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REMARKS BEFORE ERNST & ERNST PARTNERS MEETING

by

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I welcome this opportunity to discuss with you a variety of matters that are presently of concern to our profession. Since I am among friends I intend to speak with considerable candor about these matters.

I would like to start by describing the current diversity which exists in what I call the house of public accounting and what this implies for the future of our profession.

The recent annual meeting in Atlanta was the 86th in the history of the Institute and its predecessor organization. In 1887, the first year of existence of the American Association of Public Accountants, it attained a membership of 31. By 1947, sixty years after establishment of the national society and just after the end of World War II, the membership numbered about 9,000. Today the American Institute consists of more than 96,000 members.

Such growth is of course gratifying. But change in size -- of a city, a company, or a professional society -- almost always brings about changes in character and operational needs.

When the profession numbered in the hundreds or low thousands, communication among the entire group was not too difficult. Also, the scope of practice in those days was relatively narrow and its boundaries plain. The profession was largely homogeneous; there were few

dissimilarities between the areas of expertise of one CPA compared with those of another, and the differences in size of firms were not great. Today, in sharp contrast, the accounting profession includes a range from sole practitioners to firms with several hundred partners and total personnel running into the thousands.

As we all know, there are still some people who automatically equate bigness with badness -- not so much in the professions perhaps as in business. And this attitude strikes me as rather unrealistic. For obviously, an economy composed entirely of small businesses could not economically manufacture jet airliners and space crafts, or process and distribute all the food required by a nation of 200 million people, or do a myriad of other things that make life healthier and happier for vast numbers of human beings.

It is equally true that accounting firms consisting of two or three partners could not audit a corporation having scores of plants, selling nationwide, and possibly doing business overseas as well as domestically. So as some users of accounting services have grown to very large size, the firms they engage have grown proportionately.

Similarly, in response to economic and technological

evolution, the range of services offered by CPAs has expanded. Until the second or third decade of this century, the bulk by far of professional practice consisted of accounting work and auditing. The services of auditing, in fact, remains the only one that CPAs are specifically licensed to do.

With the advent of the income tax, tax advice and preparation of returns became a substantial part of CPAs' practice. And now, in the more recent years, management advisory services have become a major segment of practice.

The continuing evolution of society has led in accountancy -- as in most other professions and fields of learning -- to increasing specialization. I am sure that generalists continue to constitute the majority of our profession, but the proportion of CPAs who concentrate on audit work or tax service exclusively is undoubtedly mounting. In addition, the growth of management advisory services has brought into accounting firms considerable numbers of highly ranked specialists who are not CPAs but industrial engineers, mathematicians, electronic data processing experts, and so on.

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In the light of all these circumstances -- the growth in the size of our profession -- the evolving

diversity of services -- the disparity in size of practice units -- the variety of backgrounds of persons practicing within firms -- is it any wonder that there are tensions in the atmosphere and stresses in the structure of the house of accountancy? It seems to me that these tensions have been manifesting themselves more frequently of late in the form of a growing uneasiness that all is not as well as it should be. Generally, however, we have been reluctant to talk about our tensions openly. Perhaps from fear of accentuating them or in the hope that by ignoring them they will spontaneously go away. My own inclination is to regard intraprofessional stress like psychic stress in an individual -- if bottled up and repressed, it can produce serious disability, but if brought into the open and aired, it can be resolved.

Accordingly, I want to lay before you some personal thoughts on the characteristics of our profession which give rise to tensions, on how those tensions come to light, and on steps that might alleviate or eliminate them.

The characteristic of our profession that is most pertinent in this respect is that the house of public accountancy has two wings -- the local-firms wing and the large-firms wing. I'm sure all of you are fully familiar with the characteristic of each but I would like to draw a brief profile of each one for purposes of making a point.

Typically, a local firm has one or, at most, only a few offices, all in a limited geographic area. The number of partners is small and their relationship is usually that of a true partnership. A large part of the firm's activity consists of tax work. Returns are prepared for individuals and closely-held companies. And some tax counseling is done, although specialization in tax planning is likely to be the exception rather than the rule. In this area of its work, a local firm faces competition from unlicensed tax preparers and small law firms.

Another very considerable part of a local firm's activity is accounting work for small and medium-size businesses and drawing up unaudited financial statements for their managements. Also some opinion audits are performed for closely-held companies.

