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Progress in financial accounting and reporting since February 1985

Michael J. Cook

United States. Congress. House. Committee on Energy and Commerce. Subcommittee on Oversight and Investigations

American Institute of Certified Public Accountants (AICPA)

Progress in Financial Accounting and Reporting Since February 1985

Prepared for the
Subcommittee on Oversight and Investigations
of the Committee on Energy and Commerce of the
House of Representatives

by

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AICPA 100
A CENTURY OF PROGRESS IN ACCOUNTING
1887-1987

February 2, 1987

The Honorable John D. Dingell
Chairman
Subcommittee on Oversight and Investigations
Committee on Energy and Commerce
United State House of Representatives
2323 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Chairman:

I am pleased to submit with this letter a report on the progress made in financial accounting and reporting over the last two years. In these pages we have summarized the major steps taken to improve audit quality and to strengthen the financial reporting system. We begin our summary in February 1985 when the Subcommittee's hearings on the accounting profession and the Securities and Exchange Commission (SEC) began so that you might relate our actions during this period to the public concerns identified in your proceedings. Also, we have sought to place the American Institute of Certified Public Accountants' (AICPA) initiatives in context by identifying those activities of the Financial Accounting Standards Board and of the SEC which have been a part of the mutual effort to improve the financial reporting process.

In particular, I call your attention to one of the most important and far-reaching aspects of this effort: the work of the AICPA's Auditing Standards Board (ASB). Listed in Appendix C to the accompanying report are a number of exposure drafts of pronouncements of the ASB which have recently been approved for consideration by the profession. As you will see, these exposure drafts offer guidance on a number of important subjects which have been discussed before the Subcommittee including:

> "Red flags" to identify and assess the risk of material fraud.
>
> The characteristics of error and fraud.
>
> Circumstances when a duty may exist to notify parties outside the client about detected fraud and illegal acts.
>
> Procedures to follow when a question arises about an entity's continued existence.

The ASB's exposure drafts also include obligations to communicate important matters to the audit committee of the issuer, guidance on applying analytical review procedures, and a revision of the auditor's standard report that more clearly conveys the auditor's role and responsibilities. Of special importance to your expressed concerns, please note that the objective of the ASB's exposure draft on errors and irregularities is to set forth the auditor's responsibility to detect fraud in "clear, positive, nondefensive language." In my opinion, this objective has been achieved.

The work of the ASB to improve auditing standards and procedures and to sharpen delineations of auditors' responsibilities complements other initiatives of the AICPA to provide increased assurance of audit independence and to improve the profession's monitoring and disciplinary mechanisms. Among the most important of these initiatives have been steps to reduce the abuses of "opinion shopping" and to expand the scope and effectiveness of the peer review system administered by the AICPA's SEC Practice Section under the supervision of the independent Public Oversight Board.

Taken together, the initiatives summarized in the accompanying report represent a labor of many conscientious professionals who have unselfishly given their time and expertise to improve on our mechanisms for financial accounting and reporting. The collective scope and intensity of the effort is evidence of the accounting profession's good faith commitment made to you and to the public to maintain the integrity of our nation's financial reporting system and to improve upon its accuracy, credibility and utility.

Sincerely,

J Michael Cook

J. Michael Cook, CPA
Chairman of the Board of Directors
American Institute of Certified
Public Accountants

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INTRODUCTION

In order for our capital markets to function effectively and for our economy to allocate resources efficiently, it is essential that business enterprises report accurately and fairly to investors and that investors perceive that they do so. Our economy needs both the fact and the appearance of credible financial reporting—of financial reporting free of fraud and error. The independent auditor's central role is to assure exactly that, and no one has more incentive than auditors to deliver on that demand and expectation: our profession would otherwise fail to fulfill its valuable and necessary role in our economic system.

Because of the public interest in the financial reporting process, a system of oversight and regulation has developed over the years. It includes state boards of accountancy, government regulatory agencies, the courts, the independent Financial Accounting Standards Board (FASB), the independent Public Oversight Board, and the profession itself (through the American Institute of Certified Public Accountants). This system of regulation, with its mix of public and private sector components, rather completely covers management's responsibilities for financial reporting and the form and content of financial statements, auditors' qualifications (the uniform CPA examination and other licensing requirements), professional performance and ethical standards for audits, and measures to assure adherence to those standards. This combined public-private regulatory apparatus is remarkable in two respects: (1) it produces the world's most comprehensive, accurate, and believable financial reporting (our robust capital markets that attract capital from all over the world are an independent indicator of this) and (2) it has the adaptability to respond to changing circumstances.

