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6-21-1971

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before The 56th Annual Meeting of the Texas Society of CPAs,
Austin, Texas, June 21, 1971**

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A TIME FOR SELF-RENEWAL
IN THE ACCOUNTING PROFESSION

By

Leonard M. Savoie
before
The 56th Annual Meeting
of the
Texas Society of CPAs

Austin, Texas
June 21, 1971

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IN THE ACCOUNTING PROFESSION

During the lifetimes of us in this room, the accounting profession has experienced a remarkable rate of growth and has produced a notable record of accomplishment. Not the least notable have been the profession's contributions to the commercial and industrial development of our country -- contributions stemming from the attest function and the establishment of accounting principles.

A main factor of our progress has been the youth and boldness of the profession. During its development years it was open to new experiences, receptive, not inhibited by fixed attitudes.

As a result of our ability to recognize and deal with problems, and of our willingness to respond to the needs of the times, the accounting profession has reached a considerable degree of maturity and visibility.

It is precisely this maturity, however, which may pose a challenge to our continued well-being.

John Gardner, in his classic work Self-Renewal, describes the growth and decay process in this way:

"When organizations. . .are young, they are flexible, fluid, not yet paralyzed by rigid specialization and willing to try anything once. As (an organization) ages, vitality diminishes,

flexibility gives way to rigidity, creativity fades and there is a loss of capacity to meet challenges from unexpected directions."

If we desire continued growth and health for our profession, we must be aware of, and vigorously defend against, the causes of stagnation which Gardner describes.

We must not become complacent because of past accomplishments nor rigid in our thinking because of present success. For changes in our environment will continue -- changes so profound and far-reaching that it is difficult to comprehend all their implications. The rise or fall of the profession will be measured by our responsiveness to these changes.

Take, for example, the Institute's role in establishing standards of financial reporting. As you know, some critics contend that pronouncements of the APB are too rigid. Others complain that opinions are not tight enough. Some suggest that the APB does not move quickly enough, while others counter that it acts precipitately.

A number of actions have already been initiated in response to these challenges.

The APB recently introduced a new procedure into its deliberative process -- the use of public hearings on the more important and controversial matters under consideration. The first of these open hearings was held last month on

accounting for marketable securities -- a question of general concern to the financial community and of particular interest to groups such as the insurance industry and stock brokerage firms. The meeting proved to be a valuable source of input to the APB. Over 45 individuals and organizations submitted written briefs, while more than 20 requested time to speak at the hearing.

Opinion No. 16 on business combinations and No. 17 on intangible assets consumed much of the APB's time in 1970. Since then the Board's tempo of productivity has increased significantly. Two new Opinions -- No. 18 on equity accounting for long-term common stock investments and No. 19 on changes in financial position -- have been issued within the past two months. Two proposed Opinions dealing with accounting changes and imputing interest on long-term receivables and payables have been circulated for comment. And the Board's agenda is literally loaded with items approaching the exposure stage.

Another important step was taken early this year when Marshall Armstrong, President of AICPA, formed two high-level study groups to consider whether our efforts to improve financial reporting standards are sufficiently prompt and productive.

One group will study whether present procedures for establishing accounting principles can be improved; the

other will seek to refine the objectives of financial statements. Both groups will consult with interested organizations and individuals, hold hearings and maintain a public record. Each group includes representatives of business and professional life outside public accounting. In fact, a majority of those on each study group is from outside public practice.

The group studying the establishment of accounting principles is chaired by Francis M. Wheat, a recent member of the Securities and Exchange Commission. Serving with him are a university professor, a financial analyst, a financial vice president of one of the nation's largest industrial corporations, and three CPAs in public practice.

The group studying the objectives of financial statements is chaired by Robert M. Trueblood, a practicing CPA and past president of the American Institute. Serving with him are a financial analyst, an economist, an industrial executive, two professors, and two CPAs from public practice.

The study on establishment of accounting principles is expected to be completed next fall and the study on objectives next year.

A current source of pressure upon accounting principles is the Treasury Department. It has recently been following a policy of permitting for tax purposes, in certain instances, use of an accounting method only if it is not at

variance with the method used by the taxpayer for reports to shareholders.

