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**News  
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**PUBLIC ACCOUNTING: WHOSE PROFESSION IS IT ANYWAY?**

Remarks to

1986 Thirteenth Annual AICPA  
National Conference on  
Current SEC Developments

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The views expressed herein are those of Commissioner Cox and do not necessarily represent those of the Commission, other Commissioners or the staff.

As we meet today only one week into 1986, I suspect that most of us have recently reflected on the beginning of the new year, and our plans and aspirations for the coming months. In accounting, however, the new year brings a distinctly different focus. For the public accountant, the first few months of the new year are usually spent in the audit process -- taking a good hard look at the year just completed. In that spirit, I believe this conference presents us with a good opportunity to review the events of the past year, and determine which of those will be especially significant in the current year. Although I don't intend to end my remarks today with an opinion on whether these statements fairly present the position of the public accounting profession at December 31, 1985 and for the year then ended, I hope, as you usually do, to thoroughly review all the material items.

Over the next two days, you will participate in several programs intended to examine the Securities and Exchange Commission's positions and prognostications on detailed accounting issues. But before diving into the accounting, we should remember that that's only half the battle. The profession is not accounting, but rather public accounting. As the name implies, I think the public part should come first, and that's what I intend to do today -- discuss a little about the "public" before this conference gets down to the accounting. In reviewing the events of the past year, we may be tempted to ask of our public accountants -- "Whose profession is it, anyway?"

#### The Course of Public Accounting: 1985

One year ago, it looked as though 1985 would be a watershed year for public accounting. It appeared that John Dingell was prepared, if necessary, to take apart and restructure the entire profession. The Supreme Court had recently issued some broad platitudes about the accountant's overriding public duties. The Securities and Exchange Commission reported that, as in years past, it still had been provided no meaningful access to information from which it could opine on the effectiveness of the special investigative process, an integral part of the profession's program of self-regulation.

During 1985, the profession began responding to these problems, but was met with some new and unexpected ones. The focus to this point had been on pressure from the regulators -- the SEC, the courts, and the Congress. It became apparent as 1985 unfolded, however, that more important problems were coming from the customers: customers who didn't understand that a business failure didn't necessarily imply an audit failure; customers who believed that the auditor's opinion certified the absence of management misconduct; customers who became plaintiffs in record numbers and settled for record amounts. Although accountants had expected pressure from above, it came from below.

The challenge for 1985 became, as Commissioner Treadway accurately stated in the midst of his prognostications last year, to "recapture public confidence." 1/

The problem with capturing public confidence is that accountants have set about doing so without direct public regulation. Although this is a 50-year-old arrangement that no one has seriously suggested disturbing, accountants are beginning to realize that this arrangement has its limitations when the emphasis is on the appearance as well as the actual existence of paramount concern for the public interest.

In essence, public accountants have chosen for themselves a thin and carefully-negotiated line between public authority and private self-regulation. They have used both to their advantage, but now have found their public and private roles misinterpreted by their customers, the Commission, and the Congress. I believe that to disperse this public misunderstanding, the profession must place both feet squarely in the "public" camp, and take the initiative in creating their future regulatory environment. This is especially important in facing the issues of the coming year.

#### The Course of Public Accounting: 1986

As we look ahead to 1986, I believe there are five major problems facing public accountants. Each of these will test the effectiveness of your ability to recapture public confidence through private action.

First, there is the "perception gap" or "credibility gap," as some have called it. Essentially, this means that the public does not understand exactly what accountants and auditors do and what their opinions mean. 2/ This is the source of most, if not all, of the "customer revolt" which became more apparent in 1985, and I believe may present the most pressing problems in 1986.

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1/ James C. Treadway, Jr., "The State of the World of Accounting -- Thoughts About the Past, Present and Future" 12 (Address to the Twelfth Annual AICPA National Conference on SEC Developments, Washington, D. C., Jan. 9, 1985).

2/ See, e.g., Dodds, Auditing the Auditors, Fin. World, Oct. 30 - Nov. 12, 1985, at 66; "Early Warnings, Expectation Gap, FTC Probe Discussed at AICPA Meetings," 17 Sec. Reg. & L. Rep. (BNA) 1853, 1854 (Oct. 18, 1985) (remarks of Auditing Standards Board Chairman Jerry D. Sullivan).

