

Mr. ANDREWS. They may have been; but I will say this to you, that if the accountants were responsible in that case, we feel that the profession not only is capable of dealing with them as they should be dealt with, or from the standpoint of discipline, we can assure you that past experience will prove beyond any question that they will be dealt with properly. There has never been, as far as we know, any case of violation of a proper rule of ethics by any member of the profession that has not been dealt with conclusively. If there has been, we would like to know about it, because we have undertaken, to put it in the popular venacular, to police our own profession.

Senator WAGNER. Are there not statutes or public utility laws in some States as to accounting, or am I mistaken about that?

Mr. ANDREWS. It may be that there are statutes, Senator, which do prescribe minimum requirements, but I think their requirements are as to accounting rather than as to auditing. I should like to point out that there is a difference between the two subjects. When you audit something you verify it, check it, and give your opinion as to the correctness or incorrectness of it. You are then assuming considerable responsibility. We do not object to the portions of this bill which deal with accounting. We have no word to say about that.

Senator WAGNER. It is with reference to auditing that you object to it?

Mr. ANDREWS. Yes, sir; where we are called upon to give our professional opinion as to the truth and veracity of a statement, as to its full disclosure, there we think that you cannot substitute mandate or legislation for the exercise of professional judgment, any more than you can tell a doctor how to treat a pneumonia case, or a lawyer how to prepare his brief if he is going to represent you. After all, it comes back to the exercise of professional judgment.

It may clarify our suggestion to interpolate at this point a brief statement of the status of the certified public accountant and the nature of his work. There are, at present, more than 19,000 certified public accountants in the United States. The certificate of certified public accountant is issued by State administrative boards, created by law, to candidates who have met prescribed educational and experience requirements and have passed written examinations in auditing, commercial law, accounting theory and practice and, in some cases, other subjects. Certificates may be revoked for malpractice or unprofessional conduct.

The certified public accountant in professional public practice is an independent practitioner. He is not employed on a salary basis by the concerns which he audits but is retained by them as clients, on a fee basis. His position is different from that of the bookkeeper, internal auditor, or controller permanently employed by a corporation. The position of the independent certified public accountant is comparable with that of the practicing attorney, engineer, or physician performing services in particular cases for clients or patients who do not direct the professional man as to methods but look to him for results.

The rapid development of the profession of the certified public accountant is largely a result of the public demand for a disinterested, independent review and check by competent technicians of the accounting records and the accounting judgment of the management

of corporate enterprises which make use of the savings of the public. The certified public accountant recognizes a heavy responsibility to all interested parties, including stockholders, potential investors, and creditors, who may be influenced by his professional opinion regarding the financial position and the results of operations of the company concerned, as expressed in his report or certificate as a result of his audit.

An audit is not a simple mechanical process. It is a highly technical and complex procedure of examining or testing accounting records and the evidence which supports them. Some book entries may be confirmed by inspection of cash, securities, or other physical assets. Underlying evidence which may be called for to support other entries in the accounts may consist of such varying items as written confirmations of accounts with debtors or creditors, directors' minutes, contracts, vouchers, invoices, canceled checks, and so forth.

It is the duty of the auditor to satisfy himself that the accounts and the financial statements based on them fairly present the situation. He must use his own judgment as to the extent to which it is necessary to check individual records of transactions, and the manner in which they shall be checked, in order so to satisfy himself. Various factors—for example, the efficiency of the internal accounting or internal auditing of the company—may have a bearing on his judgment of the extent and nature of the examination which he must make in each individual case.

No two cases are exactly alike. Frequently the auditor finds it necessary to go further in some respects than is usual, and perhaps, in other respects, due to favorable factors, he may decide that it is unnecessary to do as much work as might be customary. He is responsible morally and legally for the opinion expressed in his report or certificate. He must decide for himself the amount and nature of the work he must do in order to justify the expression of his opinion.

If auditing were a simple mechanical process, the profession of the certified public accountant would not have developed so rapidly in numbers and in prestige. It is the need for skilled judgment, based on technical training and experience, which has brought into existence the thousands of certified public accountants who are practising in this country today.

The minimum scope of and procedures to be followed in an audit cannot satisfactorily be laid down by rules and regulations as is provided in section 32 (e) (1) of the bill. The auditor must use his judgment and discretion in determining the scope of the audit and the methods of procedure just as much as in formulating his final opinion on the balance sheet and income statement which are the subject of his report.