In this area of activity, the local firm faces potential competition from non-certified accountants, service bureaus and banks.

Beyond these main kinds of work, a local firm provides consulting on a variety of matters generally on an informal basis.

Now, if we walk over to the other wing of the house of accountancy, we see not only that a large firm has a great many partners and offices in all parts of the

nation, all under a central management, but that it operates more like a large corporation than a partnership. Also the large-firm wing is really composed of three sections.

The first is that of auditing and accounting. The clients here, as in the other two sections, include big, publicly held corporations. In this area of activity, a large firm faces the possibility of competition only from other accounting firms of comparable size. In addition, however, it experiences pressures and constraints emanating from the SEC, the FASB, the stock exchanges, the CASB and from the constant awareness of exposure to legal liability.

The second section of the large-firm wing is made up of the tax specialists. They include not only CPAs but lawyers and other non-CPAs. This group has pretty much a realm of its own in a large firm and a status which derives from the natural attractiveness that prospects of tax-savings have for the firm's clients. In this area of work, a large firm faces competition, although not to any widespread extent, from large law firms. A fact to note is that the tax work done in a local firm is usually performed by a generalist while the tax personnel of large firms are almost always specialists.

The third section of the large-firm wing is that

of management advisory services. Here we find a great variety of disciplines and background experience, and, understandably, the non-CPAs involved in rendering the services often do not feel any great bond with the accounting profession. Further, they tend not to identify personally with the firm to the same extent that the CPAs do. The accounting and auditing personnel are likely to have ambivalent feelings about the MAS people, and the tax specialists have little work in common with them. Also consulting engagements are generally not repetitive as is the case in accounting, auditing and taxation.

In this area of activity, a public accounting firm faces competition from the large consulting firms.

The non-CPAs practicing within the MAS section of the big firm wing are to a large extent confused about where they should live. The CPA tenants living in the other sections of the house can't make up their minds whether to treat them as part of the family or as poor relatives. The consultants yearn for a sense of identity and recognition of their professionalism. Finding a less than loving attitude at home they are increasingly looking to the Institute of Management Consulting which promises through support of pending legislation in California to offer them recognition and identity through licensing

and accreditation.

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From this brief review of the characteristics of the various groups residing in the house of accountancy it is clear that the outlook and the aims and needs of members of our profession can be very different, one from another.

In the view of many small firms, for example, it is the failure of the large ones to supervise their far-flung organizations properly, or the fear of offending their large corporate clients, that leads to the lawsuits which give the whole profession a bad press, damage our credibility as auditors, increase the disposition of people to sue CPA firms, and cause the rates for liability insurance to rise.

The small firms claim the Institute is dominated by the large ones, so that accounting procedures are prescribed which, while appropriate for application to big corporations, are unnecessary for a small firm's clients and impose needless burdens on small practitioners.

The small firms believe the large ones engage in unseemly competition and seek additional business in ways that are ethically doubtful and employ resources that a local firm simply cannot match. They deplore cases of the displacement of small firms when their clients go public.

On their side, the large firms feel that the small ones are loath to accept change and therefore resist measures desirable for the progress of the profession. They think the Institute pays too much attention to this opposition. The large firms blame the smaller ones for doing poor work in registration statements and other filings which raises complaints from the SEC and stock exchanges

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All the dissatisfactions and complaints of members converge sooner or later upon the Institute. Members urge it to do something about unfavorable press treatment when, in fact, much of the bad publicity flows from situations over which the Institute has absolutely no control and which it does not even know about until the stories break in the newspapers. Exhortations from different segments of the membership on some issue or other are often diametrically opposed.

Because I am at the convergence point of all these tensions and pressures, I am perhaps unduly concerned about them, and I must admit that, so far at least, we have got along fairly well by letting events more or less take their own course. But I have come increasingly to the opinion that we can no longer rely on a method of muddle-through. As I said at the outset, I think the tensions and stresses

I have outlined should not be politely ignored but should be openly acknowledged and examined. Beyond that, we should seriously consider the ideas that have been expressed, even if somewhat offhandedly, of how our diversities might be adjusted in such a way as to bring about a healthy coexistence.