The second problem is related to the first, because it presents a question of image. The accounting self-regulation program suffers from the same sort of credibility gap. I believe this was apparent in the 1985 Congressional hearings, as the Dingell Subcommittee members came away essentially unimpressed with the SEC Practice Section's ambitious and largely successful program of peer review. 3/ In addition, the SEC has had some difficulty arranging for effective access to information about the Section's Special Investigations Committee. I have held discussions with Section executives and members of the Public Oversight Board, and believe that this problem can be overcome, but much work remains for 1986. 4/

The third problem has been labeled "commercialism" by some, and refers to the sacrifice or compromise of professional standards in pursuit of audit and other engagements. 5/ None of the commentators have, I believe, suggested that this amounts to a widespread problem, but all have cautioned accountants to be aware of its sobering implications. This problem will be compounded in 1986 by the fact that accountants must steer between the Scylla of "commercialism" which lowers standards and public perception, and the Charybdis of anticompetitive restraints, which has recently attracted the interest of the Federal Trade Commission. 6/

Fourth, auditors need to assure both regulators and customers that they can and do maintain sufficient independence while performing management advisory or other non-audit services for their audit clients. Many commentators have suggested that this

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3/ See SEC and Corporate Audits (Part 1): Hearings Before the Subcomm. on Oversight and Investigations and the House Comm. on Energy & Commerce, 99th Cong., 1st Sess. 972-1010 (1985) (questions following testimony of Arthur M. Wood, Chairman, and A. A. Sommer, Jr., Vice-Chairman, of the Public Oversight Board) (hereinafter Oversight Hearings).

4/ See Public Oversight Board, Annual Report 1984-1985 at 19, discussing SEC review of the SIC.

5/ See Dodds, supra note 2, at 68-69; Sack, Commercialism in the Profession: A Thread to be Managed, J. Acct., Oct. 1985, at 125; "Audit Price Cutting Could Pose Problem for Profession, Chief Accountant Warns," 17 Sec. Reg. & L. Rep. (BNA) 1679 (Sept. 20, 1985).

6/ See 17 Sec. Reg. & L. Rep. (BNA) 1853 (Oct. 18, 1985).

is a problem, although none have proved it to be so. 7/ The challenge for the profession in 1986, in my opinion, will be establishing guidelines that eliminate even the appearance of impropriety in such engagements. 8/ Here again, the task is to show that self-regulation is not synonymous with self-interest.

The fifth major problem for the profession in 1986, I believe, is "opinion shopping." Although the practice has been uniformly decried by critics, 9/ its presence or absence is difficult to prove. As with the MAS issue, the challenge here is to eliminate even the appearance of improper "shopping." 10/

### Charting the Course of Public Accounting

The five items on my list pose great but not insurmountable problems for 1986. What is as important as the problems themselves is to notice who's going to be responsible for tackling each of these problems. True, the SEC has been active in some of these areas. But the most important problems -- credibility, effective self-regulation, and the control of commercialism -- demand answers that come solely from the profession. The SEC, courts, or even Congress can do very little to polish up public

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- 7/ The major critic of auditors' MAS is Professor Abraham J. Briloff, who documents cases he believes have affected auditor independence. See Oversight Hearings, supra note 3, at 97-101; Briloff, Are Auditors Becoming Too Cozy With Their Clients?, Bus. & Soc'y Rev., Summer 1985, at 72. Other commentators have suggested that the provision of MAS has the potential to affect auditor independence. See Dodds, supra note 2, at 69; Wood, What Must be Done: A Report from the POB, J. Acct., Aug. 1985, at 146-48. What type of problem MAS poses is not clear. Professor Previts, in his recent exhaustive study of auditor independence, has titled his chapter on the 1977-84 period "Controversy in Search of an Issue." See G. Previts, The Scope of CPA Services: A Study of the Development of the Concept of Independence and the Profession's Role in Society (1985).
- 8/ The Public Oversight Board has suggested that some MAS would be proper for an auditor to perform, and it is studying other impacts. Public Oversight Board, Annual Report 1984-1985, at 24-25.
- 9/ See, e.g., id. at 25; Wood, supra note 7, at 146; Treadway, supra note 1, at 12.
- 10/ See the Commission's Concept Release on Opinion-Shopping, Securities Act Release No. 6594, 50 Fed. Reg. 28,219, 28,219-20 (1985).

accounting's image with the public or the regulators. It can do little to eliminate the appearance of unprofessional conduct or conduct which, for many reasons, does not meet the public's expectations. This is what makes the problems of 1986 different for the profession from the problems of 1985 -- neither the source nor the solution lies principally with the public regulators.

