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THE ROLE OF THE SEC IN OVERSEEING THE ACCOUNTING PROFESSION

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The decade of the 1980s has opened with the promise of a full plate of volatile and explosive issues which will test the relevancy and adequacy of many of our American institutions and conventions. For the United States accounting profession, in particular, this promises to be a period of challenge, innovation and change. Events over the past few years have spurred significant progress toward the objective of improving the profession's capability to ensure that appropriate ethical and professional standards are developed and maintained on a timely basis and with a minimum of government legislation or regulation. The successful attainment of this goal will permit the accounting profession in the United States to emerge from the decade of the 1980s even stronger and more vital than it entered.

Much, however, remains to be accomplished if the American accounting profession is to realize this goal. During the past two years, it has faced challenges embracing the full spectrum of the profession's activities. Criticisms directed at the accounting profession from without, as well as the profession's own efforts at self-assessment, have served as the basis for change. While the profession can justifiably derive a sense of confidence and satisfaction from its ability to conceive and implement significant changes, it must guard against the tendency to become complacent, or to develop an attitude that enough, or too much, has already been done --

or that much of what is being done is not substantively necessary or cost justifiable, but rather a mandatory tithe to keep powerful, but misguided, external forces at bay. This must not happen. A major part of the stress which the American profession is under stems from its own failure in the past to recognize, in a timely manner, challenges to its discharge of the only responsibility which justifies its existence today -- ensuring the credibility and reliability of financial reporting.

The Commission's view of the accounting profession's progress in response to the issues facing it has been described in our two recent reports to the Congress on "The Accounting Profession and the Commission's Oversight Role." In the last analysis, however, the maintenance of an independent, private profession depends on the profession's own progress. In this paper, I will examine six facets of that progress: the financial accounting standard-setting process, including the role of the SEC; auditors' responsibilities and the role of the SEC in setting auditing standards; the American Institute of Certified Public Accountants' (AICPA) self-regulatory program; corporate accountability and the accounting profession; international harmonization of accounting standards; and finally, future trends I visualize in financial reporting. Each of these issues will entail, in my judgment, significant tests of the profession's efforts and direction.

I. THE PROCESS OF SETTING ACCOUNTING STANDARDS AND THE ROLE OF THE SEC

Various Acts of Congress clearly state the authority of the Commission to prescribe the methods to be followed in the preparation of accounts and the form and content of financial statements filed under the federal securities laws. More generally, these statutes charge the Commission with responsibility to ensure that investors receive information necessary for informed investment decisions. In meeting this statutory responsibility, and in recognition of the expertise, energy and resources of the accounting profession, the Commission has historically looked to the standard-setting bodies designated by the private accounting profession to provide leadership in establishing and improving accounting principles, subject to Commission oversight. With minor exceptions, the Commission has regarded the determinations of such bodies as responsive to the needs of investors.

History

The Commission and the accounting profession have supported the elimination of accounting alternatives for similar facts and circumstances since the adoption of the Securities Acts of 1933 and the Securities Exchange Act of 1934. The latter Act conferred upon the Commission broad authority to determine the accounting practices utilized in the preparation of filed reports.

Accounting Series Release No. 1, issued in 1937, announced that opinions on accounting principles would be published periodically "for the purpose of contributing to the development of uniform standards and practices on major accounting questions." In that vein, Accounting Series Release No. 4, issued in 1938, established the Commission's policy of looking to the private sector for the initiative for establishing and improving accounting standards, subject to Commission oversight. ASR No. 4 stated:

> "In cases where financial statements filed with this Commission pursuant to its rules and regulations under the Securities Act of 1933 or the Securities Exchange Act of 1934 are prepared in accordance with accounting principles for which there is no substantial authoritative support, such financial statements will be presumed to be misleading or inaccurate despite disclosures contained in the certificate of the accountant or in footnotes to the statements provided the matters involved are material. In cases where there is a difference of opinion between the Commission and the registrant as to the proper principles of accounting to be followed, disclosure will be accepted in lieu of correction of the financial statements themselves only if the points involved are such that there is substantial authoritative support for the practices followed by the registrant and the position of the Commission has not previously been expressed in rules, regulations or other official releases of the Commission, including the published opinions of the Chief Accountant."

