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I am very pleased to have this opportunity to visit with you since you are responsible for playing a key role in the self-regulatory structure of the profession. It is especially timely that we stand back and re-examine our entire disciplinary system since we are clearly in the midst of a fast-moving stream of events that are washing away many of our long-held policies and traditions. In short, we are in a period of transition and we need to rethink what we are doing and what our objectives should be with respect to disciplining our profession.

In doing this, we need to understand the forces that are causing us to change our rules of conduct and our approach to self-regulation. We have been caught up in separate waves of concern about protection of consumers and making corporate managements more accountable for their actions. These have led to intensive inquiries by Congress and federal agencies such as the Justice Department and the Federal Trade Commission into the structure and practices within our profession as well as those of other groups.

As you are aware, these forces have culminated in decisions of the U. S. Supreme Court that left little room for doubt that

our traditional prohibitions on advertising and solicitation could not withstand legal challenge under the antitrust laws. We have responded by voluntarily modifying our rules even though I am certain that many of us remain unconvinced that the consumer will be better served by unfettered competition within our profession.

In changing our rules, we have attempted to retain some limited restraints by continuing to prohibit direct uninvited solicitation. However, even this modest effort to avoid a completely commercial approach has been judged unacceptable by the Justice Department. Recommendations have been made within that agency to file a complaint against the Institute in federal court to set aside our rule on encroachment and the second sentence of Rule 502 on advertising and solicitation.

Our Board of Directors and Council have approved submitting to a vote of the membership a proposal to voluntarily accede to the objections of the Justice Department. However, in the course of taking this action, a majority of the Council expressed opposition to the elimination of the prohibition of direct uninvited solicitation. In addition, the Board of Directors acted principally out of the conviction that a voluntary repeal was the lesser of a set of undesirable alternatives. It was convinced

that we would not prevail in litigation and that we would be better off by retaining the right to urge our members to voluntarily refrain from direct uninvited solicitation. This right would be lost if we were to be enjoined under a court decision that our present rule is in violation of the antitrust laws.

While no one can be absolutely certain of the outcome of a vote by our members, I believe it is highly unlikely that 2/3 of those voting will favor modification of the present rule, especially in view of the attitude of our governing council. If I am correct, it seems almost certain that the Justice Department will provide us with the opportunity to prove our case in court after the vote has been completed.

We will, of course, do our utmost to argue at the highest possible level of the Justice Department that our need to maintain our independence as auditors justifies, as a matter of public policy, retaining a restriction on uninvited solicitation. I must confess, however, that I am not sanguine about our success in avoiding the filing of a lawsuit or of prevailing in litigation. While it may seem futile to spend perhaps as much as $1 million on a case involving very poor odds, we are prepared to do so if that is the will of the membership.

In the meantime, I believe it would be inappropriate to go ahead with discipline under pending cases until such time as the outcome of the vote is known. Complaints should be received and held on file until that time. In my view, however, such a policy should not be generally announced to the membership because we may want to continue enforcement during litigation and it would be difficult to resume enforcement having once announced a hiatus period.

In connection with the proposal to remove the second sentence of Rule 502, I would like to express a personal view that those who view the present limitations on solicitation as the last bastion of professionalism are vastly overstating the case. If this is all we have as a basis for our professionalism, we have no right to lay claim to being a profession. Competence, quality of service, objectivity, integrity, and a learned body of knowledge are all of far greater importance.

It seems very likely that within the next year or two most of our behavioral type rules of conduct will either have been eliminated or rendered unenforceable under court order. Remaining will be the rules dealing with independence, the payment or receipt of commissions, confidentiality of client information, and the enforceability of technical standards. Even the rule on confidentiality is likely to be further eroded by attempts of plaintiffs to invoke discovery proceedings.

These changes will have a significant impact on our disciplinary machinery and make it imperative that we give careful thought to what our future course ought to be. The balance of my remarks are devoted toward this end.

