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WHO ACCOUNTS FOR ACCOUNTANTS

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1976 Mountain States Conference
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WHO ACCOUNTS FOR ACCOUNTANTS

The public accounting profession is currently being pressed by a number of groups to account for itself and the quality of its performance in conducting audits. For example, the SEC has been invoking mandatory quality control reviews of CPA firms which audited registrants whose financial statements were subsequently found to be unsatisfactory. Such quality control reviews are intended to serve as a form of discipline as well as a measure for prevention of similar failures in the future.

More recently a subcommittee of the Senate Government Operations Committee chaired by Senator Metcalf has been conducting an investigation of the major CPA firms and their relation to the FASB and the AICPA. By means of two separate letters and questionnaires to the eight largest firms the subcommittee is seeking a wide range of information about these firms regarding their clientele, their degree of influence in professional and standard-setting affairs, and their relationships with Federal Governmental bodies.

The stimulus for this investigation is not readily apparent but there are a number of developments which may have triggered the inquiries. When the energy legislation was being considered by Congress several months ago there was great concern that reliable financial information was not being

supplied to government by the oil and gas industry. Congressman Moss, among others, attributed part of the blame for this situation to the failure of the public accounting profession to establish proper accounting and reporting standards and to insist on full and fair disclosure in their audits. Presumably it was assumed that this failure was the result of auditors not being sufficiently independent of the large and powerful oil companies in conducting their audits.

The concern was so great that at one point it was proposed by Congressman Moss that the GAO be directed to establish accounting and reporting standards for the industry and to audit both the oil companies and their independent auditing firms. Although these proposals were ultimately modified they are an indication of a critical attitude toward the profession which prevails in the minds of many members of Congress.

More recently, members of congress have become highly alarmed by the scores of revelations about corporate illegal political contributions, bribes and unrecorded slush funds. Senators Proxmire and Percy, among others, have raised the familiar questions of where were the auditors and what are they doing to prevent similar oversights in the future. There is little doubt that this development has seriously eroded the credibility of auditors in the halls of Congress.

In addition to the Metcalf subcommittee investigation, the Federal Trade Commission is known to be conducting an inquiry into whether the CPA requirements are being implemented by the State Boards of Accountancy and the uniform CPA examination is being designed in a manner to restrict the number of entrants into the profession. We know very little about this investigation but it is no doubt linked to the overall concern on the part of both the FTC and the Justice Department about restrictive anti-competitive practices in a wide range of professions and trade groups.

The attacks on the advertising rules in the legal and medical professions are symptoms of what lies ahead for the public accounting profession. In this instance, however, the concern of governmental bodies is centered in anti-trust considerations rather than being based on allegations of failure of the profession to meet its audit responsibilities.

There is also pressure being exerted on the profession from the private sector. A coalition of public interest groups aided by Ralph Nader's organization has filed a petition for rule-making with the SEC. The petition seeks to amend Regulation SX to invoke more stringent SEC control over the public accounting profession and to require the rotation of auditors every three years for all registered companies. Here, also, the underlying assumption is that auditors are not being sufficiently independent

of their clients and are not to be fully trusted to fulfill their responsibilities. Cleraly the handwriting is on the wall. Our profession is being increasingly scrutinized and asked to account for itself as never before.

If you are a practitioner who does not practice before the SEC, has no listed companies as clients, and has never been a defendent in a lawsuit you may well ask what all these developments have to do with you. It may be that in the short run you will not be directly effected by these developments. But it would be dangerous indeed to conclude that any part of our profession can long remain isolated from the problems encountered by another segment.

It would be unwise to attempt to predict the outcome of the current investigations and pressures on the profession. However, in an age when all our customs and institutions are being challenged it is hard to be optimistic about our ability to maintain the status quo in public accounting. We are in the midst of a period of rapid change that is occurring in our technical standards, in what is expected of us and in how we are perceived by the public, particularly by government.