Its adaptability is illustrated by responsiveness to rapid economic change, which often creates difficult accounting problems for standard setters, those who prepare financial statements, and auditors. Recent economic change has brought new financial instruments, unusual types of transactions, and complicated business restructurings, but the system has been generating in a timely fashion the needed accounting and auditing guidance. Clearly, economic change makes the status quo, or any status quo, an unrealistic goal for the financial reporting process and for the public-private regulatory system.

The rapidity of change in the financial reporting process has brought the "standards overload" issue, now more than a decade old. Both businesspersons who prepare financial statements and CPAs who audit them have complained about the pace of change and the volume of new obligations. Nevertheless, those who participate in the financial reporting process have cooperated to improve it.

We believe the existing regulatory framework has been effectively fulfilling the objectives of the financial reporting process, namely, to provide users of financial statements with accurate, believable, and meaningful financial information—information that contributes to the efficiency of our capital markets. We have summarized in the passages below major initiatives since February 20, 1985, when the Subcommittee's hearings on the accounting profession and the SEC began. The summary includes initiatives by bodies outside the AICPA and not under its control (for example, the SEC and FASB). The AICPA is a component in the existing regulatory system—not the whole of it—and no summary of recent progress would be complete without reference to the initiatives of the other components.

PROGRESS IN FINANCIAL REPORTING

Steps to improve the quality of financial reporting must address the three elements necessary to successful reporting: the measurement and reporting standards, called *generally accepted accounting principles* (GAAP), that govern the preparation and presentation of financial statements; the efforts by management to prepare the financial statements; and the efforts of independent auditors to evaluate whether financial statements comply with GAAP.

GAAP is to financial reporting what product design is to automobile manufacture. No matter how carefully a car is put together or how thoroughly the quality control inspector checks for compliance with the product design, if the product design is unsatisfactory (underpowered, poor gas mileage, too little headroom), the consumer will not be satisfactorily served. Similarly, no matter how carefully management prepares the financial statements or how thoroughly the independent auditor ascertains whether GAAP has been properly followed, the investor will not be well served unless GAAP provides meaningful and useful financial information. The initiatives to improve financial reporting cited below are therefore sequenced: (1) the quality of GAAP, (2) the quality of the preparation of financial statements, and (3) the quality of auditing.

Quality of GAAP

The FASB is the body with primary responsibility for setting GAAP. Since February 1985, it has issued nine *Statements of Financial Accounting Standards* (listed in Appendix A), several of which had significant effects on financial reporting. Employers' accounting for pensions was improved by Statement 87, and the financial statements of those who develop or purchase computer software that is to be marketed or who engage in lending activities were improved by Statements 86 and 91. Projects on accounting for income taxes, cash-flow reporting, and consolidations—each of which promises to have a strong effect on corporate financial statements—should lead to final pronouncements in 1987. A major project on financial instruments and off-balance-sheet financing should lead to disclosure standards in 1987, with work on measurement and recognition problems to follow.

Since the summer of 1984, the FASB's work has been supplemented by that of its Emerging Issues Task Force (EITF). The EITF assists the FASB in identifying emerging accounting and reporting issues, and when the task force reaches a consensus on appropriate accounting, the SEC expects it to be followed by registered companies. The Chief Accountant of the SEC attends the EITF's meetings and participates in the discussions. From February 1985 to January 1987, the EITF reached a consensus on 61 emerging accounting issues. The issues that came before the EITF in that period reflected the turbulent times of the financial sector of our economy; they include, for example, costs incurred in takeover defenses, interest-rate and currency swaps, collateralized mortgage obligations, offsetting nonrecourse liabilities against related assets, and risk participations in bankers' acceptances.