The following year, the accounting profession responded to ASR No. 4 by establishing the Committee on Accounting

Procedure to identify accepted accounting practices, including alternatives. The Committee gradually eliminated some questionable practices, but did not make firm choices between "acceptable" alternatives. This situation led to the creation of the Accounting Principles Board (APB) in 1959. The APB made some progress towards narrowing areas of difference in accounting practice by dealing with certain critical issues (e.g., earnings-per-share and business combinations) on a problem-by-problem basis. The APB was, however, criticized for its lack of representation from a broad constituency (it was composed of members of the accounting profession only), its functioning as a part-time body, and its growing backlog of problems. As a result, the AICPA formed the Wheat Committee. The recommendations of that Committee led, in turn, to the establishment of the Financial Accounting Standards Board (FASB) in 1972.

The FASB is a seven member, full-time board composed of individuals from both within and without the accounting profession. The Commission noted, in Accounting Series Release No. 150 (1973), that:

> "the collective experience and expertise of the members of the FASB and the individuals and professional organizations supporting it are substantial. Equally important, the commitment of resources to the FASB is impressive evidence of the willingness and intention of the private sector to support the FASB in accomplishing its

task. In view of these considerations, the Commission intends to continue its policy of looking to the private sector for leadership in establishing and improving accounting principles and standards through the FASB with the expectation that the body's conclusions will promote the interests of investors."

The Commission also noted in ASR No. 150 that the FASB would provide an institutional framework which would permit prompt and responsible actions flowing from research and consideration of varying viewpoints. Thus, the Commission announced the following policy in ASR No. 150:

"In Accounting Series Release No. 4 (1938), the Commission stated its policy that financial statements prepared in accordance with accounting practices for which there was no substantial authoritative support were presumed to be misleading and that footnote or other disclosure would not avoid this presumption. It also stated that, where there was a difference of opinion between the Commission and a registrant as to the proper accounting to be followed in a particular case, disclosure would be accepted in lieu of correction of the financial statements themselves only if substantial authoritative support existed for the accounting practices followed by the registrant and the position of the Commission had not been expressed in rules, regulations or other official releases. For purposes of this policy, principles, standards and practices promulgated by the FASB in its Statements and Interpretations will be considered by the Commission as having substantial authoritative support, and those contrary to such FASB promulgations will be considered to have no such support."

In recent years, the respective roles of the FASB and the Commission have received an increasing amount of attention from both government and the business community. The result has been a broad reexamination of the nature and structure of the accounting standard-setting process in particular, and of the accounting profession in general. That inquiry began in 1976 with the Report of the Subcommittee on Oversight and Investigations of the House Committee on Interstate and Foreign Commerce, chaired by Congressman John Moss. It continued, a little over a year later, with the work of the Subcommittee on Reports, Accounting and Management of the Senate Committee on Governmental Affairs, chaired by the late Senator Metcalf, which held a series of public hearings concerning the accounting profession. Those hearings were preceded by a staff report of the Senate Subcommittee and were followed by the Senate Subcommittee's own report issued in November 1977.

The primary question underlying these inquiries was where the initiative should rest for establishing and improving accounting standards -- in the private sector or the public sector. The Commission, as reflected in its first two annual reports to the Congress on the accounting profession, continues to believe that the initiative for establishing and improving accounting standards should remain in the private sector -- subject to Commission oversight. There are several reasons for this approach: the private sector has greater resources; its standards can be applicable to all companies, whether or not publicly owned; professionals are more likely than is government to respond in a sensitive and timely manner when new or modified standards are necessary to meet changing conditions and concerns in their areas of expertise; and professionals are also more inclined to act effectively when enforcing their own standards, rather than when complying with rules imposed externally. In the aggregate, these factors make a compelling case for private sector primacy in routine standard setting.

Structure of the FASB

The Metcalf hearings conveyed clearly a sense of expectation and urgency for the profession and the Commission to take action which would enhance public confidence in the processes by which accounting standards are promulgated. Questions were raised by members of the Congress and others concerning the timeliness, openness, structure and effectiveness of the FASB in setting accounting standards; whether public and nonpublic companies should be governed by the same set of accounting and disclosure standards; how standards could be developed to achieve uniformity and comparability in financial statements for similar facts and circumstances; and how accountants can determine the circumstances under which one particular accounting principle is more appropriate to use than an alternative accounting principle.

In response to these concerns, and in its own self-assessment of its processes, in December 1976, the Board of

Trustees of the Financial Accounting Foundation -- the organization which oversees the FASB -- established a Structure Committee. This group was charged with responsibility to review comprehensively the role of the FASB and of the Financial Accounting Standards Advisory Council, a part-time body composed of individuals from all the constituencies of the FASB formed to provide advice to the FASB on emerging matters. In April 1977, the Structure Committee issued its recommendations, which included opening all aspects of the FASB to public view, increasing involvement in the FASB from all segments of its broad constituency, strengthening the organization of the FASB and accelerating its work pace, establishing planning goals, issuing prehearing papers explaining proposed standards in layman's language, systematically reviewing existing standards, and broadening the base of FASB financial support.

