee on Accounting Education prepared its own statement of standards and a comparative analysis of its standards and those of the AICPA. One significant difference was the AAA's suggestion to
accredit four-year and MBA programs with accounting concentrations, not as professional accounting programs but as preparation for beginning managers. The AICPA proposed accreditation of only those professional accounting programs requiring a minimum of five years to complete.

Because of this significant difference, the AAA Executive Committee passed a resolution on March 26, 1976, that failed to commit the AAA to joint sponsorship with the AICPA of a new accrediting agency but that authorized continuing exploration with the AICPA under two conditions. They were that standards would be set by the accrediting agency, if it were established, and that all interested accounting organizations would be represented on the accrediting agency. These conditions reflected many educators' objections to the AICPA's proposed standards and the concern that the AICPA seemed to lean toward professional programs for only those students entering the practice of public accounting.

A further indication of the AAA's concerns was the reactivation of its committee on accreditation, which was directed to study the possible consequences of accreditation and to recommend a position regarding joint sponsorship with the AICPA of an accreditation agency.

Even though AAA President Wilton T. Anderson, head of the Oklahoma State University School of Accounting, was strongly in support of joint sponsorship of accreditation, the AICPA's representatives had many reasons to doubt whether the AAA would agree to such an arrangement. The new slate of AAA officers that would take office in August 1976 was less than enthusiastic about accreditation, and even the executive committee was divided in its views. Mr. Anderson expressed the view that AAA endorsement must be obtained by September 1 or, most likely, it would never be obtained.

In view of these dim prospects, Vice President Trump and I discussed the strategy to be followed by the Institute. We decided that the best way to get positive action was to announce that the AICPA was prepared to establish an accrediting agency on its own, with provision for participation by any other accounting organizations that expressed a desire to do so. Accordingly, we drafted an outline of a proposed structure for accrediting accounting education and presented it to the AICPA Board of Directors.
on April 30, 1976. We also reported to the board on the status of the negotiations and sought a decision on whether the AICPA should proceed by itself, if necessary.

The board affirmed its support for establishing an appropriate accrediting process and expressed the hope that other organizations would join in this effort.

These actions had the intended effect of spurring the AAA to a decision about joint sponsorship. In August 1976 the AAA Executive Committee authorized cosponsorship of an accrediting agency to be developed by a joint committee. In doing so, the AAA expressed its understanding that other interested accounting groups would participate, that the standards would be established by the accrediting agency, and that accreditation would not be confined to any one type of program.

Following this breakthrough a joint committee was appointed. Consisting of three representatives from each of the two organizations, the new group became known as the committee of six. It was cochaired by Professor Sidney Davidson of the University of Chicago, representing the AAA, and Herbert Miller, representing the AICPA. Mr. Miller had chaired the AICPA Board on Standards for Schools of Professional Accounting.

Since the accreditation agency was to serve a broadly defined profession, representatives of the National Association of Accountants, the Financial Executives Institute, and the Association of Government Accountants were invited to participate in the committee’s meetings. These groups represented accountants employed in industry and government.

Confusing Signals From the AACSB

Meanwhile, the message that the Institute was prepared to act alone, if necessary, had also received the attention of the AACSB, which previously had opposed the accreditation of programs for individual business disciplines, such as accounting. President William Flewellen and President Elect John Day met with the AICPA’s representatives on May 13, 1976. The AACSB representatives indicated that the association wanted to become involved in the accreditation of accounting programs. President Flewellen indicated that the AICPA’s proposed standards presented no
insurmountable problems and that the AACSB could probably accommodate in some way the accreditation of accounting programs at non-AACSB-accredited schools.

This was indeed a major shift in attitude, and the AICPA’s representatives were greatly encouraged, although somewhat skeptical. Their doubts later proved well founded.

On October 27 the AACSB officially responded to the standards proposed by the AICPA. In a nine-page letter, it opposed the autonomy of programs and schools of accounting and concluded that the proposed separate accreditation was undesirable and unnecessary. The letter went on to express the view that accreditation “should not be a discipline externally imposed on educators.” Nevertheless, it stated that the AACSB’s board desired “to assist all interested groups in exploring further the special accreditation concerns of accounting educators and alternative solutions which may address those concerns.” In a covering transmittal letter, President Flewellen provided a small ray of hope:

The most important message (and one the Board asked me to emphasize) concerns our sincere willingness to cooperate with you to effect solutions that will be responsive to the needs of accounting students, faculty and professionals while being cognizant of the needs of others on whom our actions will have a secondary or tertiary effect.

This was indeed a confusing message. The AACSB clearly rejected a joint effort with the AICPA but seemed willing to negotiate some sort of subordinate role for the Institute and others in arriving at alternatives to accreditation. Perhaps this reflected a difference in views between the AACSB’s board and its president, who had been so conciliatory in the meeting five months earlier.

The AAA’s new president, Professor Charles T. Horngren, urged the committee of six to explore a cooperative effort with the AACSB. Speaking on behalf of the AAA Executive Committee, he expressed the view that the AACSB might be more receptive than was indicated in its letter to the AICPA.

These were the circumstances under which the committee of six met for the first time on December 16, 1976. The committee members quickly agreed that an accrediting agency for accounting programs must be broadly representative of the interests of
major accounting organizations. They also agreed that the agency would establish the necessary standards and, in doing so, would consider the standards being developed separately by the AICPA, the AAA, and others. In response to the urging of AAA President Horngren, the committee also decided to carry on exploratory talks with the AACSB about implementation of a joint accreditation program.

On January 20, 1977, the committee’s cochairmen and Mr. Trump met with Deans Flewellen and Day and William Laidlaw, the executive vice president of the AACSB. By the end of the meeting it had been agreed that a cooperative approach to the accrediting of accounting programs should be pursued. The AAA and AICPA would jointly sponsor an accounting accrediting agency, which would set its own standards in consultation with the AACSB. Accreditation reviews of individual programs or schools would be carried out as joint efforts, under which the AACSB would apply its overall standards for business schools and the accounting accrediting agency would apply its standards for accounting programs and schools. The meeting ended with a promise by the AACSB’s officers to advise the committee of six of the official AACSB position regarding the results of the informal discussion.

During the following months the committee of six met to review successive drafts of a proposed structure for an Accounting Accreditation Council (AAC) to be jointly established by the AAA and AICPA. The AAC would use AACSB administrative facilities, and the committee sought to tie the accreditation process as closely as possible to that of the AACSB. The council would employ an accounting educator full time to administer the accreditation program.

Beginning on September 1, 1977, the meetings were attended by representatives of the AACSB, the National Association of Accountants, the Financial Executives Institute, and the Association of Government Accountants. The committee agreed that, if they elected to do so, the latter three organizations would participate in the AAC, and provision was made in the proposed organizational structure for them to appoint representatives to serve on the accrediting body. It was also agreed that the AACSB should be represented in an advisory capacity at all AAC meet-
ings. A first draft of a working agreement between the AAC and the AACSB was distributed at the September 1 meeting.

The AACSB's Accreditation Program

From this point forward it became apparent that the AACSB meant to impose more and more requirements as conditions for its cooperation. First, its representatives proposed that the AAC administrator be located in the AACSB's offices in St. Louis, Missouri, and be treated as an AACSB employee. In addition, Dean Day hinted that the AACSB should have veto power over the standards adopted by the AAC. He then objected to the prospect of accrediting accounting programs of schools not accredited by the AACSB. In short, it appeared that the AACSB intended to demand substantial control over the activities of the AAC.