Our role is truly unique in that we are a private group whose actions have a substantial bearing on matters that are normally reserved to government because they effect the whole society. We are directly involved in the process of

development and reporting of financial data which is the raw material for making economic decisions. We are, therefore, a tempting target for those who advocate more extensive governmental planning and control of our economy.

We should recognize that there exists a considerable probability of governmental intervention in the affairs of our profession and we should conduct ourselves with this in mind. Those of us who may be inclined to shrug off such a threat as the problem of only the large firms will have forgotten Ben Franklin's famous warning that "we must hang together or we shall surely hang separately."

How, in fact, do we go about accounting for ourselves and demonstrating, what we so firmly believe, that a self-regulated private profession is the best vehicle for meeting the public need. And who should be responsible for doing this? Is it the task of all of us as individual CPAs or should it be left to the firms, the state societies or the Institute? Should the effort be coordinated or should all of these entities go their own way? Is the solution to simply "educate the public" about what we do or is this too simplistic?

The answers to some of these questions may seem self-evident, but if they are, we sometimes seem to be studiously ignoring them. Individual practitioners plea for their organizations to mount extensive public relations efforts overlooking

the fact that the solution rests largely on the conduct and performance of individuals. The larger CPA firms often seem convinced that there is no need to coordinate their actions with those of the rest of the profession or its organizations. Unilateral firm actions which effect the entire profession are not uncommon. State societies are sometimes guilty of criticising national programs for parochial reasons rather than on the basis of what is good for the profession. The Institute is often rendered impotent by the sharp divisions which exist within its membership. The thousands of medium and smaller-sized CPA firms feel aggrieved by an oppressive burden of technical standards that force them to charge for services their clients don't want. Their partners are all too fond of repeating the ill-informed and self-exonerating complaint that the Institute is the captive of the large firms and provides all other members with nothing for their dues.

Not all of these evidences of divisiveness are without some justification and none of them, taken individually, are necessarily fatal to the effectiveness of the profession. Indeed, a reasonable degree of diversity is necessary to our continuing vitality. But taken together, some of the attitudes and conduct which I have described constitute a form of madness in the face of the challenges which confront the profession. If ever there was a time when selfish interests should be put

aside in favor of working together toward a common set of goals it is now. We can no longer afford the luxury of going in diverse directions if we are to preserve our present freedom to practice as a self-regulated profession.

If these observations cause you to ask what we should do to give a good accounting for ourselves let me describe what we are attempting to do toward this end. We are, in fact, engaged in a whole mosaic of programs designed to assure that the profession's credibility will be maintained. As concerned CPAs you can help in this effort by your active participation and support as proposals are discussed and considered both at the state and national levels.

One of the most important initiatives that is currently underway is the Commission on Auditors' Responsibilities being chaired by Manny Cohen. The Commission has experienced difficulties in determining how to best report on its conclusions about the many complex issues which it has addressed. However it now appears that it will express its views on each issue in individual papers that will be published as they are completed. A great deal of research and deliberation has been completed and it is expected that the results will be forthcoming over a period of months starting during the last half of this year. In the meantime a preliminary paper of the Commission on the meaning of the phrase "presents fairly" in the auditor's opinion will be discussed at the spring meeting of Council early next month. I

am confident that when the work of the Commission is completed we will have a comprehensive set of papers that will go a long way toward reducing any gap between performance of the profession and expectations of the public.

Another major effort to establish that we are a responsible profession is the proposal to implement an expanded quality control review program that can be broadly applied to CPA firms of all sizes. One part of this program which is designed to apply to SEC practice will be discussed and possibly voted on by Council on May 3rd. A second part of the program will entail modifications and expansion of the existing local firm quality review program to involve more firms than in the past. I believe that Council will adopt these proposals. If so, it will be an important step in the direction of doing all that we can reasonably be expected to do to assure a high level of professional performance. We should recognize, however, that no set of procedures will ever provide an iron-clad guarantee of infallibility and we ought not panic if critics are not totally silenced by our good-faith efforts.