The FASB has taken expeditious action to implement the structure of the Committee's recommendations. The resulting changes have created a greater degree of openness and effectiveness in the work of the FASB.

Interaction of Statutory Responsibility and Policy of Oversight

The interaction between the Commission and the FASB is the key to the operation of the standard-setting process. While the Commission has the statutory responsibility for accounting standards employed in public reporting, it looks to the FASB to take the initiative in establishing new principles and improving existing standards. What does this mean in a working sense? Principally, as accounting issues which require examination emerge, the Commission expects the FASB to study the area in question and provide appropriate guidance. In those instances where that guidance is either insufficient or is not promptly forthcoming, the Commission, under its statutory authority, stands ready to step in and fill the void.

The fact that an FASB standard is considered acceptable to the Commission and its staff does not necessarily mean that the Commission would have arrived at the same conclusion as the FASB, or that it considers the FASB standard the most preferable solution. Reasonable people can differ, and, if the Commission approached its oversight function with the expectation that the FASB must always choose the solution that the Commission itself would have chosen, then the assertion that the private sector should set accounting standards would be hollow. Rather, the Commission believes that its role is more properly to determine that a standard adopted by the FASB falls within the range of acceptable solutions. If it does not fall within that range, the Commission must then examine the reasoning process that the FASB followed in reaching its decision and act accordingly.

To illustrate the Commission's role as an overseer rather than standard-setter, I want to examine three case histories -- accounting for the effects of changing prices, the conceptual framework project, and oil and gas accounting.

1. Accounting for the effects of changing prices

The experience in the United States over the past decade in attempting to deal with the problems associated with the interplay between high rates of inflation and historical cost-based accounting affords one example of the interaction between the Commission and the private sector in formulating new accounting standards. In 1974, the FASB issued an exposure draft proposing supplemental disclosure of specified financial information stated in units of general purchasing power. The Commission, while not intending to preempt the FASB, believed that the development of useful data on the impact of changing prices should not be limited to adjustments for changes in general price levels. Accordingly, in March 1976, the Commission issued ASR No. 190 which announced the adoption of a Commission replacement cost rule requiring supplemental disclosure by the 1,000 or so largest public companies of the current replacement cost of inventories and productive capacity, and of the related depreciation expense and cost of sales based upon those costs.

These disclosure requirements met substantial criticism -- chiefly because of the subjective nature of the data and the allegedly unrealistic assumptions on which replacement cost computations were premised. As a result, issuers typically included ASR No. 190 data only in financial reports filed with the Commission -- rather than in the more informal annual reports furnished directly to shareholders. Even then, these disclosures were typically surrounded with disclaimers and caveats. These reactions to ASR No. 190 appear to have reflected a deeply engrained notion that only "hard" data -- data which reflects objectively verifiable historical costs -- should be embodied in financial statements. Skepticism about ASR No. 190 also indicated a tendency to oppose any serious reexamination of traditional accounting conventions -- especially when the reexamination might lead to more volatile, less predictable, and lower reported earnings.

Unfortunately, the Commission's promulgation of ASR No. 190 had the unintended effect of temporarily blocking the FASB from assuming its primary role in providing guidance in this area. Thus, when the Commission's staff reconsidered the replacement cost rule subsequent to its issuance and recognized that certain modifications were necessary, it deferred further action and urged the FASB to resume the initiative.

Last September, the FASB responded with its Statement No. 33, "Financial Reporting and Changing Prices," which requires large, publicly-held corporations to report certain supplementary information on both a constant dollar (i.e., general price level) and current cost basis. The FASB has acknowledged that its Statement No. 33 is not a final answer, and a period of experimentation will be required. Moreover, Statement No. 33 does not resolve fundamental issues concerning capital maintenance, the appropriate measuring unit (nominal or constant dollars), and the attributes to be measured. Indeed, the requirement for both constant dollar and current cost information reflects the lack of consensus among accountants and preparers as to the nature of the problems and the trade-offs between reliance, reliability and cost which can be tolerated in arriving at a solution. And, more fundamentally, FAS No. 33 reflects uncertainty among potential users concerning how inflation-adjusted information should be employed and which measuring unit would be most useful.