Nevertheless, the dialogue between the committee of six and the AACSB's representatives continued on the assumption that a satisfactory arrangement would be worked out. As a result, the committee was taken by surprise when it was learned on March 15, 1978, that the AACSB Standards Committee had earlier appointed a subcommittee to address the accreditation of accounting programs. Included on the four-member committee, without the knowledge of the AICPA, was the chairman of the AICPA Education Executive Committee. The subcommittee recommended that both undergraduate and graduate accounting programs be accredited and that the AAA and AICPA be brought into the accreditation process.

The subcommittee's report was rewritten by the standards committee to provide that the accreditation of all accounting programs be within the purview of the AACSB. This included the setting of standards. The committee also deleted all reference to cooperation with the AAA and AICPA. The report did acknowledge, however, that the AAC might participate in the development of the accounting accreditation process, and it recommended "the full participation of the accounting profession." The standards committee proposed that the subcommittee should be reconstituted as the accounting accreditation planning committee.
On March 27 the committee of six received a copy of the report, *Proposal to Promote Improved Quality in Accounting Programs Through AACSB Accreditation*, and learned that it had been approved by the AACSB Operations Committee on March 16. Mr. Laidlaw invited suggestions from the committee of six regarding the makeup of the new planning committee and ways in which the AAC might work with the AACSB.

The AICPA’s representatives on the committee of six were outraged by this development, which they regarded as an act of bad faith. The AACSB appeared to have negotiated with the committee of six simply to buy time to initiate its own accreditation program. Clearly, the AACSB wanted to control all accreditation efforts and intended to take every step necessary to achieve that objective.

Despite their anger, AICPA officials and the committee of six took comfort from the fact that they had goaded the AACSB into initiating a program to accredit accounting programs. This would be a positive result if the AACSB’s program were structured to suit the profession and provided for the profession’s active participation.

With this objective in mind, the committee of six sent a letter to the AACSB Operations Committee. The letter, dated April 3, 1978, recommended several changes in the AACSB’s proposal. The accounting accreditation planning committee should include two accounting educators (nominated by the AAA), two accountants in public practice (nominated by the AICPA), two accountants from industry (one nominated by the Financial Executives Institute and the other by the National Association of Accountants), and two deans. The planning committee’s successor, the accounting program accreditation committee, should have similar representation. Finally, the committee insisted that the standards should recognize the significant difference between undergraduate and graduate programs. The letter stated that if these changes were adopted the committee of six would recommend that the AAA and AICPA cooperate fully in the implementation of the AACSB’s program.

The AACSB Accreditation Council approved these proposals in principle, along with the overall report of the operations committee, on April 20, 1978. Following that action the council
invited the AAA and AICPA to nominate representatives to serve on the new accounting accreditation planning committee.

The AAA, AICPA, and committee of six concluded that implementation of its own proposed Accounting Accreditation Council would be duplicative and unnecessary. They decided, therefore, to establish the AAC corporation but not to activate it unless the AACSB program proved unsatisfactory. This action ended the work of the committee of six.

The accounting accreditation planning committee issued an exposure draft, *Proposed AACSB Standards for Accreditation of Accounting Programs*, in October 1979. The proposed standards provided that three types of programs would be accredited: baccalaureate degree programs with an accounting concentration, MBA programs with an accounting concentration, and accounting programs leading to master’s degrees. For convenience these became known as A-, B-, and C-type programs respectively.

An AICPA position regarding the proposed standards proved difficult to formulate. Many differing views existed. The education executive committee opposed the standards because they failed to distinguish between the B- and C-type programs. It believed that the C-type should be designated as “professional” accounting programs. A member of the board of directors strongly opposed the accreditation of B-type programs, and Herbert Miller believed that A-type programs should not be accredited. After considerable debate, we agreed that the AICPA should refuse to support the proposed standards unless the C-type programs were distinguished as professional programs whose objective would be to prepare students for careers as professional accountants. It was believed that a professional designation was vital to motivate educational institutions to commit resources to the establishment of C-type programs. We also agreed that the AICPA should express the belief that there was no compelling need to accredit B-type programs, but this point would not be made a condition for the AICPA’s support of the proposed standards. There was little chance that the AACSB would agree to drop accreditation of the B-type programs since MBA programs were so important to the association’s constituency and since the AAA, NAA, and FEI did not support the Institute’s position in this matter.
Thus, the AICPA decided to tolerate, if need be, the accreditation of A- and B-type programs if the C-type programs were designated as professional accounting programs. Implicit in this decision was the virtual abandonment of an AICPA drive for the establishment of separate schools of professional accounting, which were strongly opposed within the AACSB.

Given the difficulties that the AICPA would encounter in attempting to establish its own accreditation program, even this relatively cooperative position was viewed by some members as too harsh. They believed that the AICPA should support the standards even if the Institute’s objections to them were not accommodated. Chairman Gregory and I believed, however, that reserving the option to pursue other alternatives if necessary was the best way to persuade the AACSB to accede to the AICPA’s requests. We felt certain that the AACSB officials were anxious to have the Institute’s support before proceeding with an accreditation program.

The Institute’s official position was conveyed to the accounting accreditation planning committee, and Lawrence S. Dunham (the chairman of the education executive committee), William Gregory, and I represented the AICPA at a public hearing on February 15, 1980. At the hearing we made it clear that the AICPA would withdraw its support if the committee did not accede to our major objection. Even though the alternatives were not spelled out, most interested parties were aware that the AICPA might decide to activate the Accounting Accreditation Council.

If the AAA chose not to support such an effort, the Institute might enlist the cosponsorship of a newly formed group, the Federation of Schools of Accounting, which had been established at an October 1976 meeting attended by accounting faculty members from a number of schools with existing or proposed professional accounting programs. Following the initial meeting twenty-one schools joined together to form a federation to foster support for programs and schools of professional accounting. Although it disclaimed any intentions of engaging in accreditation, the membership requirements under the organization’s bylaws seemed to amount to de facto accreditation standards. The Federation of Schools of Accounting sought and obtained financial support from the large CPA firms, and by 1978 it had become a functioning organization. Some of its representatives
made no secret of their interest in joining with the AICPA to mount an accreditation program. While this was of some interest to the Institute as a fall-back possibility, the federation seemed too new and untested to warrant top priority for this alternative. Nevertheless, the prospect was sufficient to convince the AACSB representatives that the Institute's vow to pursue other alternatives, if necessary, had substance.

Following the AACSB's public hearing, the accounting accreditation planning committee modified its proposed standards to accommodate the AICPA's proposal: that C-type programs be distinguished as professional accounting programs. On March 9 Mr. Dunham and I agreed to the changes.

At the March 9 meeting Mr. Laidlaw indicated that the AACSB would seek financial support from the AICPA for the accreditation program. While making no commitment, I expressed the belief that the AICPA would be willing to assume a reasonable share of the start-up costs, since it had been prepared to fund its own program through the proposed AAC.

On April 24 the AACSB Operations Committee approved the revised standards, and similar action was taken by the AACSB Accreditation Council on June 13. The stage was now set for accreditation of the three types of programs.

In December 1980 the AICPA Board of Directors considered the AACSB's formal request for supporting funds of $50,000 annually for three years. Some board members objected to provision of the funds without certain assurances from the AACSB. As a result, approval of the request was deferred, pending a discussion with the AACSB regarding the conditions under which the funds would be provided. On February 16, 1981, the AACSB and the AICPA agreed on the desired assurances. When the results were reported to the board, however, several members again objected because they believed that the program would set back progress in accounting education for many years to come. Once again the board deferred a decision. Finally, on May 8, 1981, the board agreed to provide funds to be used solely to defray expenses in connection with the accreditation of C-type programs.