The SEC's rules on financial accounting and disclosure supplement the accounting standards issued by the FASB. Since February 1985 the Commission has issued 11 *Financial Reporting Releases* and 10 *Staff Accounting Bulletins.* (They are listed in Appendix B.) The accounting issues covered by the SEC's pronouncements in this period include amortization of goodwill by financial institutions, allowances for loan losses when applying purchase accounting to a bank acquisition, loss reserves by property-casualty insurers, and disclosures of repurchase agreements. The Commission also exercises its oversight of accounting standards by monitoring FASB projects and making known its views on current accounting issues.

The Quality of the Preparation of Financial Statements

To reduce the incidence of material financial statement fraud, the AICPA, in cooperation with four other accounting organizations, sponsored the National Commission on Fraudulent Financial Reporting (the "Treadway Commission") to study fraudulent financial reporting and recommend measures for improved detection and deterrence. Several of the Treadway Commission's preliminary recommendations pertain to improving the process of preparing financial statements. For example, the Commission has recommended, on a preliminary basis, mandating audit committees with at least a majority of independent directors, "good practice" guidelines to encourage more effective audit committees and their deeper involvement in the financial reporting process, reports by management on the adequacy of internal controls, required maintenance of an internal audit function, and corporate codes of conduct.

The Institute of Internal Auditors, one of the groups sponsoring the Treadway Commission, has been active in improving the qualifications and standards for internal auditors and has directly addressed the issue of the internal auditor's role in preventing and detecting fraud. In May 1985 the Institute issued *Statement on Internal Auditing Standards No. 3*, "Deterrence, Detection, Investigation, and Reporting of Fraud." The Statement holds that internal auditors are responsible both to have sufficient knowledge of fraud to be able to identify indicators that fraud might have been committed and to evaluate indicators that fraud might have been committed and decide whether to recommend an investigation.

Audit Quality

Initiatives to improve audit quality can be divided into four categories: those designed to improve auditing procedures, to clarify the scope of auditors' responsibilities, to provide increased assurance of auditor independence, and to improve the monitoring and disciplinary mechanisms applicable to errant auditors.

Auditing Procedures. The AICPA's Auditing Standards Board has issued a number of exposure drafts of pronouncements that would provide procedural guidance on subjects discussed at the Subcommittee's hearings or closely related to them. The exposure drafts, which are listed in Appendix C, include the following procedural guidance:

- An extensive list of "red flags" to assess the risk of material fraud.
- Guidance on the characteristics of errors and fraud.
- Circumstances when a duty may exist to notify parties outside the client about detected fraud and illegal acts.
- Procedures to follow when a question arises about an entity's continued existence.
- Guidance on auditing accounting estimates.

Repurchase securities transactions were discussed at the Subcommittee's hearings in the context of the ESM case. In January 1985, the AICPA had already issued accounting guidance on these complex and unusual transactions (Statement of Position 85-2, "Accounting for Dollar Repurchase-Dollar Reverse Repurchase Agreements"), and soon after it appointed the Special Task Force on Audits of Repurchase Securities Transactions. The Task Force's report, containing the most thorough auditing guidance available, was published in June 1985.

A good deal of the procedural guidance provided in the ASB's exposure drafts addresses concerns raised by the Treadway Commission. The Commission has stated, in its preliminary recommendations, that analytical review procedures should be emphasized because they have proved to be effective in detecting potential fraudulent financial reporting and that the auditor's role and responsibilities should be more clearly stated in the standard report. The ASB's exposure drafts include guidance on applying analytical review procedures and a revision of the auditor's standard report that more clearly conveys the auditor's role and responsibilities.

Guidance has also been provided that is relevant to the concerns expressed at the Subcommittee's hearings that investors receive too many unpleasant surprises. Additional audited disclosures of prospects, risks, and uncertainties are one way to reduce the frequency of such surprises, though no one can foretell the future with certainty. In October 1985 the ASB issued the Statement "Financial Forecasts and Projections," which establishes procedures and reporting standards for examining financial forecasts and projections, an important step in building a financial reporting process that can provide users with information particularly helpful in assessing a company's future prospects. To the same end, the ASB has issued an exposure draft containing procedures for examining the SEC's required forward-looking disclosure called *Management's Discussion and Analysis*.