Statement No. 33 does, however, make a significant contribution to the evolution of supplemental changing price disclosure. The Commission might have adopted many of the Board's modifications in methodology had we not decided to defer the further development of our replacement cost rule pending FASB consideration of measurement issues. Of particular significance is the fact that Statement No. 33 calls for presentation in annual reports to shareholders of a computation of "income from continuing operations." As a result of this private sector initiative, the Commission was able recently to announce the repeal of its own replacement cost rule, while at the same time taking action to extend a safe harbor from liability to Statement No. 33 disclosures.

Yet, more will be required than merely the issuance of an accounting standard. The proof of the business community's recognition of the need to confront the problems created by changing prices will be found in its application of the new standard. The management of each company must make a conscientious effort to provide meaningful analysis of the significance of the data in the context of the company's business activities. The FASB's statement requires only certain minimum information; a complete presentation will include whatever additional information may be appropriate for achieving the most relevant reporting for the individual company. Also, it remains to be seen whether small companies -- which are not subject to the reporting requirements of Statement No. 33 -- will make these disclosures voluntarily. Such efforts would add to the utility of the financial reports of these entities and would, at the same time, contribute to the FASB's ongoing evaluation of its standards.

To further this evolutionary process, the Commission has recently proposed to require publicly-held companies to provide in their annual reports a narrative discussion of the effects of inflation and changing prices. This Commission action reflects the belief that all public companies should discuss how changing prices affect their operations -- even if those effects are not presented in the degree of detail required of large issuers by Statement No. 33. Of course, companies subject to the FASB standard could satisfy the Commission's proposed requirement with a single presentation.

2. Conceptual framework

My second case study of the standard-setting process is the formulation of a conceptual framework for financial reporting. The need for an effective and adaptive framework within which coherent standards can be established has never been clearer, and the FASB has made considerable progress in developing a conceptual framework. It would, however, be difficult to overstate the importance of the FASB's continuing to pursue this project aggressively. While its completion will not provide answers to all difficult accounting and financial reporting problems, it will help to resolve those problems in a timely, effective and consistent manner.

The Board's first concept statement -- Statement of Financial Accounting Concepts No. 1, "Objectives of Financial Reporting by Business Enterprises" -- establishes the objectives of general purpose external financial reporting by business enterprises. This statement does not limit the scope of financial reporting objectives to financial statements, but rather sets forth those objectives in terms of financial reporting in general. In addition, its focus on users of financial information and their interest in evaluating future performance, including earnings, is a significant and worthwhile step.

In my view, a major element of the conceptual framework project should be to rethink the objectives of the primary financial statements, and, therefore, to reconsider what types of information should be included in, and what types should be presented outside of, the financial statements. In this regard, a shift toward increased reporting of soft data -- while retaining historical cost data in the primary financial statements -- has already begun. This trend may eventually necessitate substantial changes in the total reporting model with which we are all quite familiar -- an idea that many accountants and businessmen seem to abhor. Ideally, the most relevant information would be projections of cash flow for future periods. Such information, however, may be highly uncertain, and surrogates may have to be developed. The decision as to what information is relevant, and which of that data should be included in the primary financial statements, will be influenced by the problems of measurability. The current FASB exposure draft on qualitative characteristics addresses this issue.

Similarly, the factors involved generally in the tradeoff between reliability and relevance are key to developing guidelines for the types of information that should be included in financial statements. A further clarification of these factors is necessary before display issues, such as the reporting of earnings, can be finally resolved. Moreover, the recognition criteria phase of the project will be critical to the Board in its search for a definition of "earnings." I hope and expect that the Board will give appropriate attention and priority to these important issues.

It might, at this point, be useful to look at a practical example of the type of problems currently facing the profession which a comprehensive conceptual framework should help to resolve. One clear application can be seen in the Board's current reconsideration of its Statement No. 8 on accounting for foreign currency translation -- an issue which the FASB Chairman has characterized as the most complex and difficult problem the FASB has confronted. Like many of the issues with which the FASB is dealing, the question of the appropriate disposition of translation adjustments raises basic conceptual questions. In the final analysis, the issue turns on an articulation of the objectives of financial statements, i.e., once the objectives of an income statement are determined, one can more appropriately determine whether certain items, such as translation adjustments, should be included. Major standard-setting initiatives -- like foreign currency translation -- cannot be resolved in isolation from these more fundamental problems, and the existence of a conceptual framework should help to ensure that this is the case.