I believe it is clear from recent developments in Washington that the credibility of self-regulation of our profession rests squarely on our ability to effectively discipline both individual CPAs and CPA firms for being found guilty of substandard work. If this is so, it follows that we should be placing our full emphasis on surveillance of practice to identify substandard work as well as violations of our rules on independence. In a sense our independence requirements are a part of our technical standards in that they are likely to come into play in connection with substandard work. In these circumstances, violations of our independence rules might be viewed as constituting deliberate participation in the issuance of misleading financial statements. This, of course, can lead to criminal charges which are far more serious than civil damage suits stemming simply from violations of technical standards.

If we are to now turn our full disciplinary energies toward substandard work, we must address a number of difficult questions that do not lend themselves to simple answers. These questions are as follows:

1. What constitutes substandard work?

2. How do we fit sanctions to the degree of severity of substandard work?

3. What institutions should make determinations of guilt or impose sanctions?

I will discuss these in the order mentioned.

WHAT CONSTITUTES SUBSTANDARD WORK

At first blush it might appear to be a simple matter to determine what types of substandard work should give rise to discipline. Most people feel that they know substandard work when they see it. But when it comes to evaluating the performance of practicing CPAs there are many degrees of substandard work that make disciplinary decisions very difficult. Indeed, in deciding circumstances when auditors should be held liable, even the courts have had great difficulty in defining where the dividing lines should be drawn.

Probably everyone would agree that a conscious violation of the profession's technical standards or a knowing participation in the issuance of misleading audited financial statements call for a disciplinary action. Less clear is whether an honest oversight or mistake by an auditor should result in a sanction.

Even if it should not, is there a point of such gross negligence or recklessness that a sanction should be imposed and where should the line be drawn? Also, to what extent should it be required that harm resulted before the disciplinary process comes into play?

In most cases involving questionable technical performance a further complication is the difficulty in determining the technical standard to which the practitioner should be held. For example, when a mangement fraud has not been detected by an auditor, it is seldom clear whether a normally prudent auditor exercising due care would have uncovered the fraud.

Often the technical standards are not sufficiently defined to be able to measure performance. For instance, the responsibilities of auditors associated with unaudited financial statements have yet to be fully determined. Also, the Continental Vending case is an example of a specific case where the existence of an appropriate standard to apply was unclear.

Tribunals faced with making decisions about the adequacy of technical performance, whether it be the courts, the SEC, state boards of accountancy, or the profession's trial boards, find themselves more often than not making subjective judgments about what the defendent auditors should have done under the circumstances. Such judgments are always made with the benefit

of hindsight when it is known that a mistake was made and what caused it. It would take a body of saints to prevent such knowledge from causing a bias in the judgment about what the auditors should have done at the time when the present information was not known.

Under these circumstances it seems clear that the standards for determining misconduct are, to a large extent, established ad hoc by subjective judgments made with the benefit of hindsight. Broad concepts such as negligence, recklessness and scienter may be followed but applying them to a specific set of facts is largely a subjective process. Thus, the profession is in a position of having to impose discipline on the basis of a shifting set of standards subjectively determined by hindsight. This is not to say that the standards of the profession are useless or should be ignored for disciplinary purposes. But compliance with them is no guarantee that in a particular set of circumstances an auditor will or should be held blameless. There is simply no substitute for the application of good judgment when it comes to imposing discipline for substandard work.

As previously noted, it is one thing to describe in a general way what types of substandard work should give rise to discipline but it is quite another to make judgments about whether in a specific case misconduct that should result in

discipline has occurred. Nevertheless, the profession, the courts, and governmental regulatory bodies should and must do the best they can to impose punishment fairly for offenses under broad categories, however imprecise they may be.