In reaching this decision, several members of the board refused to support the policy decision that had been adopted by the AICPA in January 1980 in testifying at the AACSB's public
hearing. Some were holdouts for accreditation of only C-type programs, and others objected to the accreditation of B-type programs. Their preferences would have required overturning the AICPA’s official support of the AACSB’s program even though they offered no alternative that appeared to have any prospects for success. As a practical matter it would be exceedingly difficult for the AICPA to mount its own accreditation program in the face of opposition by the AACSB and without the support of the AAA. Apparently, the dissenters believed that the AICPA’s influence was sufficiently strong to persuade the AACSB to accede to all the preferences of the Institute. This hardly seemed to be a realistic appraisal of the situation.

A Summary of the Decade

In the end, the AICPA did not gain all that it would have liked. Separate schools of professional accounting are not likely to proliferate at a rapid rate, given the alternative of accreditation of professional programs. The Institute’s objectives were further diluted by the intent to accredit undergraduate programs and MBA programs with concentrations in accounting.

The concept of separate schools designed exclusively to prepare candidates for careers in public practice continues to be viewed as preferable by many practicing CPAs. Realistically, however, such an objective is not likely to be achieved. Accounting educators must recognize the fact that more than half of all graduating students do not go into public practice. As a result, their interests are directed toward preparing students for accounting careers in industry and government as well as public practice. Deans of business schools also resist the establishment of separate schools of accounting because accounting is basic to the business school curriculum. Without the enthusiastic support of educators, the profession cannot hope to attain its goal of separate schools to prepare candidates for public practice.

Therefore, the AICPA adopted a more flexible approach, accepting either schools or programs of professional accounting designed to serve industry and government as well as public practice. Whether the same programs can serve equally well the needs of different career paths in accounting is debatable, but
the existing political climate makes this issue largely moot. In any event, the curriculums within single programs are likely to be sufficiently flexible to accommodate most of the special interests that apply to a particular career path.

Perhaps the greatest achievement resulting from the effort to improve accounting education was the adoption of standards that recognize the need for faculty with practical experience in accounting and that give accounting faculty a stronger voice on such matters as curriculum and allocation of resources. These standards, coupled with a program of accreditation, should go a substantial way toward meeting some of the criticisms that have been levelled at the quality of accounting education.

What they will not do is give the practicing profession the prestige that separate schools would provide. Professional prestige will have to be won in other ways.
CHAPTER 14

Other Matters

During the 1970s there were many other developments worthy of mention. Although they were not necessarily interrelated, in many instances they had a bearing on the events discussed in the preceding chapters. The order in which these matters are discussed below does not indicate any attempt to assess their relative importance.

Changes in Staff Officers

After thirty-two years of outstanding leadership and service to the profession, John L. Carey retired in 1968 as the Institute’s administrative vice president and secretary. To help fill the void, Leonard M. Savoie, a top technical partner of Price Waterhouse, had been hired in 1967 as executive vice president. A year later, when Mr. Carey retired, John Lawler, a long-time top staff member, was named administrative vice president and secretary. Under the new arrangement, Mr. Lawler devoted most of his attention to administrative matters, while Mr. Savoie, as chief of staff, mostly handled professional and technical matters. Mr. Savoie was particularly involved in the operations of the Accounting Principles Board and the setting of accounting standards.

After Mr. Savoie announced that he would leave the AICPA at the expiration of his contract in June 1972, I was asked to succeed him as chief staff officer with the understanding that the Council and membership would be urged to change the position’s title to “president” and the title of the elected head of the AICPA to “chairman of the board of directors” (consistent with the recommendations of a prior committee on structure). At that
time I was head of Alexander Grant and Company. I had been active in the Institute’s affairs as chairman of the professional ethics committee and a subcommittee to develop a restated code of professional ethics and as a member of other committees. I had also served as a member of the Wheat committee, whose recommendations led to the establishment of the Financial Accounting Standards Board. Attracted by the challenge of serving as head of the Institute’s staff at a time when extensive changes in the profession seemed likely, I agreed to a five-year employment contract that began in September 1972.

Prior to my appointment three staff vice presidencies had been created. Guy W. Trump had become vice president for education; Gilbert Simonetti, Jr., was vice president for government relations, and William C. Bruschi was technical vice president. Mr. Trump continued to serve in his new capacity until ill health forced his retirement in 1977. Mr. Simonetti left the Institute for Price Waterhouse and Company in 1976 and was succeeded by Theodore A. Barreaux. Mr. Bruschi, whose responsibilities have changed over the years, now serves as vice president for review and regulation.

At the time I joined the Institute’s staff, legal matters, particularly the filing of amicus curiae briefs, were assuming considerable importance in the AICPA’s activities. As a result, Donald J. Schneeman, a lawyer and director of the professional ethics division, was promoted to the position of general counsel and given responsibility for all legal matters. In 1976, when Mr. Lawler retired at age sixty after twenty-six years of distinguished service, Mr. Schneeman replaced him as AICPA secretary while retaining his other position.

The outstanding contribution of Mr. Lawler, who had long wanted to devote time to his first love, writing, was recognized when he received the Institute’s highest award, the gold medal for distinguished service.

Other changes occurred over the years. Donovan Roberts, a former partner of Alexander Grant and Company, joined the staff in April 1977 as vice president for communications and education. Donald Adams was promoted from managing director of administrative services to vice president for administrative services. At that time he assumed the responsibilities of George Taylor, who for many years had served as controller in admin-
istering the Institute’s financial and accounting affairs. Douglas Carmichael was promoted to vice president for auditing when the auditing standards executive committee was restructured in 1978 as the Auditing Standards Board. Thomas Kelley was promoted in 1980 to technical vice president, responsible for all technical divisions other than auditing. Lastly, Rex Cruse was promoted to managing director of the continuing professional education division after many years of service on the staff in a variety of important capacities.

In 1977 I agreed to continue as chief staff officer, but I requested that my service be on a year-to-year basis. I did not want to stay in the position for another five years and hoped that circumstances in Washington and in the profession would permit my retirement by the end of the 1970s. By the spring of 1979 the pressure from Washington had abated sufficiently to allow a change in the presidency, and accordingly I notified Chairman Joseph Cummings of my desire to leave the Institute.

By May 1980 Philip Chenok, a top partner of Main, Hurdman and Company and a past chairman of the auditing standards executive committee, had been chosen by the AICPA Board of Directors and elected by the Council to become president effective July 1, 1980.

When I retired in 1980 the top staff officers reporting to the president were Messrs. Adams, Barreaux, Bruschi, Carmichael, Cruse, Kelley, Roberts, and Schneeman. They were an able group of individuals, and the profession was fortunate to have them working in its behalf.

Financial Matters

During the decade membership dues were increased twice, once in 1971 and again in 1975. For the remainder of the 1970s revenues exceeded expenses by a substantial margin in spite of back assessments of income taxes on the Journal of Accountancy advertising revenue, which was deemed “unrelated business income.”

Provisions were also made for potential tax liabilities when the Internal Revenue Service asserted that part-time graders of the Uniform CPA Examination were employees rather than independent contractors. These provisions were restored to in-
come when Congress forestalled any such assessments before a specified date, after which a more explicit definition of an "employee" would apply.

By 1969 the Institute had begun to outgrow its space at 666 Fifth Avenue, and a study was initiated to consider the possible relocation of the headquarters. It was not until 1972, when the crowded office space was becoming highly inefficient, that a possible move was given high priority.