And this, in turn, takes on special significance -- for the opportunity of public accounting to solve its own problems coincides with a consensus by regulators and others that it ought to do so. When you examine the views of the major overseers of public accounting -- the profession itself, the Commission, and the Congress -- I believe you'll find they are also looking for solutions to these problems to come from within the profession as well. Let's look at each of them.

### The Profession's Position

It appears that the major accounting self-regulators believe that the problems of 1986 can be solved from within. For example, the "perception gap" or "credibility gap" is a major concern of most regulators. The Chairman of the Public Oversight Board noted that the self-regulatory process needs added legitimacy from a favorable SEC evaluation of its processes, including special investigations. 11/ The Chairman of the Auditing Standards Board called for modification of certain standards as well as the traditional auditor's opinion, in an effort to narrow the public's "expectations gap." 12/ And the Chairman of the Financial Accounting Standards Board has noted a certain contradiction in public attitudes about the FASB: everyone agrees that the current system of independent standard-setting is preferable, but on the other hand, all groups want to have their own particular views receive special consideration by the Board. 13/

Each of these major institutions, I believe, recognizes that public approval is necessary for self-regulation to succeed.

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11/ "As long as no one outside the [Special Investigations Committee] or the [Public Oversight Board] knows what the committee is doing on individual cases or understands the bases of its decision, the self-regulatory program will never gain the credibility it deserves." Wood, supra note 7, at 144.

12/ See 17 Sec. Reg. & L. Rep. (BNA) at 1854-55 (Oct. 18, 1985).

13/ Donald J. Kirk, "Can You Hear Me Now?" 16-19 (Address to the Financial Executives Institute Fourth Annual Conference on Current Financial Issues, San Francisco, Cal., Nov. 11, 1985 and New York, N. Y., Nov. 18, 1985).

Not only must the process be effective and impartial, but the public must believe it is so. This is not a new idea, really, for the Supreme Court said essentially the same thing in the Arthur Young decision. The celebrated Fernando is onto something when he admonishes that it's more important to look good than to feel good.

Accountants are realizing that in 1986 it will be at least as important to look effective as to be effective. This is an important part of three of the major problems of 1986 which I mentioned above: the accountant's "credibility gap" which manifests itself in increased litigation; the challenge to maintain effective self-regulation, and to ensure that it is seen as effective; and the need to avoid unprofessional "commercialism" while not appearing to stifle healthy competition. The profession recognizes, I believe, that public approval cannot be legislated or mandated by rule, but must be sought and won.

#### The Commission's Position

Turning from the self-regulators to the SEC, I believe we see the same kind of attitude: one of "wait and see what the accountants will do themselves." Noted SEC-watcher Joel Seligman has suggested, in a historical sketch of the Commission's regulation of accounting, that the SEC relies primarily on full disclosure to solve accounting problems, with occasional forays into accounting and auditing standard-setting. 14/ I believe this is an accurate assessment when you look at the Commission's current program, from the financial fraud enforcement cases to the proposed proxy rule on disclosure of accountants' memberships in SROs and the concept release on opinion-shopping. Mr. Seligman also notes a historical disparity between Commissioners and accountants on the importance of accounting, 15/ but I do not believe this is the case today. The SEC looks first to the accounting profession not out of negligence or neglect, but in reliance on those most deeply involved to take the "first cut" at solving problems -- whether in standard-setting or public relations -- and in reliance on full disclosure to highlight the solutions.

In an interesting paper presented at the Arthur Young roundtable in 1984, Professor Horngren described this type of public-private regulation as "muddling through." 16/ He indicated that it was

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14/ Seligman, The SEC and Accounting: A Historical Perspective, 7 J. Comp. Bus. & Cap. Market L. 241 (1985).

15/ Id. at 241-42 (referring to views first articulated by SEC Chairmen Joseph Kennedy and Jerome Frank).