HOW DO WE FIT SANCTIONS TO THE DEGREE OF SEVERITY OF SUBSTANDARD WORK

The range of possible sanctions that might be imposed by the profession's organizations against members or firms include:

1. Letters of constructive criticism.

2. Private or public administrative reprimands.

3. Private or public censure by trial boards.

4. Remedial actions, including peer reviews and attendance at specified educational courses.

5. Suspension or expulsion from membership in the profession's organizations.

Based upon experience to date, it seems clear that a great deal of judgment must be exercised in applying these sanctions. However, if uneven justice is to be avoided, we must develop more specific guidelines on when a particular sanction should be imposed. I admit that this is a difficult task but if we are going to step up our enforcement of technical standards, it will be imperative to have such guidelines to assure members that they are being fairly treated.

I suggest that the professional ethics division turn its attention to this need as soon as possible in anticipation of what lies ahead.

WHAT INSTITUTIONS SHOULD MAKE DETERMINATIONS OF GUILT OR IMPOSE SANCTIONS?

A major question to be addressed is whether the present forms of discipline of the profession are sufficient to assure the levels of performance that can reasonably be expected, given the nature of the functions involved. The Commission on Auditors' Responsibilities concluded:

> "The Total system as it now exists, including litigation and actions by regulatory bodies, provides a reasonable level of protection to the public. Nevertheless improvements in the system are warranted and should be implemented."

At the hearings of the House Subcommittee on Oversight and Investigations chaired by Congressman Moss, contrary views were expressed. The SEC and members of Congress believed that a more stringent system of regulation of CPA firms practicing before the SEC is necessary either within the AICPA or a quasi-governmental body under the control of the SEC. It can be argued

that the threat of unlimited legal liability is sufficient, standing alone, to assure that the profession will take all reasonable steps to avoid audit failures. Some have questioned whether it makes sense for the profession to add its own layer of discipline on top of legal liability, SEC sanctions, and the possible suspension by state boards of accountancy. Although this addition may not be necessary from the standpoint of needed restraining pressures, it is likely that neither the profession nor the public is prepared to accept a complete abdication of disciplinary responsibility by the profession. To the contrary, there are strong pressures to increase the amount of self-regulation and make it more effective.

Despite these pressures, I believe we ought to stop and ask ourselves how many layers are really necessary to properly protect the public against malpractice. I am troubled by the suggestion of the SEC and some of our members that the state boards should now be stimulated into aggressive action. It seems to me that this will only aggravate the present duplication whereby a practitioner can be subjected to multiple disciplinary proceedings by the courts, the SEC, the state societies, and the AICPA in addition to the state boards for the same offense. This strikes me as gross over-kill.

Perhaps the time has arrived for a complete overhaul of the disciplinary structure. One possible solution to the present and potential duplication and credibility problems might be the creation of an independent non-profit organization, similar in concept to the FASB, to receive and investigate all complaints and to conduct hearings to make a determination of guilt or innocence. Such an independent, free-standing body could provide its findings to the state boards, the state societies, and the Institute for use in imposing appropriate sanctions. This would eliminate the duplication and might well be more effective in dealing with the highly complex technical standards cases that we must increasingly come to grips with.

I have not developed the details of such an approach but it offers interesting possibilities, including the utilization of non-members of the profession such as members of the bar or retired judges. Financing would, of course, be a problem but I believe that it could be solved by a combination of contributions and fees required as a condition to membership or holding of a CPA certificate.

Whether or not this is a good idea, I have suggested that the time is ripe for NASBA and the Institute to jointly reexamine the whole approach to disciplining the profession. Let's not

engage in adding more layers and patches to what is obviously an outdated structure. It seems to me to be a form of madness to proceed with attempts to crank up fifty different jurisdictions with all of the lack of uniformity, duplication, and unevenness of sanctions that such a course entails.

Until an alternative approach is developed, however, we ought to move forward with improving our present integrated disciplinary machinery and bringing all of the state societies within the program. Also, we should be considering what restructuring is required to devote our main emphasis and attention to the surveillance of practice and dealing promptly and effectively with cases involving substandard work.