The unpleasant-surprise concern clearly applies to banks because of the number of bank failures in the past few years. The *Auditing Procedure Study*, "Auditing the Allowance for Credit Losses of Banks," issued in October 1986, significantly expands the available guidance on evaluating loan losses.

Auditing procedures have also progressed in this period because of the research efforts of academicians and the research and development efforts of individual firms. The most obvious sign of technological advances is the increasing use of microcomputers at audit sites, which automate various elements of the audit process and extend the capabilities of the auditor in the areas of analytical review and risk analysis. Academic research in artificial intelligence and human information processing has also assisted firms in their efforts to develop expert systems that can enhance the consistency and quality of difficult audit judgments.

Auditors' Responsibilities. The ASB's exposure draft on errors and irregularities anticipated the Treadway Commission's preliminary recommendation to spell out the auditor's responsibility to detect fraud in "clear, positive, nondefensive language." The exposure draft states the auditor's obligation unambiguously: to detect material misstatements, however caused. The ASB's exposure drafts also articulate a number of more specific responsibilities that would extend and enhance those already incorporated in generally accepted auditing standards:

- The auditor would be responsible to assess the likelihood of material misrepresentations by reviewing information obtained about risk factors and the control environment.
- The auditor would be responsible to reconsider the initial assessment of the risk of material misstatement of the financial statements and the adequacy of the planned scope of audit procedures when evidence obtained during the audit indicates conditions or circumstances differing adversely from the auditor's expectation.
- The auditor would be responsible, when he or she suspects an illegal act, to apply additional procedures to evaluate and respond to the act.
- The auditor would be responsible to perform a defined minimum level of work to evaluate internal controls on every engagement.
- The auditor would be responsible to apply analytical review procedures at the planning and final review stages of the audit.
- The auditor would be responsible to communicate specified important matters to the audit committee.
- The auditor would be responsible to consider conditions and events coming to his or her attention in the course of the audit that might affect the entity's continued existence; to consider, if such conditions and events raise a question about the entity's continued existence, other factors associated with those conditions or events and to obtain evidence about such factors; and, if necessary, to modify the audit report.

Auditor Independence. Audits are a marketplace phenomenon, a service that responds to a market demand that can be satisfied only by auditors who are independent. Rational economic behavior by auditors in the marketplace as currently structured is the best long-term assurance that auditors retain their independence.

To explain these points further: the market demand for audits originated prior to the securities acts, which recognized and legislated a role for auditors that was substantially in place. Prior to the Securities Exchange Act of 1934, 94 percent of the companies traded on the New York Stock Exchange were receiving independent audits, and independent audits are widely demanded today in the market sector not covered by the securities acts. The demand for audits was created, and is sustained, by two factors: first, the need of those who seek credit, sell stock, or report on their stewardship to prepare and issue financial reports and, second, the desire of users of financial reports for independent assurance that the information they use in their decision making is reliable. Thus, independence is essential to respond to the market demand for audits. It is an economic necessity for auditors. No other fact is sufficient to explain the extraordinary rarity of cases where an auditor's independence has been compromised.

Because independence is so important to the accounting profession, the AICPA and the SEC have rules on independence, and many firms have adopted policies that are even more stringent. Moreover, since February 1985, the AICPA and others have taken a number of steps to help assure independence.

The first set of steps pertains to establishing closer relations between audit committees and auditors. Closer relations provide assurance that audit committee members, who are representatives of the shareholders, can be ready to buffer attempts by management to pressure auditors. The SEC Practice Section, the AICPA component designed to improve practice before the SEC through membership requirements applicable to firms and through peer reviews, has adopted a membership requirement that six additional important matters be communicated to the client's audit committee. A related ASB initiative would extend those requirements to all audits, not just to those of SEC registrants.

The AICPA has also taken steps to reduce the likelihood of "opinion shopping," a term used to describe the situation in which a client seeks an opinion from one or more additional CPA firms and, when an opinion so obtained is more suitable to management's preferences, either threatens to replace the engaged audit firm in order to change its opinion, or actually replaces the engaged audit firm in order to obtain the desired opinion. It has not been demonstrated that this practice is prevalent, but the risks it presents were discussed at the Subcommittee's hearings, and the Treadway Commission requested action on it in its preliminary recommendations. *Statement on Auditing Standards No. 50*, issued by the ASB in July 1986, sets out performance and reporting requirements for providing opinions to nonclients on the application of accounting principles, which should reduce abuses of opinion shopping.