After careful consideration of locating in other cities or in the suburbs of New York City, it was decided that remaining in mid Manhattan was the best alternative. Although the lease on the Fifth Avenue space had several years to run, we concluded that an early move would eventually result in a substantial savings in rental expense. This was because at that point Manhattan had an excess of office space, and very favorable rentals were available on new premises. In November 1974 the Institute moved to new office space at 1211 Avenue of the Americas in the Celanese Building of Rockefeller Center.

Some board members were skeptical of the projections and opposed moving before the expiration of the old lease. However, a majority supported the early move—a decision that proved to be correct when financial projections were borne out and the operations of the Institute were made substantially more efficient. The new offices readily accommodated the Institute's increasing activities by providing adequate space for numerous committee meetings to take place at Institute headquarters and alleviated overcrowded working conditions.

Bylaw Amendments

In February 1972 an ad hoc committee was appointed to make a comprehensive review of the bylaws. The committee reported its recommendations to the board on November 30, 1972, and the proposed changes were exposed for comment.

Based upon comments received and subsequent study, the board modified the proposed changes. It eliminated a proposal to authorize the Council to create a class of associate members. The membership requirements were retained in the bylaws, which could be changed only by a vote of the membership. The
board also restored a provision for the annual election of three vice presidents in lieu of the proposal to substitute three board members who would serve for three-year terms. Finally, the board inserted proposals to change the fiscal year to one beginning August 1 and to require a ninety-day delay period after approval by the Council before proposed changes in the bylaws and rules of conduct could be submitted to a vote of the membership.

In general, the proposed changes were designed to enable the Institute to act more swiftly by assigning increased authority to the Council and board. Also included in the proposals was a change in the titles of the chief staff officer and the elected head of the Institute to president and chairman of the board.

The modified proposals were considered by the Council on May 7, 1973. After several minor amendments in wording, the Council approved the proposed changes and authorized their submission to the members for a mail ballot. The proposals were approved by the membership.

The next change in the bylaws came about at the recommendation of a committee of members in industry and government. The proposed change would permit members not in public practice to serve as Institute officers and members of the Trial Board. This proposal was approved by the Council on May 3, 1976, and subsequently adopted by a vote of the membership.

The door was thereby opened to the possible election of a nonpractitioner as chairman of the Institute. This has become commonplace in Canada and England, but it has not yet happened in the AICPA. It seems inevitable, however, that a nonpractitioner will be elected to the highest office since almost half of the Institute's members are employed in industry or government and that ratio is growing.

Another bylaw amendment became necessary on September 17, 1977, when the Council approved the proposed addition of three public representatives to the AICPA Board of Directors. The proposal was approved by a vote of the membership, and the three new members were elected by the Council on October 21, 1978: Barbara Hackman Franklin, former commissioner on the U.S. Consumer Product Safety Commission; Thomas C. Pryor, partner of the investment banking firm, White, Weld and Company, who had previously served on the Wheat committee;
and John C. Sawhill, president of New York University. Mr. Sawhill was succeeded in 1979 by A. A. Sommer, Jr., a prominent securities lawyer and former commissioner of the SEC, when Mr. Sawhill accepted appointment as deputy secretary of the newly established U.S. Department of Energy.

As the decade came to a close, proposals to amend the bylaws were contained in a petition signed by nearly 1400 members, many of whom objected to the establishment of the division for CPA firms. They were designed primarily to allow 500 members to require a mail ballot of the membership on proposed changes in the bylaws and rules of conduct without the approval of the board or the Council. In addition they would eliminate life membership on the Council for past elected presidents and chairmen and would change the manner in which the Institute's nominating committee was elected.

Although the petitioners' proposals were not approved by the board or Council, they did lead to other proposed bylaw amendments, which were approved by a vote of the membership in 1981. Those amendments increased from 200 members to 5 percent of the membership the number required to call a special meeting of the AICPA. They also provided that 5 percent of the membership could require a membership vote on proposed changes in the bylaws or rules of conduct without the approval of the board or the Council. Other clarifying and administrative amendments of lesser importance were also included in the package adopted by the members.

Meetings

During the 1970s the number, type, and format of meetings sponsored by the Institute changed considerably to meet the needs of a rapidly growing profession. One of the early changes began when a committee was appointed in July 1971 to reexamine the objectives and format of the annual meeting of the membership. The committee, chaired by Wilbur H. Stevens, a partner of Elmer Fox and Company, recommended that the technical divisions hold regular meetings in conjunction with the annual meeting to encourage the attendance of more members.

Although this recommendation proved impracticable and was
not implemented, it led to the evolution of a new format for the annual meeting that included simultaneous technical sessions conducted by the various divisions of the Institute. Interspersed were three plenary sessions at which nationally known figures spoke on broad issues outside the field of accounting. These sessions were combined with the annual corporate meeting in a two-day gathering, a reduction from the prior three-day format. The new format was well received by the members attending the annual meetings, and it was continued in subsequent years.

Another innovation satisfied the committee's desire to acquaint more members with the functions of the technical divisions. The Institute initiated a series of national technical conferences, which any member could attend upon payment of a registration fee. Over a period of time the following annual conferences were introduced: SEC developments and practice, management advisory services, federal taxation, practice in industry and government, management of an accounting practice, audits of federally assisted programs, and computer developments and applications.

A number of other national conferences were held periodically to coordinate activities between the state societies of CPAs and the Institute in such areas as professional ethics, state legislation, continuing professional education, and public relations. Also, a national conference on accounting and auditing was held in 1980 on a trial basis to determine whether there was sufficient interest to warrant continuing it on an annual basis.

All of these national meetings served a useful purpose in helping practitioners keep up to date on new developments and in involving a larger number of members in the profession's affairs. They contributed to a more informed membership and a greater spirit of unity.

Another important innovation, which began in December 1975, was the holding of regional meetings of Council members to brief them on rapidly evolving developments and to seek their views on current issues. The meetings proved to be extremely effective in expediting action at the full Council meetings; the Council members arrived with a common understanding of the major issues and the available options. Also, Council members felt a greater sense of involvement in the decision-making process. There is little doubt that these regional meetings played an
important part in enabling the AICPA to respond effectively to the challenges that arose during the latter 1970s.

Other types of meetings were initiated for various purposes. The chairmen of the senior executive committees assembled periodically to sort out responsibilities for projects that affected the jurisdictions of two or more divisions. Regional meetings of practitioners in local firms were held annually to solicit their views on various current issues and to inform them about the Institute’s activities and services. Also, periodic meetings of members were organized through the state societies to discuss current developments in the profession. These member discussion forums proved invaluable for exploring members’ views on new programs being considered by the AICPA. In addition, on one occasion representatives of twelve of the principal associations of CPA firms were assembled to explore how the AICPA could assist them in carrying out their mission.

In another development, in 1977 certain meetings were opened to attendance and observation by the public. This change originated when some of the state society executive directors requested permission to attend Council meetings. It was also stimulated by criticisms of the manner in which accounting and auditing standards were being established. The sessions that now operate “in the sunshine” are meetings of the Council, those portions of senior technical committee meetings that relate to the public interest, and certain portions of the meetings of the federal government relations executive committee and the Board of Examiners. Predictably, attendance at open meetings by non-members and members alike was very sparse. Of greatest interest were the meetings of Council, which in the following years regularly drew a sizable gallery of observers, consisting mostly of AICPA members.