No Government agency nor any other body could set up practicable rules or regulations prescribing the scope (extent) of audit and the procedure (how to do it) to be followed by auditors in all cases. If that were possible auditing would be a routine procedure which could be left to clerks. No one can foresee the circumstances which the auditor will encounter in an individual case. The American Institute of Accountants has had considerable experience with this problem. It published in 1917, at the request of the Federal Trade Commission, an outline of points to be covered in typical examinations, under the title, "Approved Methods for the Preparation of Balance-Sheet

Statements," which was later approved by the Federal Reserve Board. This outline was revised in 1929, under the title "Verification of Financial Statements" and again in 1936, under the title "Examination of Financial Statements by Independent Public Accountants." The several revisions indicate growth and progress, as well as the impossibility of rigid standardization. It has been necessary in each bulletin to make clear that in individual cases an auditor may be justified in departing and may find it necessary to depart from these outlines, and may frequently find it necessary to go further than the outline suggests.

It has been frequently announced that the policy of the Congress in enacting the Securities Act was only to provide for full disclosure of material facts in the affairs of a company offering its securities for sale, in order that the prospective investor might have a fair basis for a decision as to whether or not to purchase the securities. The Securities and Exchange Commission requires that every prospectus issued under the 1933 Act bear the words, "These Securities have not been approved or disapproved by the Securities and Exchange Commission" and "it is a criminal offense to represent that the Commission has approved these securities or has made any finding that the statements in this prospectus or in the registration statement are correct." In other words, the Government says it takes no responsibility for the results of the investor's decision. It seems to us that there is an analogy between this problem and the problem raised by section 32 (c) (1) of the Senate bill 3580.

If a Government agency prescribed "the minimum scope of and procedures to be followed in any audit of" an investment company it could hardly escape responsibility for the results of an audit conducted in compliance with that prescription. It is possible that a competent auditor might comply exactly with rules of the Commission regarding minimum scope of audit and procedures to be followed, and yet fail to discover material facts of the utmost importance to investors. In such an event would the auditor be relieved of blame because he had meticulously followed the instructions of a Government agency? Probably not, but the Government agency could hardly escape a share of the blame in the minds of the investors whose interests had been adversely affected.

It is an ancient principle of law that a person whose conduct may be controlled and directed as to details of procedure is an employee, or servant, as distinguished from an independent contractor who may choose his own methods and who is held only for results. It is equally well established that there is a definite liability for acts of an employee performed in the course of his employment. If the Commission were to prescribe the procedures to be followed by accountants in their audits, the independence of their relationship would be seriously impaired, and if they were to be treated like employees or servants, the Commission could not escape a share of moral responsibility for any harm that might result from their acts.

It seems to us not in the interests of the Government itself to assume a share of a responsibility which is rightfully a private responsibility, resting on the shoulders of a professional practitioner.

Prescription of a minimum scope of audit would not, on the face of it, prevent an auditor from undertaking additional steps beyond the required minimum; but experience shows that there is a tendency for

minimum requirements to become, in fact, maximum requirements. It would be difficult for an auditor to persuade a client to agree to an examination more extensive than that required by the Securities and Exchange Commission. We believe that such a condition might result in a lowering of the standards of auditing practice and might dull the sense of personal responsibility which is now keenly felt by the independent certified public accountant.

Section 32 (c) (1) is a new departure in Federal legislation. We know of no Federal law providing for specification by a Government body of the procedures that professional practitioners shall follow, the manner in which they shall follow them, the steps that they shall take in the performance of their professional work. Section 32 (c) (1) of Senate bill 3580, which does provide for such dictation to professional certified public accountants, would be an innovation in Federal legislation.

It would be manifestly absurd to engage an attorney to present a case, and then prescribe exactly what statutes and decisions he should study, what arguments he should include in his brief, and how he should present them in court. He must use his judgment, with due regard for his professional standing and integrity. It would be equally absurd to instruct an engineer just how to apply the techniques of his profession in the planning and supervision of the construction of a bridge, or to instruct a physician in treating a patient. It is no less futile to attempt to lay down a pattern in advance which all certified public accountants must follow in conducting independent audits.

It is a commonplace that responsibility should carry commensurate authority. Certified public accountants bear heavy responsibilities. They risk their professional reputations every time they sign a report. They are subject to civil liabilities under the common law and under the Securities Acts. They are entitled to determine for themselves, without outside interference, what steps they will take in forming the opinions in the expression of which they incur these risks.