In this connection, I intend to explore with the Board of Directors the desirability of converting the present practice review function to being a research and surveillance arm of the professional ethics division. I believe the time has come to adopt a much more aggressive approach to searching out malpractice. This will require a staff group whose sole function will be to utilize every source available to search out evidence of substandard work that should give rise to discipline.

The practice review function is presently intended to be educational and not punitive. While it has done useful

work in the past, I believe that we can no longer afford the luxury of this soft approach. In any event, our technical information service division is fully capable of providing the guidance needed by practitioners and we have extensive CPE programs to meet the educational needs of our members. I hope that the AICPA's Board and Council will agree that we should now move to a practice review function whose mission is to identify cases requiring discipline.

A key problem that must be resolved in dealing promptly and effectively with technical standards cases is finding a way to take disciplinary action immediately even though litigation is involved in an alleged case of substandard audit performance. Because we do not have subpeona powers, we have found litigation to be an insurmountable barrier to prompt action. We cannot compel production of witnesses or evidence and our files are open to discovery by adverse parties in litigation.

Most CPA firms take the position that the profession should not attempt to preempt the judicial system. On the other hand, the SEC, members of Congress, and other critics of the profession's disciplinary efforts find our policy of deferring action to be wholly unacceptable.

To solve this problem and avoid a new federal regulatory body from being established, somebody will have to give ground.

Either the SEC and members of Congress must be persuaded by the merits of our policy or we will have to voluntarily comply with immediate disciplinary proceedings under whatever protection or privilege can be secured through legislation to prevent unfair influence on pending litigation.

This issue is currently under study by the Public Oversight Board. A comprehensive study of all the legal questions and implications has been completed which essentially concludes that there are no existing legal barriers to immediate disciplinary proceedings where litigation is involved. I cannot predict what conclusion will be reached by the Public Oversight Board, but it may well conclude that our present policy is not warranted and should be changed. If so, it would substantially complicate the process of handling technical standards cases. We ought to be considering how to deal with this problem in the event it should materialize.

Another unrelated suggestion which I would like to make pertains to the recent trends which have surfaced in our ethical rulings and interpretations. It seems to me that we have fallen victim to attempting to replace judgment with a mass of detailed guides that attempt to cover every conceivable circumstance however inconsequential or infrequently encountered. I believe this tends to be counter-productive in that the objective gets

lost in the detail and our members become confused by the growing body of dos and donts. I urge that we reexamine our approach and place more emphasis on stating the broad objectives without attempting to be quite so definitive.

One final matter that I would like to touch on is the matter of scope of services. As you know, the question of proscribing certain types of consulting services is currently under study by the Public Oversight Board. While its conclusions will not necessarily apply to all our members, it will be difficult to restrict them only to SEC Section members, particularly if they are based on concerns about the effects on audit independence.

Fortunately, I believe that the POB is not inclined to find that proscriptions of MAS are necessary. If this proves to be the case, it may pose problems in our relations with the SEC but it will at least avoid what will otherwise be a difficult question for the professional ethics division to resolve. Even so, we should be prepared to take prompt and appropriate action with respect to our independence rules as soon as a decision on the scope of services question is resolved.

CONCLUSION

We are obviously operating in times of rapidly changing expectations and needs. The decision as to whether the profession will be allowed to remain self-regulated hinges to a considerable degree on how well we police the quality of work being performed by the profession. It is imperative, therefore, that we concentrate our future efforts on disciplining our members for substandard work and to do this far more effectively than we have in the past.

This will be extremely difficult to do but we must find a way. We must rethink our traditional approaches and devise new solutions. It is urgent that we do this.

By working together, the state societies, the AICPA, and NASBA can do what is right for the public and the profession, which is not necessarily inconsistent. Your task is a vital part of the profession's program to regain a high level of credibility and you are to be commended for devoting your time and effort to this very important mission. I urge you to continue to do so.