For example, one sometimes hears suggestions that it might be well if the Institute were to split, the small firms having an organization of their own, and the large firms a separate one. I am strongly of the opinion, that such a move, far from resolving problems, would compound them. In the first place, it would bring about the duplication of many services to practitioners -- publications, informational and educational programs, and the promulgation and enforcement of standards, to name a few.

Secondly, it would blur public understanding of the designation "certified public accountant" and dilute the prestige attached to it. Finally, and probably most damaging, it would institutionalize disagreement and thereby probably intensify it over time.

Other suggestions of a divisive nature are that tax services and management advisory services might be split off from accounting and auditing, or that firms should be prohibited from doing MAS work for audit clients. In

my view such courses of action would be unlikely to be acceptable to anyone -- the clients, the business community or the CPA firms themselves.

It seems plain to me that instead of splitting the house of accountancy and moving part of it onto a new foundation somewhere, the sensible action is to effect some rearrangement of rooms, and to improve the functional qualities of the structure. We badly need, and promptly, a remodeling plan. We need a blueprint of where we are headed.

In contemplating such a plan for the future we need to address a basic threshold question. Do we want to be a narrowly based profession, confined primarily to attesting to financial statements or do we want to be a broadly based profession offering a wide range of analytical and advisory services designed to benefit a variety of users including management, investors, creditors, governmental units and the general public. This may seem to be an academic question since the profession is already engaged in providing services that go far beyond merely attesting to financial statements. However addressing ourselves to the question of what we want to be can be very helpful in providing guidance for our future actions.

It seems to me to be self-evident that we want

to be a broadly-based profession. There are, however, some fundamental limitations to our scope which will always be imposed by the natural forces in the marketplace. For example, we must not engage in services which are staked out by law for other professions. Neither should we as a matter of self-interest provide services which clearly result in an intolerable risk of conflict with our ability to attest to financial statements. Furthermore if there is no demand for a particular service or if other groups or disciplines are able to offer a superior service it is unlikely that such service would remain a part of our repertoire.

On the other hand, if the marketplace looks to us for a much-needed service we ought not rule out such a service on the grounds that we don't want to broaden our profession. We ought to apply our talents to provide whatever services are needed, even if it means that we must include in our house of accounting a variety of disciplines and skills.

If we make a conscious decision to be a broad-based profession that involves skills beyond those required solely for expressing opinions on financial statements a number of things about the future of our profession becomes more evident.

First of all it seems clear that the Institute as the principal membership organization of the profession should make membership available to the non-CPAs doing professional work in public accounting firms. Unless we take this step we will discourage talented individuals with diverse backgrounds from entering or remaining in our professional firms. To restrict membership to CPAs, as at present, is to opt for a narrow-based profession in which even the quality of our auditing may suffer. Furthermore it is unrealistic to expect any single accreditation scheme, such as the CPA exams, to be able to test competence in all the complex areas of practice that exist today or that are likely to exist in the future.

Perhaps we should frankly recognize the diversity of services by moving toward a broader title which would clearly denote a broadly based, licensed profession and serve as an umbrella.

It might cover the existing services of accounting, auditing, tax and management consulting as well as other services which might evolve in the future. And under such a general identification the several specialities could be recognized and accredited and the CPA designation would continue to denote a specialist in accounting and auditing.

If we were to adopt such a pattern, entrance to the profession might be by an examination sufficiently broad to test a candidate's competence to perform as a generalist -- perhaps at the level of non-publicly held companies. Additional examination might establish the degree of competence in auditing, taxes and various branches of management consulting necessary to offer such services to publicly-held companies.

Let me quickly admit my awareness that the ideas of a new umbrella designation for the profession is a radical departure from tradition and thus not likely to be quickly embraced. It serves to illustrate, however, the kind of exploratory thinking that we must engage in if we are to find imaginative solutions to the growing tensions with which we are faced.

Regardless of whether a broader title is seen as a desirable future goal it is increasingly clear that the growing complexities of practice and variety of services will ultimately demand formal accreditation and recognition of specialization to assure that services are rendered with an acceptable level of competence. This will not be achieved however without a great deal of difficulty. For example, it is hard to imagine acceptance of the concept of a specialist in auditing when this is the basis of

granting the CPA certificate. However it may come to pass that accreditation as a specialist would be required to audit publicly held companies. It is just possible that this might prove to be a key to solving the displacement problem when clients go public.