Such conformity does not, at first glance, have an undesirable appearance. However, if the Treasury's policy of conformity is broadened, accounting methods used for income tax purposes are likely to control eventually the methods for financial accounting. Naturally, taxpayers would use the accounting methods which produced the lowest tax, and these would then have to be used for financial reporting regardless of whether they were sound and proper methods for reporting to owners and creditors. One result would be to make it exceedingly difficult for the Accounting Principles Board to eliminate undesirable methods.

The Institute's Board of Directors has recently appointed an ad hoc committee to review the matter in depth and to recommend a course of action.

The profession's role in establishing accounting principles is not the only area of our activities requiring a "self-renewal" effort. The attest function also requires fresh scrutiny.

Problems regarding the auditing function are multi-faceted. Practitioners voice concern over the quantity and the quality of statements issued by the Committee on Auditing Procedure. Many believe the Committee has not gone far enough in codifying generally accepted auditing standards,

or in issuing guidelines on acceptable audit techniques. They believe that too much of the Committee's attention has been devoted to reacting to specific events and not enough to more forward-looking proposals. A small number of practitioners have an opposing view; they believe that so many statements have been issued that the CPA is put in an auditing straitjacket.

Many of the concerns of the Committee arise from the flurry of lawsuits which have plagued the profession during the past few years. Much of this litigation arises, no doubt, because auditing standards and guidelines do not exist in a specific area or are not precisely defined. Many, however, arise because of sub-standard field work and reporting practices.

Some say that the auditor's liability is being extended with each court decision and that auditing standards are being set by the courts. This is debatable -- and legal counsel for the Institute assures us that the profession still has the opportunity to set its own standards, even on points where a court has decided differently.

Some members of the profession believe that further statements on auditing procedures will only tend to increase auditors' liability. To the extent that new standards impose additional obligations, this may be true. On the other hand, the very existence of standards may

tend to limit liability in all cases where auditors adhere to them.

The organized profession through the American Institute has recognized the problem and has initiated steps to overcome it. When Tom Holton, one of your fellow-Texans, took over as chairman of the Committee on Auditing Procedure late in 1969, he in effect doubled the number of days it meets in order to better attend to the volume of items on the agenda.

Although the full results of this effort cannot be expected immediately, significant advances are already visible. Three statements have been issued since January 1970, two more should be approved for publication this month, and a statement on subsequent events will almost assuredly be issued before the end of 1971.

Statement 42 on reporting when a certified public accountant is not independent, and Statement 43 on confirmation of receivables and observation of inventories were issued in 1970. Last April the Committee, as a result of APB Opinion 16, issued Statement 44 on reports following a pooling of interests.

The two Statements on which the Committee on Auditing Procedure is currently balloting deal with piece-meal opinions and using the work and report of another auditor.

The Committee's agenda, like that of the Accounting Principles Board, is full of items under active consideration. Most notable is the expanded scope of projects on its agenda. Subjects such as qualitative aspects of inventory taking, report qualification criteria, and reliance on non-accounting experts are sure to make valuable contributions to auditing literature.

The Institute's effort in the auditing area is being enhanced in other ways. First, the amount of resources -- manpower as well as monetary -- applied to this function is being studied, and it is likely an increased commitment will result. The addition two years ago of a full-time auditing research consultant has given the Committee research support in preparing position papers and background information on a more timely and thorough basis. An additional research associate will be joining him this summer.

The Practice Review mechanism, which has been operative since 1962, and the newly created Quality Review program are, in my judgment, effective ways of combating sub-standard auditing and reporting performances which result from lack of knowledge of the standards.

The number of cases processed by the Practice Review Committee has more than doubled during the past two years and the number of noted departures from generally accepted auditing standards has increased commensurately. In each case of a noted departure, a letter of comment,

instructional in nature, is sent to the CPA.

In an effort to meet the increased work load, it is contemplated that the Practice Review Committee will be expanded and divided into two panels. This should facilitate the review of cases and preparation of letters of comment.