A second vehicle for deterring opinion shopping is the Form 8-K filing with the SEC, which is required when there is a change in auditors and discloses differences with predecessor auditors on material accounting and auditing matters. The SEC staff reviews such filings and investigates when it believes opinion shopping may have occurred. A similar practice has been instituted by the SEC Practice Section of the AICPA. Future peer reviews will cover all engagements for clients accepted since the last peer review whose Form 8-Ks reveal disagreements with predecessor auditors. In addition, the AICPA has recommended to the SEC that it amend its Form 8-K requirements to include the following disclosures:

- Whether the auditor has communicated, in connection with the last two audits, concerns or conclusions regarding management integrity or possible irregularities that were not resolved to the auditor's satisfaction.
- Whether the audit committee or board of directors had discussed the communication with the auditor.
- Whether the auditor has been authorized to respond fully to the inquiries of the successor accountant.
- Whether the former accountant resigned, declined to stand for re-election, or was dismissed.

Although SEC action on the AICPA's recommendation is still pending, both the SEC and Federal Home Loan Bank Board have taken steps to reduce the likelihood of opinion shopping. The SEC extended the applicability of its Form 8-K disclosure requirement on changes in accountants and disagreements with former accountants to the period prior to becoming a registrant, and the FHLBB issued requirements (Bulletin PA-7A-4) for savings and loan associations to notify the Office of Examinations within 15 days of changes in accountants and disagreements with former accountants.

Monitoring and Disciplinary Mechanisms. The primary monitoring mechanisms are the peer review system, the SEC Practice Section's Special Investigations Committee (SIC), the SEC Practice Section's Public Oversight Board, and SEC oversight. All members of the SEC Practice Section are required to undergo triennial peer reviews, to report to the SIC litigation alleging deficiencies in the conduct of audits of SEC reporting companies (plus certain others), and to cooperate with the SIC's investigations. Peer reviews and the SIC's work not only monitor practice but also improve it by recommended remedial actions. Both mechanisms have been strengthened by expanding the SEC Practice Section's jurisdiction, including the scope of the Special Investigations Committee, to audits of financial institutions exempt from filing with the SEC by section 12(i) of the 1934 Exchange Act.

A further extension of the jurisdiction of the SEC Practice Section is now being acted on. AICPA members are voting by mail ballot on an amendment to the AICPA's by-laws that would require all firms that audit SEC registrants to be members of the SEC Practice Section. Although the SEC Practice Section has since early in its history regulated the practices of firms auditing the vast preponderance of revenues (currently 99.6 percent) of public companies, mandatory membership would be a fundamental change in a program that has always been voluntary. It would enable the Section to impose requirements without considering whether those requirements make membership appear less attractive to some members or to nonmembers with SEC clients, a consideration necessitated by criticisms over the years that the Section was structurally flawed because membership was voluntary.

The Public Oversight Board is a unique and powerful oversight body. It was created by the constitutional document establishing the SEC Practice Section, but it is fully independent. It has its own staff, nominates its own successors, selects its own chairman, and sets its own compensation. The Board has access to all aspects of the SEC Practice Section's operations, digs deeply into those operations, and systematically monitors all phases of the peer review program and the SIC process with "hands on" oversight. In the year covered by its most recent annual report, for 39 of the 80 peer reviews of member firms, the Board's staff observed the performance of fieldwork, reviewed the review team's workpapers, and attended the final exit conferences. Such oversight procedures are always followed for the peer reviews of the largest firms.

The scope and intensity of the Board's activities is evident from its annual reports, but the most important fact about the Board is that its membership is credible evidence that it can be trusted to uphold the public interest in exercising oversight and in making recommendations for improvements in the Section's operations. The chairman of the Board is former SEC Commissioner A. A. Sommer, Jr. Current members include Melvin R. Laird, former Secretary of Defense and U.S. Representative; Robert K. Mautz, one of the country's most eminent accounting academicians; Paul W. McCracken, former Chairman of the President's Council of Economic Advisers; and Arthur M. Wood, former Sears, Roebuck & Co. Chairman.