In the tax area it may be that specialization in the highly complex areas such as corporate reorganization or estate taxes should be considered. Similarly in the MAS area we may have to define those areas of service that can be performed by a generalist and the more complex areas that require a higher degree of competence and thus specialist accreditation.

Whatever steps are taken toward formal specialization, they are likely to be accepted only after a united and broadened profession has become our acknowledged goal and after we have developed careful definitions of specialization that will not pose undue hardship or threats to existing practitioners in both large and small firms.

Even if formal recognition of specialization does not achieve early acceptance, it seems imperative that we set up better lines of communication among the present de facto specialities within the profession. I don't suggest the establishment of formal sections at this time because this might aggravate our tensions and lead to polarization

of the various groups. However, I believe it would be feasible and desirable to hold national or perhaps regional technical conferences for some of the present areas of specialization. Such conferences could lay the groundwork for breaking our over-sized membership down into logical and more manageable sized groups.

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Any discussion of the causes of present tensions within the profession would be incomplete if it failed to include recognition of the need to seek an early solution to the question of whether application of all the generally accepted accounting principles to small companies is really necessary or useful. This may require action by the FASB in which case it is outside our control. Alternatively, however, it may call for a reexamination of the classes of service that we should be offering. Perhaps we should abandon the presently confused concept of "unaudited" financial statements and substitute two classes of service -- one class designed solely for management use with appropriate safeguards and another class designed to lend a limited degree of credibility to financial statements and other data based on well defined sets of limited procedures and standards. There is an ever-increasing demand for such a middle class service. Comfort letters, forecasts,

interim reports of publicly-held companies, reviews of government programs to determine economy, efficiency and effectiveness under GAO standards, and reports on adequacy of record keeping and internal control are all examples of the growing need for forms of limited assurance that fall short of the scope of the traditional opinion audit. While the formal recognition and adoption of a middle ground may not be the ultimate answer, I have the uneasy feeling that we are not presently being fully responsive to the realities of practice and the needs of the users of our services. In fact, without fully realizing it, I believe that our responsibilities when associated with unaudited statements have already reached the point where we are in fact conveying a degree of limited assurance. The sooner we recognize this and establish standards for giving such limited assurance the better off we may be.

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In considering a plan for the future we also must give careful thought to a number of problems that are highly interrelated, having to do with questions of liability, strengthening the hand of auditors, regulation of the profession and the problems posed by the lack of a national system of accreditation. Each of these is a complete subject in their own right and time does not

permit me to go into detail. But I would like to point out that as an integral part of the functioning of the capital markets we cannot escape for much longer the scrutiny of Congress. I believe that our turn to be reviewed and to be more directly and heavily regulated lies just down the road, perhaps two to four years away.

Assuming that concurrently the FASB issues pronouncements that severely restrict the latitude of one or more powerful industry groups I foresee a convergence of attention in Congress on our profession that will almost inevitably lead to some form of involuntary outside regulation.

If this analysis of the immediate future is valid it suggests that serious consideration be given to taking the initiative before it is too late. One program that we might follow would be to seek legislation encompassing provisions to strengthen the position of the auditor, place upper limits on the amount of liability exposure, require audits of companies below the present cut-off point of the SEC and create a Federal Board of Accountancy empowered to issue a national certificate and with subpoena powers which it could delegate to the disciplinary machinery of the profession.

I'm certain that at least a part of what I just

listed is somewhat shocking at first blush. It may not be the right course of action but considering what appears to be ahead we ought to be devoting careful thought to the various alternatives that might be pursued.

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I've already spoken longer than I intended, and yet have touched on only some of the disparities of activities and the many cross-currents of interest that we have to deal with. I believe the time is at hand for us to take a hard look at what we are and where we want to go. We need to decide whether we should be broad or narrowly based. I emphasize, that in pursuing the answer, we must hold to unity as an indispensable element of our goal. Let's not tear our house of accountancy down or cut it in half. Let's do some remodeling to make it a better place to live. I believe that the plans we form must be evolutionary rather than revolutionary so that the continuity of our work will be maintained even as we progress. At the same time, we should not shrink from challenging any practice or pattern merely because "that's the way we've always done it." We must take to heart the fact that new times bring new obligations and we must dispense with intra-professional strife and get on with the job of serving the public interest better.

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