The independent status of the professional certified public accountant is vitally important in the performance of his function. A principal reason for his engagement to conduct an audit is to secure an objective, disinterested review of the facts and the presentation of the company's affairs, which will fully disclose information of importance to all parties at interest. The independent auditor is "in the middle." He is a kind of umpire. It is his duty to reveal the truth as he sees it, not to present a report favorable to the wishes of management, of creditors, of a governmental regulatory agency, or of any other one group. If a governmental agency had power to prescribe the scope of his investigations and the procedures which he should follow, it would acquire control and influence over the accountant which might impair his objectivity. The accountant might, to a degree at least, assume the status of an agent for the regulatory body.

A. A. Berle, Jr., now Assistant Secretary of State, in an address before an accounting society, ascribed great importance to this point. He said:

\* \* \* your profession \* \* \* having freed itself from the chains of servitude to businessmen \* \* \* may all too easily find itself merely the ciphering agency for virtually unreviewable bureaucrats. It took time to teach merchants that they could not give orders to accountants as to what their figures should show:

and the profession must never drop to the point where its members are in demand primarily because their opinions will change whenever a subexaminer, for reasons not put on the record, wishes a different arrangement of figures.

Section 32 (c) (1) would be an unwarranted and unnecessary invasion of a field of professional practice.

Certified public accountants have achieved recognition as a profession in statutes, in the courts, and in the public mind. They have built strong State and National professional organizations; they have developed technical standards of practice, have maintained and enforced rules of professional conduct, and have exercised disciplinary authority over their members. This development has been gradual over the years and is continuing. They welcome the opportunity to cooperate with the Securities and Exchange Commission and other private and governmental agencies in further improvement of accounting and auditing and corporate financial reporting.

It is offensive to the members of this profession to suggest that the work of developing its technical and professional standards should be taken from the hands of the profession itself and be assumed by a department of the Federal Government.

The effect of section 32 (c) (1), if it were administered under the widest possible interpretation, would be to make the Securities and Exchange Commission practically a partner of the accountant in every audit engagement undertaken pursuant to the terms of Senate bill 3580—a situation inconsistent with the basic concept of the practice of any profession.

If the sponsors of the bill should argue that there is no intention of applying the provisions of section 32 (c) (1) in any such extreme manner; that the Securities and Exchange Commission would administer it in a reasonable way with due respect for the considerations we have advanced, the reply must be that it is no defense of bad law to say that it will be well administered. We feel justified, therefore, in asking for the elimination of this objectionable provision from the bill itself.

Any effort to prescribe by rules and regulations the minimum scope of audit and procedure to be followed in all cases is foredoomed to failure, since every case is different from every other one. Mandate can never successfully be substituted for professional judgment.

Senator MALONEY. It is not possible for a corporation to engage certified public accountants to make a partial audit?

Mr. ANDREWS. Yes, sir.

Senator MALONEY. Is it not possible under those circumstances for there to be a failure of disclosure of things that are extremely important?

Mr. ANDREWS. That might occur.

Senator MALONEY. What do you have to say in that connection?

Mr. ANDREWS. In that connection, an auditor should state clearly what kind of an audit he has made, so that the person reading his report can understand definitely what he can depend upon and what he cannot depend upon.

Senator MALONEY. You do not think that it is wisdom on the part of the Federal Government or the S. E. C. to require a complete audit in those instances?

Mr. ANDREWS. I am not objecting to the requiring of a complete audit. If the S. E. C. wants to require a complete audit, if it feels

that nothing but a complete audit should be made, that is one thing. But telling us how to make it, where we shall exercise our judgment and where we shall not exercise it, is an entirely different proposition.

Senator MALONEY. You object to the word "minimum"; is that it?

Mr. ANDREWS. Yes; we object to that, and we object to having the procedures which we shall follow laid out for us. We might, for instance, in one case feel that it is necessary to go to great lengths in an examination. In another case there may be circumstances which make that unnecessary. For instance, the degree of the internal check in a given enterprise as compared with the lack of it in another. By "internal check" I mean, stated simply, a system of procedure which is set up so that one person checks upon another. Obviously, in one case where you have one person checking on another, you would not have to make as detailed an investigation or examination as you would in another case where there are all sorts of opportunities for mistakes. That is what I mean by the use of professional judgment.

Senator MALONEY. You are basing your assumption of course on the fact that your 19,000 certified public accountants are capable and honest?

Mr. ANDREWS. Yes, sir; and I submit, sir, that the profession as a profession is honest.