The SEC has maintained liaison with the Public Oversight Board and has exercised oversight since the SEC Practice Section was created. The SEC's oversight extends beyond the SEC Practice Section to include other aspects of the AICPA's regulatory responsibilities and the FASB, and for a number of years it has reported annually to Congress on its oversight role. Based on the reviews by the Commission's staff of Public Oversight Board files and selected peer review working papers, the Commission has concluded that "the peer review process contributes significantly to improving quality controls of members and thus should enhance the consistency and quality of practice before the Commission." (SEC Annual Report to Congress, December 31, 1985.) SEC access to information about the SIC's operations has been increased on a trial basis as part of an effort to provide the Commission with sufficient information to reach its own conclusions on the effectiveness of the SIC.

The SEC Practice Section's monitoring and remedial systems are not designed to be punitive, although sanctions may be imposed in certain circumstances. They are designed to provide assurance on quality controls, to improve quality controls and professional standards, and to provide assurance of compliance with membership requirements. Sanctions are primarily the province of other elements in the public-private regulatory system, namely, state boards of accountancy, the SEC through its enforcement actions, and the courts through criminal and civil litigation against accountants. The current vigor of the system of sanctions through litigation is illustrated by the difficulty in obtaining auditors' professional liability insurance. The SEC's recent activism is clear from its record of enforcement actions.

Monitoring, remedial, and disciplinary actions depend on standards, because standards permit performance to be judged. The ASB's work cited above thus contributes to the monitoring, remedial, and disciplinary efforts. The AICPA's code of ethics contributes similarly. It is therefore significant that the code has been carefully reviewed to see how it can be improved. The Special Committee on Standards of Professional Conduct for Certified Public Accountants (Anderson Committee) has completed its work and published its recommendations, and steps are underway to adopt proposed revisions.

Many of the Anderson Committee's recommendations would extend requirements now applicable to members of the SEC Practice Section to AICPA members whose firms are not in the Section—required quality control review and continuing education requirements, for example. However, the revision of the code, which is designed to improve its relevance and effectiveness, would affect all members. In addition, the proposed new standards contain a section providing guidance for making decisions on the types of services that are compatible with the required integrity and objectivity of CPAs and with the need to safeguard the public interest. Finally, the committee has recommended improvements in the structure for handling complaints, including enhanced coordination of the disciplinary and enforcement procedures of the AICPA and state regulatory bodies.

CONCLUSION

Some of the initiatives cited above are still in process. All ASB exposure drafts, for example, are subject to the ASB's due process procedures, which require consideration of comments received from practitioners and other interested parties. Nevertheless, the initiatives address major concerns expressed at the Subcommittee's hearings, and given the sweep and difficulty of the issues being addressed and the degree of change they could bring to the financial reporting process, the pace of change has been very rapid. We believe that the AICPA is acting responsibly in the public interest, that the current public-private regulatory system has been effectively fulfilling the objectives of the financial reporting process, and that no statutory initiative to change the financial reporting process is necessary.

Appendix A

Statements of Financial Accounting Standards Issued Since February 1985

No.	***Title***
83	Designation of AICPA Guides and Statement of Position on Accounting by Brokers and Dealers in Securities, by Employee Benefit Plans, and by Banks as Preferable for Purposes of Applying APB Opinion 20
84	Induced Conversions of Convertible Debt
85	Yield Test for Determining whether a Convertible Security Is a Common Stock Equivalent
86	Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed
87	Employers' Accounting for Pensions
88	Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits
89	Financial Reporting and Changing Prices
90	Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs
91	Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases

Appendix B

SEC Staff Accounting Bulletins and Financial Reporting Releases Issued Since February 1985