16/ Horngren, Institutional Alternatives for Regulating Financial Reporting, 7 J. Comp. Bus. & Cap. Market L. 267, 280 (1985).

most likely to continue to be the model of self-regulation in the future, and although it is muddling, I believe, as he apparently does, that it will serve the public and the profession well. 17/

The key to successful "muddling through," however, is supervised self-regulation. The perils of direct public regulation are as apparent now as in 1938 when the SEC designated it the road not to be taken. The Commission determined then that direct public regulation and standard-setting would have serious drawbacks, and was unwise as a policy matter. 18/ Writers since have confirmed that public standard-setting would be fraught with many problems, due partly to the infusion of other governmental interests into the standard-setting and regulatory decisions. 19/ However, it is just as universally recognized that public oversight is essential for self-regulation to be legitimate. 20/

Thus, although the Commission has often taken the initiative in its full disclosure campaign, its emphasis continues to be on supervised self-regulation. Certainly the Commission could insist on certain new accounting or auditing standards or step up investigation and oversight of the SRO activities of accountants. However, I believe this would do little to promote credibility, provide effective self-regulation, or avoid undue commercialism. Central to each problem is the profession's public perception, and thus it's the profession's response which is paramount.

### The Congressional Position

Turning now from the viewpoint at the Commission to the viewpoint on Capitol Hill, I believe that the same opinions prevail there as well. This may surprise you, given the suspicion apparently prevailing between accountants and Congress. One British magazine, viewing the Congressional events of the past

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17/ See id. at 277-81

18/ See Accounting Series Release No. 4 (1938), Accounting Series Release No. 150 (1973), 6 Fed. Sec. L. Rep. (CCH) ¶72,921.

19/ See, e.g., Kaplan, "Should Accounting Standards Be Set in the Public or Private Sector?," in Regulation and the Accounting Profession 187-95 (1980).

20/ "Some statutory or enforcement authority is necessary to give legitimacy and backbone to the private agency. Thus, the present system, which has the SEC using its statutory authority to delegate standard setting to the private agency, may be a good arrangement." Id. at 194. See also Wood, supra note 7, at 144-45.

year from a distance -- literally as well as figuratively -- titled Chairman John Dingell "probably the most feared man in US accounting circles at present." 21/ However, it became clear shortly after the accounting hearings began in February last year that Chairman Dingell's objective was to investigate, and possibly also to lecture and reprimand, but not necessarily to restructure. Although the hearings will continue into 1986, 22/ I haven't assigned them a place on the list of the accounting profession's "problems" for this year. This is not out of a lack of respect for the Congressional process and the thorough job of the Subcommittee to date, but it's my opinion that the profession can adequately respond to the concerns raised in those hearings within its current framework.

Chairman Dingell himself has noted that it is his hope -- although he calls it a "pious" one -- that accountants can deal with the problems he has identified. He stated that "[t]hey are the first and best qualified" to deal with problems "in their own home." 23/ He cites the National Commission on Fraudulent Financial Reporting as a laudable response to some of these problems. In general, Chairman Dingell believes that accountants believe that the system will be in serious trouble if they don't make some changes soon.

Thus, it appears that the Congressional attitude mirrors that of the Commission and the profession -- effective self-regulation is the first step. Although Chairman Dingell has taken the SEC to task for regulation that he terms "relaxed and comfortable," 24/ I believe that he would concur that the power to solve the problems of 1986 rests initially in your hands, and that you are capable of exercising it wisely.

### Obstacles in the Chartered Course

Now that we've established what the problems are that the profession needs to face in the coming year, and also that most

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21/ "Thoughts of chairman Dingell," Int'l Acct. Bull., Nov. 1985, at 8 (hereinafter Dingell Interview).

22/ "Dingell Panel May Push SEC to Require More Disclosure by Defense Contractors," 17 Sec. Reg. & L. Rep. (BNA) 2161 (Dec. 13, 1985) (remarks of House Energy and Commerce Oversight and Investigations Subcommittee chief counsel Michael Barrett).

23/ Dingell Interview, supra note 21, at 9.