The Quality Review Committee, formed last year, will embark on its pilot program this summer. Generally, the Committee will function in this way: At the request of a CPA firm, a team of practitioners will review the audit working papers and reports related to a number of the firm's engagements, and will discuss the team's findings with the firm. The team will give constructive criticism and recommend ways in which auditing and reporting may be improved. CPA firms will be charged a nominal fee for this service.

I believe this to be an important self-renewal effort, offering the smaller firms the advantage of a review program similar to those which have been used effectively for many years by the large and medium-sized firms.

I would urge the Texas Society to support this project, and to encourage CPAs here to avail themselves of the quality review program.

Auditing today is under pressure in other ways. The factors of judgment, estimation, and materiality in

financial reporting occasionally strain the credibility of auditing in the eyes of the public. This situation is made more difficult by the continued existence of alternative accounting principles.

As long as choices exist among principles, and judgment is a factor in determining operating results the public will be skeptical. Also, in a few instances, companies will shop for a more compliant auditor.

The possibilities of completely eradicating this practice are slim, but it can be restricted.

One effective deterrent is about to emerge as a result of the continuing dialogue between the American Institute and the Securities and Exchange Commission. Amendments recently proposed by the SEC to the 1934 Act would require that companies file an 8K report whenever there is a change in auditors. The proposed amendment would require a letter from the displaced firm, setting forth the firm's understanding of the reasons for the change, and indicating any problems encountered if the current year's audit has been started. The Institute has suggested that the amendment be modified to focus the reporting requirement more clearly on disagreements between auditor and client as to accounting principles or practices, financial statement disclosures or auditing procedures.

The proposed amendment would also require that Form 8K be filed to report unusual charges or credits of

a material amount, and to report changes in accounting principles or practices having a material effect on financial statements.

So far I have talked primarily about problems that already exist and ways in which the profession is working to combat them. But the most significant part of our self-renewal is clear-sighted appraisal of what lies ahead.

If the profession desires sustained growth and progress, it must look to the future. We must search for ways in which the auditor's role can be expanded to better serve the public interest, and ways in which the accounting discipline can be more fully applied.

The auditor's role, for example, might be extended to cover interim financial statements. This would require greatly improved techniques that would enable the auditor to assume the added responsibility without incurring excessive legal liability and uneconomical additional work.

For publicly traded companies, there is a great deal of interest in quarterly reports. Stock exchanges require them, and now the SEC is doing so, too.

Instances occur all too frequently in which interim financial statements present a picture that is considerably different from what appears in the year-end reports. Yet, the interim statements are often reported to the public as widely as the audited annual reports.

Another possibility for expanding the auditor's usefulness is to require a specific report on the internal controls of a company. This is already done to some extent. It is required for regulatory purposes for a few industries, such as stock brokerage firms, and occasionally it is done in response to specific requests from bankers and others.

Suggestions have been made that the auditor express an opinion on management performance. Often investors would like to know from an independent source that management has performed in adequate fashion, including its achievement of non-profit-oriented objectives. This is a most difficult assignment and one in which standards would have to be drawn very carefully before an auditor would be able to express an opinion. But it is an area to watch and, if the demand increases, I believe the accounting profession will find a way to meet it.

Profit forecasting is still another interesting possibility. Most well-run organizations of any size prepare budgets to guide the conduct of the business. Investors, too, would like to see budgeted plans. They are more interested in a company's future than in its past results, which are all that historical financial statements provide.

Association with forecasts presents many problems. Today's professional standards prohibit the auditor from

involvement in a profit forecast carrying the implication that he vouches for its accuracy. Yet auditors concern themselves with forecasts for various purposes, although seldom with those intended for the public. Clearly, standards are needed before they can be in a position to add credibility to profit forecasts.

One of the most interesting fields of potential growth for the profession is Federally-stimulated audits. We already participate extensively in these programs -- more than 50,000 such audits are performed each year. And the growth rate is high. Occasionally, however, obstacles are encountered to the use of independent accountants. I submit that this fact raises questions about basic assumptions of the profession and should cause us to reappraise our policies. Let me cite just three problem areas:

First, the profession seems often to take the attitude that our staple product is the standard short-form audit report, even though the Government may have a need for something different. The department or agency involved may want a report on internal control or on compliance with a particular law or on performance evaluation of a program. These are new and intriguing areas of auditing which provide interesting challenges. Performance evaluation would in many cases require participation with people from other disciplines.