A matter worth mentioning was a controversy over selection of sites for Institute committee meetings. Many committee members favored meeting in resort areas and other locations that provided the opportunity to combine business with recreation and short vacations. The advantages of this arrangement included the income tax deductibility of travel costs incurred for the business portions of the meetings. On the other hand, the managing partners of many CPA firms objected to having their partners absent on AICPA affairs longer than necessary, and the
officers of the Institute were concerned about the additional costs and lost staff time incurred by holding committee meetings at distant locations with poor accessibility.

To deal with this conflict in viewpoints, the AICPA Board of Directors instructed the president to implement a policy on meeting sites effective February 22, 1973, which did not rule out resort area sites but required a minimum of travel for a majority of the committee and its staff and ready accessibility from airports by public transportation.

Enforcement of the stricter policy raised a wave of protest. The most vocal was the committee on management of an accounting practice, whose chairman argued before the board of directors that since members donate their time to committee service they should be permitted to meet at any site they choose. The board was unsympathetic and reaffirmed its policy.

The issue was aired in a debate on the final day of a three-day meeting, May 5, 1976, when nearly half the members of Council were not present. By a vote of seventy-five to fifty-six, Council affirmed the board’s policy but adopted an amending resolution empowering each committee to interpret the policy by a two-thirds vote. The more liberalized arrangement formed the basis of an uneasy truce that is likely to be disturbed each time a committee violates the spirit of the board’s policy.

Publications

Before his departure from the Institute staff, Leonard Savoie urged that a new weekly newsletter be published, which would report all the new technical developments. This proposal was approved by the board in February 1972 but was not implemented until many months later. By that time budgetary considerations resulted in a reexamination of both the existing general newsletter, The CPA, and the proposal for a technical newsletter. After further study it was concluded that some portions of the general newsletter could be transferred to the Journal of Accountancy and that the balance could be combined with technical news in a new biweekly letter. The result was the elimination of The CPA and the birth of the CPA Letter.

The Journal of Accountancy was modified in several stages
during the 1970s to make it a better magazine. The covers were made more attractive; more articles by practitioners were included to improve the balance between the practical and the theoretical; a new "Official Releases" section was added to provide official texts of technical pronouncements, and the "Practitioner's Forum" was enlarged to include more practical information for practitioners in smaller firms. These changes were begun when William Doherty was the editor and were continued by his successor, Lee Berton.

Another innovation was the start of two separate looseleaf services, which were printed under a contractual arrangement with Commerce Clearing House. A Professional Standards service gathered in one place for the first time all of the profession's standards, including technical pronouncements, and the AICPA Code of Professional Ethics and Bylaws. The second service, Technical Practice Aids, was designed to provide practitioners with practical examples, checklists, commentaries, opinions of the AICPA Technical Information Division, an audit manual, and other nonauthoritative practice aids developed by the Institute's staff. These services, and the paperback editions that were a byproduct, proved to be very popular and resulted in substantial increases in the Institute's revenues.

Two other new periodicals were a newsletter that CPA firms could send to their clients and a special newsletter, the CPA Practitioner, designed to meet the needs of practitioners in smaller firms. The large firms were all publishing their own client newsletters, but the smaller firms found it difficult to compete because of the costs involved. To assist medium-sized and small firms and to avoid duplication of costs, the AICPA decided to produce a newsletter, which could be sent by firms to their clients under their own firm names, within certain ethical limitations. The new service proved to be highly popular, and at last count subscribing firms were receiving hundreds of thousands of copies for distribution.

The CPA Practitioner was started in 1977, largely as a result of suggestions received from members attending local firm seminars and the urging of advisory committee A, which represented the interests of members in smaller CPA firms. They felt that the Institute's other periodicals were largely oriented toward large-firm practice and were not meeting the needs of smaller firms.
As a result, the board authorized a new periodical in newsletter format to be sent gratis to all members in smaller firms and to other members upon request. The new publication, which was designed to provide practical technical and practice management information for smaller firms, was well received and became a permanent member of the AICPA’s group of periodicals.

Meeting the disparate and often conflicting wishes of thousands of members is a difficult task, and the AICPA’s publications will continue to evolve to meet new needs as they become apparent.

Committees

The backbone of the AICPA’s activities is the work of the many committees of members that deal with every aspect of the profession’s affairs. During the decade the AICPA took several actions to improve the effectiveness of its committees.

As a beginner on the Institute’s staff in 1972, I was often confused by the lack of standard terminology used in describing various committees. To correct this problem, we developed a uniform set of terms, which defined the designations of boards, executive committees, committees, subcommittees, task forces, and special committees. Over a period of two years the titles and structures of the existing committees were modified to fit the standard terminology. This action greatly facilitated the appointment and administration of committees, matters that are so important to the success of the AICPA’s programs.

The new terminology and a functional index of committees was included in the annual Committee Handbook, published in all the years through 1980.

To improve the selection of prospective committee members, the AICPA developed a computer data bank containing the names of all members who had indicated an interest during the past three years in serving on an AICPA committee. State society officers, directors, and committee chairmen were contacted to determine whether they wished to be included in the data bank. By computerizing the lists of candidates and their qualifications, the Institute achieved more complete information and broadened the number of members considered for committee service.

Committees
These changes caused some state society executive directors to complain because they mistakenly thought they would no longer be consulted about candidates from their respective states. The issue was clarified, and they were encouraged to continue to submit lists of candidates, whose names would be included in the data bank.

Although committee appointments are made as fairly as possible, many members feel discriminated against if they are not appointed. Unfortunately, explanations of the selection process and periodic reviews by groups of members have done little to allay these suspicions. Since only about sixteen hundred committee memberships are involved (less than 1 percent of the total AICPA membership) there are bound to be many members who are disappointed each year when they are not appointed for service on a committee. To make matters worse, a 1966 congressional staff study alleged that the large firms controlled the Institute and its committees. It was true that in a number of instances a majority of committee members came from the larger firms, but they did not enjoy voting control. Their substantial representation was not caused by a conspiracy in the appointment process but was a natural result of the dearth of candidates from smaller firms willing to devote time to Institute activities.

Even though the criticism was believed to be unfair, in 1977 the incoming AICPA chairman, Stanley Scott, decided to limit the number of representatives from the eight largest firms to five on each of the senior committees. This action, which was approved by the AICPA Board of Directors, was intended to satisfy both Congress and local practitioners. The large firms grudgingly accepted this decision, even though they viewed it as a form of discrimination that would damage the Institute's ability to deal effectively with the profession's needs. No doubt it did weaken some of the major committees for a time, but it also provided a more balanced representation.

Minority Group Members

When Ralph E. Kent served as AICPA president in 1968 and 1969, he began an effort to bring minority group members into the profession. He appointed a committee to develop recommen-
Public Issues

The profession began to involve itself further in public issues during Ivan Bull's term as chairman of the Institute. He had become very active in efforts to reduce the burden of governmental paperwork requirements on business, and he believed that the profession should take a public stand on this and other issues. As a consequence, an Institute committee on public service was appointed to consider ways to speak out in behalf of the profession.

The committee concluded that the Institute should prepare and publish white papers on national issues. The committee prepared pilot drafts on several subjects and submitted them to the board for consideration. The board agreed with the idea of publishing position papers but was not favorably impressed with any of the drafts presented to it. There was considerable reluc-
tance to have the AICPA express opinions about any matters that were not squarely within the normal expertise of CPAs.

Revised drafts were subsequently prepared by the committee with much the same result. Finding an approach that would win general approval proved to be very difficult, and an acceptable formula was not found. Nonetheless, the board continued to believe that the profession has a useful role to play in public affairs and would benefit by becoming known as a responsible group with broad-gauged interests that go beyond the fields of auditing and taxation.