In addition to a quality control review program an effective system of discipline is of great importance to our case for retaining the present status of our profession. We are, as you know, in the midst of integrating the disciplinary

machinery of the state societies and the Institute and strengthening our ability to bring the more grievous cases before the State Boards of Accountancy.

In general, I believe we are trying as hard as is practicable to enforce our code of professional ethics. There are, however, significant difficulties in taking disciplinary action on technical standards cases where litigation is involved. In those cases we would be attempting to pre-empt our judicial system if we took action before court decisions have been rendered. As a result, we wait for litigation to run its course, which often takes years. By the time we can take action so much time has elapsed that it seems futile to pursue the case.

This problem is at the heart of the sharp criticism that is levelled at the profession by our detractors such as Professor Briloff. There is little doubt that it contributes heavily to the suspicion that we are not serious about maintaining a stringent system of self-regulation.

It seems to me that we ought to reconsider our position with respect to litigated cases and not attempt to take disciplinary action in these instances. Any firm which has been involved in a lawsuit is painfully aware of the severe penalties which accrue in the form of lost time, attorneys fees, damage awards or settlements and adverse

publicity. Surely these constitute punishment enough without further disciplinary penalties by the profession. The restraining pressures of potential lawsuits are so potent that few if any practitioners today are likely to be indifferent to observing technical standards. The conclusion to not take disciplinary action is reinforced by the fact that a great majority of the lawsuits do not involve disputes about technical standards but are based on audit judgments which later proved faulty when the uncertainties involved were resolved. I am persuaded that auditors ought not be disciplined in such circumstances where they have exercised good faith judgments in a responsible manner.

Another troublesome problem with respect to our code of ethics is the nagging concern that CPAs are not sufficiently independent of their clients. Our code restrictions are rather stringent in many respects and I believe they are being rigidly observed. But the feeling persists among our critics that changes in our scope of services, our fee arrangements or our continuing relationships with clients ought to be imposed. We are currently anticipating that these demands will grow in intensity and are preparing to deal with them with a well-reasoned white paper on all aspects of the objectivity and integrity of the profession and the alternatives that are involved. The Board of Directors will be reviewing a first

draft at their meeting next week. Hopefully this will ultimately prove to be effective in enlightening interested governmental groups and persuading them that the problem is not one of independence but stems from the inherent difficulties of dealing with complex business transactions and entities and uncertainties of all kinds.

As mentioned earlier we are also likely to be facing a challenge to our rule prohibiting advertising. This may occur at any time and we need to be considering what our response should be. No doubt the vast majority of CPAs firmly believe that repeal of our rule would be highly detrimental to the public interest. There is certainly merit in this view but I doubt that we can persuade government authorities to refrain from bringing legal action against the Institute once the issue is raised. We should be guided by the advise of our legal counsel on this matter and be prepared to either litigate or enter into a consent decree depending upon the legal precedents. One thing is certain, our critics will seize upon any litigation as evidence that we are pursuing a course of self-serving restrictions and it will thereby be a minus in our efforts to account for ourselves to the public.

One of the pluses that we can be very proud of in demonstrating our responsibility is our progress in continuing professional education. We have been leaders in mounting an

effective program and we ought to make certain this fact is recognized by those who are inclined to impose governmental regulation on the profession. I hope, however, that we can move with greater speed toward making continuing professional education mandatory on a profession wide basis. Surely this would contribute to the enhancement of our credibility.

We also have much to be proud of in the area of technical standards but I am afraid that at the same time it is the source of much of the criticism of the profession. It is somewhat of a paradox that we have generated a long list of complex financial accounting and reporting rules and are criticized both because we have not done enough and because we have gone too far.