Second, some Federal agencies which use independent CPAs want information on the cost of an auditing service before engaging a firm. This has caused problems in states where Boards of Accountancy and CPA Societies hold that giving an indication of estimated cost is a violation of the competitive bidding rules.

A third area where the profession encounters problems with Federal administrators is in client-auditor relations. When an audit of a business or non-profit organization is called for under a Federal program, who is the client -- the entity audited or the Government? If the profession maintains that the entity being audited is the principal client, is it any wonder that a Government administrator may question the auditor's independence for the purpose of the administrator's own accountability?

Even though Federal agencies want to use independent accountants, the continued existence of such obstacles may force the building of large staffs of Government auditors to perform needed work.

These problems cannot be solved by individual CPAs or their firms, but only by the organized profession. And if the profession does not take the initiative, the issues will probably be resolved unilaterally by Government agencies, one at a time, and perhaps to our detriment.

In the three cited problem areas, I suggest that the Institute take these specific actions:

1. Intensify efforts to establish professional standards for examining and reporting on internal control, compliance with laws, and performance under Federal programs. Some good work has been done in these areas, but much more remains to be done.
2. Assume leadership in recommending a policy to State Boards and State Societies which will help them avoid confrontation with Federal antitrust laws, and which will give independent auditors reasonable opportunity to submit fee estimates in response to requests from Governments (which is in the public interest) and still guard against unscrupulous competitive bidding, which is not in the public interest.
3. Clarify client-auditor relations to assure that audit reports to Federal agencies and to owners and other interested parties are equal in independence and objectivity.

These three recommendations are not solutions but actions which, with a lot of hard work, should lead to solutions.

All of these Federal matters affect the practice of public accounting directly. But a citizen should view his Government also from the standpoint of its objectives

in meeting the needs of the people. A citizen who is a professional man has a special obligation to consider how his knowledge could help the Government in the accomplishment of its objectives. To do this in an organized way means that the Institute should take the lead in areas where it has competence.

There are Federal issues of broad concern on which the Institute has taken a position, many more where it should take a position, and still others where it has an opportunity to take a position if it wishes to broaden its horizons and become known as a profession concerned with the great issues of the day.

One such issue, for example, is the proposals for reorganization of the executive branch of Government. These proposals were recommended by the President's Advisory Council on Executive Reorganization and outlined by the President in his State of the Union message last January. Inasmuch as professional accountants have particular interest in and knowledge about concepts of organization, it is only fitting that the Institute take a position on this subject.

Another example is revenue-sharing. When the President proposed general revenue-sharing, accountability became the most controversial feature. Critics contend the plan is devoid of accountability for the billions of

dollars which would be handed over to state and local Governments, and proponents claim accountability would be enhanced. Professional accountants are highly qualified to speak out on this type of accountability.

If the Institute wants to have a voice in national affairs, it must have the courage to speak up on specific proposed measures. I am pleased to say that the Board of Directors has recently expressed support for the idea that the Institute develop additional capability to study the big issues of Government, to determine appropriate Institute policies concerning them, and to make the positions known to the Government and public. Therefore, we can look forward to an increasing effort by the accounting profession in Federal Government matters.

No discussion of the profession's future would be complete without relating our hope for advancement to the educational requirements this imposes. If our level of knowledge does not expand proportionately with the expansion of our activities, our striving for renewed vitality will be in vain. But again, definite action has been taken.

At its May meeting the Institute's Council adopted a landmark resolution calling for a program of continuing education within the profession. The resolution urges states to adopt a requirement that a CPA must demonstrate his continuing professional education in order to remain in practice. It also urges State Boards of

Accountancy to support the proposal by adopting the guidelines set forth in the report of the Committee on Continuing Education.

This, along with the other positive actions of the Institute, should indicate the profession's dedication to a program of self-renewal and our willingness and capability to respond to emerging situations.

These efforts will be successful only if each certified public accountant makes the same dedication of purpose and vigorously undertakes a personal program of self-renewal. Are you ready to make this commitment?