A directly related matter involved the efforts of an organization known as Accountants for the Public Interest (API) to enlist the official blessing and support of the AICPA. A group of CPAs in San Francisco had founded the organization to conduct financial studies in behalf of public interest groups that could not afford to engage CPA firms on a fee basis. Increasingly, younger CPAs were interested in engaging in public service activities to aid worthy causes, and the API offered such an opportunity. Parallel efforts were begun in several states, and a national umbrella organization was established.

The managements of CPA firms were ambivalent about how to deal with this development. On the one hand they contributed funds to support the organization and did not discourage their staff members from donating time to API projects. On the other hand, at least one firm found itself in the position of having the results of one of its consulting engagements critiqued by an API task force. There was also the question of whether the API was performing work that would otherwise have become fee engagements for CPA firms. The potential for conflict clearly existed, although the API was careful to adopt policies to avoid such conflicts.

On several occasions during the decade the API sought the official endorsement of the AICPA, and on each occasion the board declined. Although the board approved of a public service role for the profession, it had to consider the possibility of conflict with the interests of CPA firms and the fear that the API might overstep appropriate boundaries.

The board’s attitude toward the API once again illustrated the difficulty of involving the Institute in public service activities. There was no enthusiasm for going beyond the basic expertise
of CPAs in taking positions on public issues nor much support for taking positions that could conflict with the interests of CPA firms whose personnel are Institute members.

Public Relations

The Institute works closely with the press to foster a better understanding of the profession. It issues a steady stream of press releases on newsworthy events, provides background information to financial writers and editors, and holds periodic briefing seminars for members of the press. These efforts did not completely forestall bad publicity or public criticism of the profession during the 1970s, but they did yield more balanced reporting.

One of the most frequently heard complaints about the AICPA over the years was that it failed to advertise the virtues of CPAs and their services. The state societies were particularly vocal on this subject, and some of them engaged in institutional advertising campaigns funded by special assessments of their members.

The Institute’s officers and directors resisted the idea of engaging in a national advertising campaign on the grounds that it would be prohibitively expensive and ultimately ineffective. They believed that the promotion of CPA services was best left to practitioners and their firms, since the business community was unlikely to engage CPAs on the basis of general advertisements describing their services.

Despite this attitude, a committee on public relations was appointed in 1976 to provide suggestions on how the Institute might promote an improved image for the profession. That committee recommended, among other things, that the AICPA place institutional advertisements in *Time* magazine once a month for three months to instill a sense of self-pride in the minds of CPAs. The committee thought that this would inspire CPAs to concentrate on public relations in their local communities.

On January 5, 1978, the board rejected this proposal and instead decided to engage a public relations consulting firm to evaluate the Institute’s overall program of public relations activities. As a result, four of the leading public relations firms were
interviewed, and Burson-Marsteller was engaged to conduct the survey.

Prior to this time, based upon discussions with state society representatives, I began to realize that what was missing was a well organized public relations program to be carried out at the local level with the assistance and oversight of the AICPA. The Institute had been supplying a variety of radio and television tax commercials and sample institutional advertisements to the state societies for many years; however, only a few of the societies were using these materials effectively, and most of them were expending little effort in the area of public relations. To fill the void, the Institute began a program to develop comprehensive campaign materials on individual themes and to have them implemented by the state societies. The Institute held a national conference on public relations with state society representatives to explain the program and to gain their support.

The results were impressive. Many of the state societies added members to their staffs to administer their public relations activities, and the volume of publicity about the profession throughout the country increased dramatically. Much of the credit belongs to Bradford Smith, director of the AICPA Public Relations Division, and to his staff, which developed the materials and provided the impetus for their use.

This program was already in place when the Burson-Marsteller firm began its survey. This partially accounts for the following general conclusions, which were included in its September 1978 report:

AICPA's national public relations effort is professional and productive, reaching the important financial and federal legislative regulatory publics through major national publications.

The accounting profession is economically healthy and expanding. There appears to be no real threat requiring an expanded national public relations effort.

Pressure from the states for more public relations help will continue to grow. Since state activities, with AICPA coordination, would provide the most cost effective public relations for the profession, AICPA should probably continue and upgrade its support of the states.

The report was most gratifying because it showed that the AICPA was on the right track. Indeed, the long-standing criticism by
the state societies lessened, and a spirit of cooperation toward a common goal began to prevail.

Accountants' Liability Insurance

For several years the AICPA had been sponsoring a professional liability insurance program for CPA firms having up to fifty staff members. Late in 1973 the American Home Assurance Company, the program's underwriter, insisted on imposing several restrictive endorsements on the basic policy, which seemed unwarranted to the legal liability committee. As a result, the Institute contacted other brokers and underwriters and began to sponsor a new program, which was administered by RBH/Reid and Carr and underwritten by Crum and Forster. The new coverage had several novel features and was significantly broader than the old coverage. State societies and CPA firms were urged to participate to provide the benefits of a national pooling of risk; however, some of the societies felt that the profession was better served by access to a number of alternative plans.

Much effort went into this program, and it attracted a sizeable portion of the market, despite competing plans sponsored by some of the state societies. In 1980 over 10,000 firms were participating in the AICPA plan. It represented a very valuable service to the profession, and both the guiding committee and Donald Schneeman, general counsel and secretary of the Institute, deserve credit for the program's success.

Prior to this program, the Institute actively considered the feasibility of establishing a captive insurance company to provide liability insurance to CPA firms. The idea was abandoned, however, on the basis of a preliminary analysis and advice received from an insurance consulting firm.

A Change in Law Firms

In May 1975 the Institute changed its outside legal counsel from Covington and Burling to Willkie, Farr and Gallagher. The Covington firm, based in Washington, D.C., had served the Institute well for many years, but beginning in 1973 the relation-
ship began to sour. The heads of two CPA firms complained that
the law firm was accepting engagements that conflicted with the
interests of the Institute and the profession. These complaints
referred to the firm’s representation of a CPA firm in a lawsuit
in which the workpapers of another CPA firm were subpoenaed
and to the firm’s engagement as special counsel to the trustees
of Penn Central.

In May 1973 the Institute’s Board of Directors discussed these
matters with the law firm’s partner responsible for the account.
The partner’s explanation seemed to indicate that conflicts did
not exist. Nevertheless, the board requested the firm to review
its conflict policies, which were originally set forth in a letter to
the Institute dated March 9, 1967. Under those policies the firm
stated that it would disqualify itself from representing an existing
or future client in asserting any claim against an accountant-
defendant based upon an issue of professional practice. Pursuant
to the board’s request, a letter was provided in July 1973, which
elaborated on the earlier letter but did not change its basic
substance.

During the next couple of years the Institute’s officers came
to feel that the law firm was representing its own special interests
more than those of the AICPA in meetings and negotiations with
governmental agencies. This seemed to occur especially in the
case of the SEC, and it was apparent that bad feelings existed
between the firm’s representatives and the SEC staff. The profes-
sion was having enough problems of its own with the SEC
without complicating them with the possible adverse relationships
of its legal representatives.

When the problems with the firm began to emerge in 1973,
Mr. Schneeman and I met with a senior partner of the firm to
discuss the Institute’s concerns. The meeting was cordial, and
vague promises were made to review the situation. However, by
the spring of 1975 it was clear that the meeting was not going to
produce the desired improvements, and the Institute decided to
seek a new firm, even though we recognized that the inconveni-
ence and expense of a learning period for new counsel would
be incurred.