Staff Accounting Bulletins

No.	Title
58	LIFO Inventory Accounting Practices
59	Views on Accounting for Noncurrent Marketable Equity Securities
60	Views Regarding Accounting for and Disclosure of Certain Financial Guarantees
61	Adjustments of Allowances for Business Combination Loan Losses—Purchase Method Accounting
62	Interpretations Regarding Discounting by Property-Casualty Insurers
63	Views on Application of SFAS No. 68, "Research and Development Arrangements"
64	Views on SAB Applicability, Common Stock Reporting, Redeemable Preferred Stock Accounting, and Issuance of Shares Prior to Initial Public Offering
65	Views on ASR Nos. 130 and 135 Regarding Risk Sharing in Business Combinations Accounted for as Pooling of Interests
66	Interpretations Concerning Bank Holding Company Disclosures of Foreign Loans
67	Interpretations Regarding Restructuring Charges

Financial Reporting Releases

No.	Title
18	Business Combination Transactions—Adoption of Registration Form
19	Business Combination Transactions—Adoption of Registration Form—Foreign Registrants
20	Rules and Guide for Disclosures Concerning Reserves for Unpaid Claims and

Claim Adjustment Expenses of Property-Casualty Underwriters

21 Technical Amendments to Rules and Forms

22 Technical Amendments to Rules and Forms

23 The Significance of Oral Guarantees to the Financial Reporting Process

24 Disclosure Amendments to Regulation S-X Regarding Repurchase and Reverse Repurchase Agreements

25 Technical Amendments to Rule

26 Interpretive Release About Disclosure of the Effects of the Tax Reform Act of 1986

27 Amendments to Industry Guide Disclosures by Bank Holding Companies

28 Accounting for Loan Losses by Registrants Engaged in Lending Activities

Appendix C

Selected AICPA Pronouncements Since February 1985

AUDITING GUIDANCE

Statements Issued by the Auditing Standards Board

No.	*Title*
50	Reports on the Application of Accounting Principles
51	Reporting on Financial Statements Prepared for Use in Other Countries
—	Statement on Standards for Accountants' Services on Prospective Financial Information, Financial Forecasts and Projections
—	Statement on Standards for Attestation Engagements, Attestation Standards

Outstanding Exposure Drafts Issued by the Auditing Standards Board

— The Auditor's Responsibility to Detect and Report Errors and Irregularities

— Illegal Acts by Clients

— The Auditor's Consideration of an Entity's Ability to Continue In Existence

— The Auditor's Responsibility for Assessing Control Risk

— Analytical Procedures

— The Communication of Control-Structure Related Matters Noted in an Audit

— Communication With Audit Committees or Others With Equivalent Authority and Responsibility

— The Auditor's Standard Report

— Examination of Management's Discussion and Analysis

— Auditing Accounting Estimates

Special Report

— Report of the Special Task Force on Audits of Repurchase Securities Transactions

Auditing Procedure Studies

— Auditors' Use of Microcomputers

— Audits of Small Business

— Auditing the Allowance for Credit Losses of Banks

Audit and Accounting Guides

— Audits of State and Local Governmental Units

— Audits of Credit Unions

— Audits of Entities with Oil and Gas Producing Activities

— Guide for Prospective Financial Statements

ACCOUNTING GUIDANCE

Statements of Position Issued by the Accounting Standards Executive Committee

No. Title

85-3 Accounting by Agricultural Producers and Agricultural Cooperatives

86-1 Reporting Repurchase-Reverse Repurchase Agreements and Mortgage-Backed Certificates by Savings and Loan Associations

Outstanding Exposure Draft Issued by the Accounting Standards Executive Committee

— Accounting by Prepaid Health Care Plans

Notices to Practitioners

— Accounting for Foreign Loan Swaps

— Acquisition, Development, or Construction (ADC) Arrangements

Issues Papers

— Accounting by Health Maintenance Organizations and Associated Entities

— Accounting for Estimated Credit Losses on Loan Portfolios

— Accounting for Options

PRONOUNCEMENTS AFFECTING MONITORING AND DISCIPLINARY MECHANISMS

Code of Professional Ethics

— Report of the Special Committee on Standards of Professional Conduct for Certified Public Accountants, "Restructuring Professional Standards to Achieve Professional Excellence in a Changing Environment"

SEC Practice Section Rules

(The parenthetical citations refer to the relevant text of the Section's constitutional document, *Organizational Structure and Functions of the SEC Practice Section of the AICPA Division for CPA Firms*.)