24/ Id. at 10. See also Oversight Hearings, supra note 3, at 3 (Opening remarks of Chairman Dingell).

everyone believes that the profession needs to take the first steps in solving those problems, I can offer some unsolicited "outsider's" advice on how to go about solving those problems, since I just left the whole task to you. Perhaps Professor Horngren meant to say "meddling through" when he coined the term "muddling through."

In solving the problems of 1986, I believe that accountants must be extremely careful when approaching the subject of civil liability. This may be easy for me to say, because as a non-accountant, the large recoveries awarded civil plaintiffs do not come out of my pocket or my firm's pocket. Everyone recognizes that geometric expansion of accountants' liability is not in the best interests of anyone -- be they users, preparers, or auditors of financial statements. Although on an individual or firm level, such liability may be devastating, it appears to me that on an institutional level, the idea of limited liability for accountants sounds suspiciously self-serving. In general, individuals, be they ordinary or professional, are held liable when they don't perform their tasks up to the standards set by society. To suggest that auditors' liability should be limited sounds rather like they should be excused from this general duty. The problem is not so much that auditors are not doing the job, although audit failures do still happen. Rather, the main problem is that the judiciary and the public, as I noted before, don't really understand what the auditor's job is supposed to be, and are therefore haphazard guessers at what constitutes fulfillment of or misfeasance on the job. The solution is to reexamine auditors' responsibilities in areas of fraud detection, much like the projects now underway at your Institute and the Auditing Standards Board. The standards should be objective and explicit, so that it is clear when the auditors are doing their job properly.

The accounting profession's preoccupation with civil liability has also contributed somewhat to its image problem. I know that at the SEC we have encountered some resistance to our requests for access to workpapers and other documents generated in the special investigative processes of the SEC Practice Section. These problems are the result of distrust by the accountants not so much of the SEC, but of the private plaintiffs who may follow in the Commission's path. <sup>25/</sup> But when the goal is effective public relations, an expectation or anticipation of liability makes the accountant look as if there's indeed something to hide, and the fear of expanding liability becomes a self-fulfilling prophecy. Thus, on an institutional level, I believe that you will be more successful tackling the problems which have caused expanding liability, rather than seeking to limit that liability directly. Strict and clear audit standards should lead to reduced liability which will be more stable than any limitation artificially imposed. Therefore, I don't believe that expanded responsibility and limited liability can necessarily be viewed as a "package deal." Lower liability should be a natural result of higher standards, not part of a political compromise. On a firm or

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<sup>25/</sup> See Wood, supra note 7, at 145.

personal level, however, I admit that it is difficult to stare at the threat of a multimillion dollar judgment or settlement and patiently take comfort in the fact that Commissioner Cox says it's not the profession's major problem right now, and will slowly disappear anyway.

### Fitting the "Public" into Public Accounting

Now that I've claimed to have examined the major events for the profession in 1985 and 1986, I want to stress again that I've looked only at the developments in public accounting. These problems may have little to do with others you will address at this conference, such as accounting for mergers and acquisitions, pensions, financial institutions, and other matters. Although the problems I have discussed don't relate to daily practice, neither can they be dismissed as "fluff," ignored by individuals and left to the Big Eight's public relations departments. All public accountants carry the professional image with them -- for better or worse -- in each contact with each client. And I think this provides an answer to the problem I posed at the outset -- whose profession is this, anyway? It is unquestionably up to the professionals in the first instance to develop, apply and maintain standards of accounting, auditing, and self-regulation. However, if those efforts are not perceived as successful by the public and by regulators, then they are not successful. One commentator set out the following requirements for CPAs in 1986 and beyond:

"To evolve in a rational manner requires some concept of what the new public image ought to be and it must be consistent with the CPA's new identity. Such a public image preferably should be built on and retain the present heritage of the CPA profession and consolidate the triad base of public practices consistent with concepts of self-regulation and the test of review. The elements of a profession must be present." 26/

It is up to you to begin to solve the problems of public accounting in 1986, and to do so loudly, so that everyone knows about it.

I believe the major lesson of 1985 is that public accounting belongs unequivocally to the public. Although accountants have been given temporary custody of their profession, they may find control wrested from them if they make misguided use of it. I believe that you can meet here next year and find the challenge met -- that your profession still ultimately belongs to the public, but you remain in possession. For if possession isn't nine-tenths of the law, in this case it's at least most of the battle.