In searching for new legal counsel, we decided that the firm
should be located in New York, have heavy experience and a
high reputation in securities law practice, be willing to devote
top partner attention to the Institute, and not be involved in extensive representation of CPA firms or plaintiffs bringing suits against CPAs. The firm of Willkie, Farr and Gallagher met all of these specifications, and it was engaged to replace the Covington firm. The new firm has since been invaluable in helping the AICPA deal with the greatly expanded volume of legal matters that confronted it in the latter half of the 1970s.

Information Retrieval

In 1970 the Institute began an assessment of the profession's information needs for the purpose of developing a computer-based information retrieval system. By February 1972 the survey had been completed, committees had been appointed, and recommendations were made to the board for a six-month pilot program. The program was to be mounted with Mead Data Central of Dayton, Ohio, which would absorb $150,000 of the estimated total cost of $200,000. The balance would be borne by a group of participating accounting firms. The data bank would consist of the full text of 500 annual reports of New York Stock Exchange companies and 1,000 financial statement notes dealing with accounting matters of special interest. This information could then be accessed through computer terminals located in participants' offices.

The board approved the proposal, and in October 1973 it decided to continue the program on an operational basis. By that time twelve CPA firms, the FASB, and the SEC had agreed to participate, and several other firms and organizations had expressed interest.

As the program, guided by AICPA staff Vice President William Bruschi, continued, the data base was greatly expanded, and the introduction of new equipment made the information more accessible. The number of participants also grew, reflecting the success of the cooperative effort by CPA firms and the Institute to fulfill a need that otherwise would have had to be met by firms individually.

The cooperation in developing a system of information retrieval was further expanded in 1976 when Price Waterhouse made available to the AICPA a system for indexing authoritative
accounting and auditing literature. As a result, the Institute was able to begin providing CPA firms with a periodically updated index in the form of computer tapes and paperback publications. It was a generous gesture by the firm, which will be of continuing benefit to the entire profession.

Continuing Professional Education

The Institute began developing and providing continuing professional education programs to its members early in the 1960s. During the formative stages this activity was not self-sustaining even on a direct cost basis. When the deficit reached a record level, the Council became alarmed and directed that henceforth the division "be operated on a business basis and revenues from the program cover all direct and allocated costs." As a result, the board resolved on March 2, 1970, that the division bear a full share of management and service charges and that the pricing structure be modified to permit a break-even basis in the 1972–1973 fiscal year.

Improvements were made, and the program was self-sustaining for the remainder of the decade. Indeed, the Institute's CPE program matured into a big business in the 1970s. In 1980 the division produced gross revenues of nearly $10 million, over 27 percent of the Institute's total revenues.

This substantial growth was largely the result of a resolution adopted by the Council on May 12, 1971, urging the state boards of accountancy to adopt, by legislation or regulation, a mandatory continuing professional education requirement for all practicing CPAs. This resolution was implemented by the combined efforts of the AICPA, the state societies of CPAs, the National Association of State Boards of Accountancy, state legislatures, and state boards of accountancy. By 1980 thirty-seven states had adopted mandatory requirements.

The program got a second boost when the division for CPA firms was established in 1977. The division required member firms to provide specified amounts of continuing professional education not only for their CPAs but for all other members of their professional staffs.

As the volume of courses and the number of groups providing continuing professional education grew, it became apparent that
standards were necessary to ensure an acceptable level of quality. After both the AICPA and the National Association of State Boards of Accountancy adopted standards, the question of accreditation of courses arose, and a special committee was appointed in November 1977 to study this issue. That committee concluded in a report dated April 4, 1979, that the costs of an accreditation program would be prohibitive in relation to the benefits to be derived. It believed that market forces would weed out poor courses through low enrollment, making a formal system of accreditation unnecessary. As an alternative, the committee recommended that the providers, sponsors, and enforcers of continuing professional education be urged to agree to comply with the Institute's standards.

These conclusions were probably right, but they leave the individual CPA to find out the hard way whether or not a course is worth attending. The quality of available courses is very uneven, and many CPAs complain that they have attended courses that proved to be worthless. This problem will require more attention in the future.

Overall, the rapidly expanding market for CPE proved to be a bonanza for the state societies of CPAs. Some acted only as sponsors, while the larger state societies developed and provided courses through educational foundations.

As might be expected, friction between the AICPA and the state societies arose over pricing policies, the sharing of revenues from jointly sponsored courses, and the fact that they were in direct competition with each other. The tensions were kept within reasonable bounds by constant efforts to coordinate activities and by the inclusion of state society executive directors on the AICPA's CPE committees.

Mandatory continuing professional education for practicing CPAs has very likely raised the quality of practice, but measurement of the benefits is extremely difficult, if not impossible. Nevertheless, experience has demonstrated that a voluntary approach is unsatisfactory as a way to remain up to date.

General Standards

In 1974 the management advisory services division developed and exposed for comment a set of proposed practice standards,
some of which overlapped with generally accepted auditing standards and certain portions of the code of professional ethics. This worried the AICPA’s officers because they foresaw the possibility that various technical divisions might issue separate standards that dealt differently with the same matters.

To eliminate this possibility, I proposed that the Institute consider a set of general professional standards applicable to all public accounting services. The AICPA’s senior technical committees responded favorably, and a special committee was appointed to develop a specific set of general standards. The committee produced a report, which was exposed for comment late in 1976. Following further modifications, the committee submitted a final report to the board on April 20, 1977. The board approved the final report on May 6, and three days later the Council authorized a mail ballot of the membership on the proposed changes in the code of professional ethics. Surprisingly, there was little controversy about this significant step, which for the first time would bring all areas of practice under a set of general standards.

The proposal substituted a new Rule of Conduct 201, “General Standards,” for the existing Rule 201, “Competence.” The revised rule read as follows:

A member shall comply with the following general standards as interpreted by bodies designated by Council, and must justify any departures therefrom.

A. Professional competence. A member shall undertake only those engagements which he or his firm can reasonably expect to complete with professional competence.

B. Due professional care. A member shall exercise due professional care in the performance of an engagement.

C. Planning and supervision. A member shall adequately plan and supervise an engagement.

D. Sufficient relevant data. A member shall obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to an engagement.

E. Forecasts. A member shall not permit his name to be used in conjunction with any forecast of future transactions in a manner which may lead to the belief that the member vouches for the achievability of the forecast.

Item E had previously been included in a separate rule 204. A new Rule 204, “Other Technical Standards,” replaced it:
A member shall comply with other technical standards promulgated by bodies designated by Council to establish such standards, and departures therefrom must be justified by those who do not follow them.

A footnote explained the references to “bodies designated by Council”:

For purposes of this Rule, it is expected that Council will consider designating the auditing standards executive committee, the management advisory services executive committee, and the federal taxation executive committee.

The intent of this construction was that the general standards under rule 201 would apply to all areas of public practice, and the senior technical committees would promulgate interpretative standards peculiar to their respective areas of services.

The proposed changes were adopted by a vote of the membership, and a few months later the management advisory services executive committee sought and obtained designation by the Council to promulgate standards under the new rule 204. The implementing resolution contained the following qualification:

provided, however, that such standards do not deal with the broad question of what, if any, services should be proscribed, and provided further that any such statements are subject to review by affected senior technical committees of the Institute prior to issuance.

In May 1979 the Council brought the pronouncements of the new accounting and review services executive committee under the rule and designated the Financial Accounting Standards Board as the body to establish standards for the disclosure of financial information outside of financial statements in published financial reports containing financial statements.

Early in 1980 the federal taxation executive committee also sought the approval of the AICPA Board of Directors to request designation by the Council under rule 204. In this instance, the board deferred action because the committee had no current plans for making its Statements on Tax Responsibilities enforceable under rule 204.