Senator MALONEY. I agree with you.

Mr. ANDREWS. You might find some cases where there have been malpractices; but I call your attention to the fact that it is not possible to make people honest by legislation. It is not more possible to make every auditor and accountant honest than it is to make every lawyer or other professional man honest. There are people who are going to be guilty of wrongdoing regardless of how much legislation you have have—

Senator MALONEY. And you cannot slow them up with traffic signs and policemen?

Mr. ANDREWS. You can slow them up; but I submit that until the profession proves unworthy of the trust of the public and until it proves itself incapable of policing its membership, it should be allowed to continue to do that.

I think I shall be able to demonstrate to you as we proceed that we have developed a profession in the truest sense of the word, and we have done it because we have followed inherent rules of honesty.

Senator MALONEY. I think that is true.

Senator HUGHES. Mr. Andrews, may I ask you this? You object to the Commission prescribing the minimum scope of the procedure to follow in auditing an investment company. If, instead of prescribing such scope, there should be a provision that every investment company should once a year, for instance, have a full audit—

Senator HERRING. You would welcome that, would you not?

Senator HUGHES (continuing). Of their accounts, and so forth; in other words, get away from these things that may be misleading, and have a full audit for the benefit of their stockholders, what would you have to say about that?

Mr. ANDREWS. Senator Hughes, we are, after all, human beings. The more work you require people to give us the better we like it. But we want to be rational about this whole matter. The accounting profession does not want anyone to feel that any member of that profession will issue an unqualified report that is not in fact unqualified

on the basis of the work done. In other words, the profession does not want to give anyone the impression that a member of that profession can be prevailed upon to make a partial check and represent it to be a complete audit. I say to you gentlemen that that cannot be done.

Senator HUGHES. In other words, if I understand you correctly, you do not want anything in the bill?

Mr. ANDREWS. That is exactly right.

Senator HUGHES. You do not want anything in the bill prescribing the minimum scope?

Mr. ANDREWS. That is right, sir.

Senator HUGHES. You would leave it to the profession?

Mr. ANDREWS. We are perfectly willing to operate in collaboration with the Securities and Exchange Commission as we have always done. I think the Commission itself will say to you gentlemen very frankly that they have never found the profession remiss in its effort to cooperate with the Commission in accomplishing the objectives toward which the Commission is working.

For instance, members of our committee of the American Institute, in the early days of the S. E. C., spent not days, but weeks and months, at the time, I believe, when Mr. Kennedy was chairman of the Commission, in developing many of the forms that are now in use by the S. E. C., designed to bring about this full disclosure which every one is interested in obtaining. We are greatly interested in full disclosures and in having audits mean exactly what they say they mean, and not to be construed as meaning something else.

Senator WAGNER. I remember the testimony given by Judge Healy on this very subject. He said that they had had some talk with representatives of accounting societies, and that the only objection they made relative to the subject was to subsection 3 of section 32. He said, "I am very hopeful that we can work out some substitute language for that."

Your substitute is the deletion of the section.

Mr. ANDREWS. In order that the committee may be fully informed as to what we have done, when this matter first arose and our committee was authorized to deal with it, we reached our own conclusions and then went to the S. E. C. in a conference with Mr. Frank, Mr. Schenker, and the chief accountant, and we told them then, very frankly, what we are telling you now. In fact, we told them the same thing. We had a very good reception and a sympathetic hearing and, as Mr. Frank expressed it, an appreciative hearing. He expressed a good deal of confidence in the accounting profession as such. We told them at the time that we thought this section should be completely deleted. We further told them that if they did not see their way clear to agree to that, we should want to appear before you gentlemen and say to you precisely what we had said to them. So I think the Commission understands that our appearance here is with full notice to the S. E. C. and in observance of the proper rules of courtesy in such matters.

Senator WAGNER. Apparently the Judge himself recognized that there was some difficulty about the provision.

Mr. ANDREWS. We hope the Judge will eventually come to the conclusion which we are suggesting here.

Senator WAGNER. The committee will have to determine eventually the provisions that are to go into the bill.

Mr. ANDREWS. I might say that a note has just been passed to me regarding a matter which had passed through my mind but which I did not mention; that is, that under our rules of professional conduct, with regard to this matter of certificates, our members cannot issue a certificate on an unqualified basis if any inadequate audit has been made. As a matter of fact, under the rules which we have adopted, if any substantial number of the assets of a corporation are not verified, the client cannot get any certificate at all. We just won't make certification of it.