— Expanded the applicability of various membership requirements and the scope of the Special Investigations Committee to audits of financial institutions that would file reports with the SEC except for section 12(i) of the 1934 Exchange Act, and to audits of sponsors or managers of investment funds whose financial statements appear in the annual reports or proxy statements of such investment funds. (Appendix D, item 2.)

— Extended the membership requirement for second partner review to include discussions with the engagement partner and review of selected working papers. (Membership requirement IV. 3. f, as elaborated in Appendix E.)

— Imposed a membership requirement mandating the communication to all professional personnel of a written statement that enunciates the philosophy and principles underlying the firm's quality controls and operating policies and procedures, with periodic reminders of required compliance. (Membership requirement IV. 3. o.)

— Imposed a membership requirement requiring the auditor to communicate six additional specified matters to the client's audit committee. (Membership requirement IV. 3. p.)

— Imposed a membership requirement mandating that firms have policies and procedures for internal consultation and for communication with the predecessor or continuing auditor when providing opinions to nonclients on accounting principles. (Membership requirement IV. 3. n, adopted September 1985, rescinded December 1986 because ASB *Statement on Auditing Standards No. 50* established similar requirements for all audits.)

— Authorized the issuance of annual reports by the SIC ("Report on the Activities of the SECPS Special Investigations Committee," issued May 1985 and May 1986).

Peer review requirements and guidance adopted by the SEC Practice Section's Peer Review Committee

(These pronouncements are included in the latest revision of the Peer Review Manual.)

— Required that peer review reports cite the reviewer's letter of comments if one has been issued.

— Required that review teams identify those SEC audit clients accepted since the last peer review where a Form 8-K or similar public filing reported that the former accountant resigned or declined to stand for reelection, or that there had been a disagreement, and required that specific review procedures be applied to such engagements.

— Made more uniform the criteria governing when a modified report should be issued and when a matter should be included in a letter of comments.

— Amended the engagement selection criteria to require that at least one audit under the Single Audit Act of 1984 be covered by peer review if one had been performed.

— Adopted an engagement review checklist for peer reviews of audits of governmental units.

— Issued guidance on how to improve internal quality control reviews ("Guide for Performing Inspections").

— Completely revised and updated the peer review program guidelines to facilitate the conduct of reviews in an effective and efficient manner.

Glossary

AICPA—American Institute of Certified Public Accountants—national organization representing the public accounting profession, prepares the CPA examination, issues auditing standards through the ASB, performs other regulatory functions through its SEC Practice Section, and provides other professional support services

ASB—Auditing Standards Board—AICPA component that issues standards for the conduct of audits of financial statements

FASB—Financial Accounting Standards Board—independent body with primary responsibility for setting the accounting principles that must be followed by businesses preparing financial statements and by auditors evaluating whether the financial statements are properly presented

EITF—Emerging Issues Task Force—group set up by the FASB in the summer of 1984, charged with identifying emerging accounting and reporting issues, an EITF consensus on appropriate accounting—reached when 13 of the EITF's 15 voting members agree with a conclusion—has the force of GAAP

GAAP—generally accepted accounting principles—the accounting principles that must be followed by businesses preparing financial statements and by auditors evaluating whether the financial statements are properly prepared—that is, prepared in conformity with GAAP

The Institute of Internal Auditors—national organization that sets standards for the conduct of internal audits and conducts programs to improve the quality of internal auditing

Public Oversight Board—independent oversight body, composed of prominent individuals, has complete access to every aspect of the SEC Practice Section's operations, exercises intensive oversight—especially on the peer review process and the work of the SIC, recommends improvements in the Section's operations, and issues an annual report on the results of its oversight activities

SEC Practice Section—the AICPA component governing firms in SEC practice, whose goal is to improve the quality of practice before the SEC through membership requirements and peer reviews

SIC—Special Investigations Committee—the component of the SEC Practice Section responsible for investigating whether allegations of alleged audit failure indicate a need for improved quality controls by the firm or improved auditing standards, may recommend sanctions, issues an annual report on its operations

Treadway Commission—National Commission on Fraudulent Financial Reporting—commission sponsored by the AICPA, American Accounting Association, Financial Executives Institute, The Institute of Internal Auditors, and National Association of Accountants, charged with studying the problem of fraudulent financial reporting and recommending measures to improve deterrence and detection