The general standards adopted under the revised rule 201 of the code of professional ethics were of considerable significance,
but the new rule 204 received all the early attention. It proved to be a convenient means of dealing with new developments in professional standards.

The framework provided by the two rules should help to avoid unnecessary duplication and conflicting standards, provided that the pronouncements and interpretations of the senior technical committees are confined to subjects unique to their respective jurisdictions. This may prove difficult to do, however, and time will tell whether further modifications are necessary to rationalize the profession’s body of standards.
CHAPTER 15

Conclusion

The period covered by this volume was a turbulent time within the profession. The forces that were growing throughout the business world in the 1960s formed into a full-blown challenge to the credibility of independent auditors during the 1970s. Essentially, the 1970s produced the first comprehensive appraisal of how well the profession was meeting the responsibilities assigned to it by the SEC under the 1933 and 1934 federal securities statutes, and the consensus seemed to be that the profession was not performing as well as it should. Paradoxically, at this same time the reputation of the business community had become so tarnished that government officials, legislators, and independent observers sought to expand the responsibilities of independent auditors as part of a program to achieve improved corporate accountability.

The problems faced by the profession were not new. They were chronicled in John L. Carey's history of the profession through 1969, *The Rise of the Accounting Profession*. What was new was the degree of attention paid to the profession in the public press and in Congress. Moreover, for the first time CPAs encountered corporate managers who took advantage of accounting alternatives to inflate the market values of the equity securities issued by their corporations. The profession was slow to recognize the full implications of the changes that were taking place in the business world.

Once the challenges were fully recognized, however, the profession met them with a speed and thoroughness that was unprecedented among the major professions. New structures were established to promulgate and enforce accounting and auditing standards and to enhance the profession's system of
self-regulation. Peer reviews of the quality controls of firms were introduced to ensure a high level of performance. In addition, the Institute worked to sharpen the public's understanding of the public accounting profession and to improve its ability to present its case before Congress and government officials.

The changes made by the profession exacted a heavy price in the form of internal disharmony. The criticisms of the profession's performance were directed almost exclusively at CPAs practicing before the SEC, and these were a minority of accountants in public practice. As a result, CPAs had little enthusiasm for the imposition of new requirements on the entire profession; yet, these practitioners generally did not wish to have distinctions drawn between CPAs based on practice before the SEC. This posed a dilemma. It remains to be seen whether the profession can come to accept without continuing turmoil distinctions that external demands have made necessary.

In serving CPAs throughout this troubled period, the Institute was constantly faced with questions about which courses of action would best meet the interests of the profession and society, which, in the long run, must be identical. To carry out its responsibilities properly, the AICPA found it necessary to be both a leader and a follower of its constituents.

With the cooperation and interaction of its officers, governing bodies, and members, the Institute will continue to serve the profession as spokesman, counselor, and conscience in helping the profession fulfill its vital role in society.
Board of Directors 1971–1982

Presidents/Chairmen of the Board

<table>
<thead>
<tr>
<th>Name</th>
<th>Position</th>
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<tr>
<td>Marshall S. Armstrong</td>
<td>President</td>
<td>1970–71*</td>
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<td>Walter J. Oliphant</td>
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<td>LeRoy Layton</td>
<td>President</td>
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<tr>
<td>Samuel A. Derieux</td>
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<td>Philip L. Defliese</td>
<td>Chairman</td>
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<td>Ivan O. Bull</td>
<td>Chairman</td>
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<td>Stanley J. Scott</td>
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<td>William S. Kanaga</td>
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<td>George D. Anderson</td>
<td>Chairman</td>
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*Since 1972, the President/Chairman has served as a member of the Board in the year preceding his election and in the year immediately following his term as President or Chairman.

Officers

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<tr>
<th>Name</th>
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<tr>
<td>Arthur L. Breakstone</td>
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<td>Wilbur H. Stevens</td>
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<td>E. Palmer Tang</td>
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<td>Harry F. Reiss, Jr.</td>
<td>Treasurer</td>
<td>1971–74</td>
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<td>William T. Barnes</td>
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<td>Max Myers</td>
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Albert H. Cohen  
George H. Horn  
Lorin H. Wilson  
David M. Culp  
Arnold I. Levine  
A. Waldo Sowell, Jr.  
John W. Zick  
James M. Arnett  
Robert Bernstein  
Don J. Summa  
Peter E. Arnstein  
George R. Catlett  
Frank B. Hill, Jr.  
Robert M. Coffman  
Andrew P. Marincovich  
Robert D. May  
Harry R. Mancher  
John L. Fox  
Bernard Z. Lee  
John L. Ricketts  
Raymond C. Lauver  
Robert A. Liberty  
Richard D. Thorsen  
A. Marvin Strait  
John J. van Benten  
Arthur R. Wyatt  
William B. Keast  
Rholan E. Larson  
Sam I. Diamond, Jr.  
Gerald W. Hepp  
George E. Tornwall, Jr.  

Vice President  
Vice President  
Vice President  
Treasurer  
Vice President  
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**Board Members**

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<td>Gordon L. Murray</td>
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<td>Ivan O. Bull</td>
<td>1971–74</td>
<td>Charles T. Zlatkovich</td>
<td>1973–76</td>
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Board Members (cont.)

Michael N. Chetkovich 1974–75
William R. Gregory 1974–77
Robert Boyer 1975–78
Rhulan E. Larson 1975–78
John R. Meinert 1975–78
A. Waldo Sowell, Jr. 1975–76
Wilton T. Anderson 1976–79
Joseph P. Cummings 1976–77
William S. Kanaga 1976–79
Harry R. Mancher 1976–77
Robert F. Isler 1977–80
Bert N. Mitchell 1977–80
Russell E. Palmer, Jr. 1977–80
George R. Catlett 1977–79
Barbara Hackman 1978–83
Franklin, Public Member 1978–83
Archibald E. MacKay 1978–79
Robert D. May 1978–81

Robert A. Mellin 1978–81
Thomas C. Pryor, Public Member 1978–82
John C. Sawhill, Public Member 1978–81
James Don Edwards 1979–82
John L. Fox 1979–82
Bernard Z. Lee 1979–82
William C. Rescorla 1979–81
Ray J. Groves 1980–83
Raymond C. Lauver 1980–83
Herman J. Lowe 1980–83
A. A. Summer, Jr., Public Member 1980–84
George L. Bernstein 1981–84
Andrew P. Marincovich 1981–84
Arthur R. Wyatt 1981–84

Staff Officers Serving as Members of the Board of Directors

Leonard M. Savoie, Executive Vice President 1971–72
Wallace E. Olson, Executive Vice President 1972–74
Wallace E. Olson, President 1974–80
Philip B. Chenok, President 1980–82
John Lawler, Administrative Vice President 1971–74
John Lawler, Senior Vice President and Secretary 1974–76
Donald J. Schneeman, General Counsel and Secretary 1976–82
APPENDIX 2

AICPA Gold Medal Awards

1970 Weldon Powell
(posthumously)
Thomas D. Flynn
Elmer G. Beamer

1971 Robert M. Trueblood

1972 Philip L. Defliese

1973 Ralph E. Kent

1974 Oscar S. Gellein
Marvin L. Stone

1975 LeRoy Layton
Louis M. Kessler

1976 Louis H. Pilie
John Lawler

1977 Marshall S. Armstrong

1978 Samuel A. Derieux

1979 Robert K. Mautz
Stanley J. Scott

1980 Wallace E. Olson

1981 Herbert Miller
Walter J. Oliphant

Medal of Honor—1980
Elmer B. Staats
Index

AAA—See American Accounting Association
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