Senator WAGNER. That is, under the rules of your association?

Mr. ANDREWS. Yes.

Senator HUGHES. Would he get anything at all?

Mr. ANDREWS. He would not get anything at all.

Senator MALONEY. Just a bill for services.

Mr. ANDREWS. The Senator has a sense of humor in which I heartily concur.

Senator HUGHES. My experience with public accountants has been very satisfactory and I have a high regard for their efficiency and ability. When it comes to figures I am lost, but they seem to always get through with it.

Senator WAGNER. I think we all concur in what has been said about confidence in the profession.

Mr. ANDREWS. The thing that we are particularly interested in is that you gentlemen recognize that, after all, this accounting profession is a profession. It is a new profession. There are lots of people who know little about it, but there is a general acceptance of the accountant as an independent investigator upon whom people may rely, upon whose report people may rely. I think that is more extensive than most people recognize.

I happen to be from Virginia, the city of Richmond. It is a small city of approximately 200,000 people. But it has been my privilege to serve my city as its auditor for 2½ years at the invitation of Ex-Governor Pollard, as most of you gentlemen probably recall. At the present moment I am working as comptroller. I know, as a matter of fact, that there is an acceptance on the part of the people of Virginia of the integrity of the auditors of that State. People are audit-conscious. When an auditor makes a certification they believe what he says; and the profession knows that and accepts that responsibility. You cannot get those men to do things that they ought not to do. As a matter of fact, I can tell you, gentlemen, as I go over the length and breadth of the country attending meetings of accountants, that I have observed that they lean backward on this question of ethics. As a profession they actually lean backward. They do not want to do things that are not proper. They want to have a continuance of that feeling of independence. An accountant, when he makes a certificate, likes to feel that nobody has influenced him; and there is not anybody that can, speaking now of the profession as a whole. Accountants are fully aware of their responsibility and they are trying to live up to it. Over a long period of years we have attempted to develop principles of conduct that will warrant that acceptance. We do not think that legislation would hasten the development of rules of conduct and personal integrity.

Senator WAGNER. I think we understand your viewpoint.

Mr. ANDREWS. Furthermore, I would like to say this. I do not want to presume upon the kindness of the committee; but if the Government undertakes to tell us the scope of the audit that shall be made or the way it should be made, then they cannot possibly escape the responsibility for any errors of either omission or commission that might be made.

I do not believe that you want to put the Government into the auditing business. I do not believe you do. That is exactly what you would have if the Government can say that you shall do this or shall do that. I do not believe you want to put it on that basis.

Furthermore, standards of that kind are likely to be maximum standards.

If an auditor were to do a certain thing and he thought that under the circumstances more needed to be done, he never could induce his client to pay for more than what the rules said should be done.

An auditor must exercise his judgment; and we say that this bill places the Government in a field in which it has no business, a field in which the profession has not proven unworthy of the confidence of the public, any more than other professions have. You would not for one minute, as I said a while ago, think of telling a doctor how to treat any kind of a case. You would leave it to his judgment. If you are not willing to take that step in a profession in which men's lives are involved, why should you take that step in relation to the practice of accounting? I do not think you should tell us how to carry it on any more than you should tell a doctor how to treat his cases.

I should like very much to ask the other members of the committee who are here to be recognized.

The first gentleman is John K. Mathieson, president of the American Institute of Accountants.

Mr. MATHIESON. I think there is nothing more to add, Senator. I appreciate your courtesy in carrying over in order to hear us.

Mr. ANDREWS. The others are Mr. Samuel J. Broad, vice president, New York; Mr. C. Oliver Wellington, a member of the executive committee, also of New York; and Mr. John L. Gerry, our secretary, also from New York.

We are most grateful to you for the time you have accorded us. I hope that we have made ourselves clear, and I would like to leave you with the understanding that our participation here has been in the spirit of cooperation. We have no quarrel with anyone. We want only to be allowed to continue to cooperate with the S. E. C., and to leave our professional responsibilities on the professional basis. We believe that the desired results can be much more readily accomplished upon that basis than otherwise.

Senator WAGNER (chairman of the subcommittee). We will recess until 2:30 this afternoon.

(Whereupon, at 12:35 p. m., a recess was taken until 2:30 p. m. of the same day.)

#### AFTER RECESS

The subcommittee resumed at 2:30 p. m., on the expiration of the recess.

Senator WAGNER (chairman of the subcommittee). The subcommittee will come to order. Mr. White?