I have little doubt that for the non publicly-held companies our technical disclosure requirements have exceeded what is either necessary or reasonable. Our task force which has been working on the problem of GAAP for Small Companies is close to reaching a conclusion. A report is in the final drafting stages and is expected to be issued perhaps as early as June. I hope that the SEC and the FASB will embrace the recommendations of the task force and that the report will lead to alleviation of a serious problem that has been undermining the confidence of smaller companies in the work of their CPAs.

A closely related technical standards problem is the need to reexamine both the standards and the methods of reporting on accounting and review type engagements that fall short of full opinion audits. We have traditionally referred to these as unaudited engagements but I think it is time that we adopt a new terminology to more clearly distinguish between different kinds of engagements and to indicate that there are more categories than the two extremes of the best or none.

You are aware that we have appointed a subcommittee of AudSEC to reconsider all aspects of accounting and review services. The committee is composed substantially of well qualified local practitioners and they are attacking their task with vigor and enthusiasm. I have high hopes that this group will be successful in defining a more satisfactory approach to our treatment of accounting and limited review type engagements. It is a need that has been widely identified by practitioners in all parts of the country.

Because this part of our scope of services is so important to such a large segment of the profession we are giving consideration to holding a national conference devoted to all aspects of the subject. If we decide to go ahead it would be held sometime this fall. We believe that it would provide a useful forum for practitioners who are heavily engaged in accounting and limited review type work.

Another facet of the technical standards area that is currently receiving a great amount of attention is the need to develop accounting methods that will better reflect the effects of inflation and current values that are closer to economic reality. The SEC has issued its Accounting Series Release 190 requiring experimentation with footnote data on current replacement costs for productive facilities and inventories. The FASB has an exposure draft outstanding on a proposal to require supplemental price-level adjusted financial statements. It also expects to issue a discussion memorandum this summer on a conceptual framework of accounting that will, among other things, describe the alternative methods of valuation. Important developments are also taking place in the United Kingdom.

Because of the diversity of these efforts the Institute has decided that there is a strong need to adopt a more comprehensive approach to the development of a revised accounting model that will incorporate an appropriate combination of the various valuation concepts. If we are successful in doing this, we will have made a giant stride toward meeting our responsibilities and our credibility should be greatly enhanced.

There are, of course, many other developments in the technical areas that have a bearing on how we are perceived. We are close to issuing a statement on auditing standards on

public reporting on interim financial statements of publicly held companies. An exposure draft has been voted out on how auditors should deal with illegal payments. A draft on the auditor's responsibilities for detecting fraud and other irregularities is nearing approval for exposure. All of these are matters of considerable substance but time does not permit me to go into detail.

We also have a number of special committees at work on a variety of projects that can have a significant impact on the future status of the profession. Among these are:

1. A proposal to establish an organization to accredit schools and programs of professional education.
2. A study of the desirability and feasibility of formalizing the recognition of specialization.
3. A study of the public service activities of the profession to determine what we ought to be doing.
4. A study of the present structure of the profession in the light of various proposals for changes.
5. An analysis of the problems posed by attempts to seek conformity between financial and tax accounting.

6. An attempt to develop an effective program to deal with unwarranted demands for access to accountants' working papers.
7. An effort to develop a position and urge its adoption with respect to proposed legislation on the sale of municipal securities.
8. Cooperation with the presidential commissions on privacy and relief from the paperwork burden.

These are by no means all of the initiatives that are being taken within the Institute but they serve to illustrate the wide range of activities that the profession has on its agenda. They constitute a strong response to the question of "who accounts for accountants." We all do -- through our individual and collective efforts to meet our obligations in a responsible and professional manner.

We shall always be faced with new challenges and criticisms for what we have not yet accomplished. By comparison with other professions and private groups, however we have an enviable record of accomplishment. We should be proud of that record and must make certain by our present and future actions we continue to be a conscientious and responsible profession that is sensitive and responsive to the public interest.