3. Oil and gas accounting

Any discussion of the SEC's role in the development of accounting practices would not be complete without a reference to an atypical example -- the issue of accounting for oil-and gas-producing activities. The appropriate accounting and reporting practices for this industry have been debated for several decades. The Commission's direct involvement in this area resulted, however, from the unique requirements of the Energy Policy and Conservation Act of 1975, which directed the Commission to ensure the development and observance of uniform accounting practices for the oil and gas industry.

That Act permitted the Commission to follow its usual policy of looking to the FASB for the setting of accounting standards, and the Board opted for the "successful efforts" approach as reflected in FAS No. 19. The Commission was required, however, in this particular instance, to submit the FASB's standard to the public for comment. Following an extensive series of public hearings at which the relative merits and deficiencies of two competing accounting methods -- successful efforts and full cost accounting -- were presented, the Commission concluded that neither of these historical cost-based methods adequately portrays the financial position or operating results of an oil and gas producer.

In this industry, the value of the primary asset -- oil and gas reserves -- is likely to have little relationship to its historical cost. Failure to recognize the value of this asset, and the crucial importance of a company's success or lack of success in adding to its reserves, places a severe limitation on the relevance of the standard measures of financial position and results of operations. Because of the need for more meaningful information, the Commission proposed the development of reserve recognition accounting (RRA), a new method which would involve a recognition of valuations of proved oil and gas reserves in the primary financial statements. The Commission's evaluation of the feasibility of RRA is continuing.

The process by which the Commission studied the issue of oil and gas accounting was unique because it resulted from a specific Congressional mandate. Nonetheless, it is an example of a Commission determination that an FASB standard did not fall within the range of acceptable solutions. However, the fact that the Commission reached an independent judgment in this proceeding that differed from that of the FASB does not represent any change in the Commission's basic policy of looking to the FASB for the initiative in establishing and improving accounting standards.

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The history of the development of accounting standards in the United States illustrates both the vitality of the private profession in America and the effectiveness of the Commission's active oversight role. As we enter the 1980s, the FASB appears willing to meet the challenge of setting meaningful accounting standards in a changing economic environment. Indeed, as the Commission reported to the Congress last year, the FASB has made important strides in addressing some of the more fundamental issues inherent in the standard-setting process. Nonetheless, if the FASB is to be successful, it must continue to exercise positive leadership. Moreover, the Board must be able to rely on the support and encouragement of the accounting profession and the corporate community -- regardless of the effect of particular Board decisions on particular reporting companies, and regardless of whether those companies and their auditors fully agree with the Board.

Leadership in standard setting cannot emerge out of consensus; by the time a consensus is forged on an issue of any significance, considerable damage to the credibility of financial reporting is likely to have been done. Yet, for the reasons outlined earlier, the private sector remains the best source of leadership. The accounting profession and the business community must give a high priority to resolving financial reporting issues if the momentum for new initiatives is to remain in private hands.

II. AUDITORS' RESPONSIBILITIES AND THE ROLE OF THE SEC

The second broad area I wish to examine is the subject of auditors' responsibilities and the role which the SEC should play in the process of setting auditing standards. I want to begin with some historical background. On an early Spring day in Washington some time ago, a Southern United States Senator and a leader of the private accounting profession briefly debated the issue whether the federal government or private auditors should have primary responsibility for reviewing the financial statements of public issuers of securities. Their dialogue went something like this:

> Senator: Suppose we decide on the final passage of this bill here to employ five or six hundred auditors from your organization, that would be all right, then, would it not?
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> Accountant: I do not think that the government could employ five or six hundred independent accountants.
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> Senator: Why could they not?
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> Accountant: I do not think the type of men that are in the public practice of accountancy would leave their practice to go in the government employ.
>
> Senator: Well, if it were sufficiently remunerative they would?
>
> Accountant: Yes, if the government made their time worthwhile. * * * [Y]ou will have to build some more buildings in Washington to house them if you are going to do that.

Senator: Then we had better not pass this bill at all. */

The year in which this dialogue took place was 1933, and the participants were Senator Robert Reynolds, of North Carolina, and Colonel A. H. Carter, President of the New York State Society of Certified Public Accountants. The legislation in question was enacted as the Securities Act of 1933 -- but without any provision for a corps of government auditors. Although apparently rather casually reached, the decision to rely upon independent, nongovernmental auditors to serve as the watchdogs of financial information under the newly-created federal securities laws was one of the critical components of the rebuilding of public trust and confidence in our Nation's capital formation processes following the 1929 market collapse. The strength and vitality of the business sector during the past 46 years, and the important role which accountants have come to play in our economic system, have, I think, demonstrated the Congress' wisdom in looking to the private accounting profession, rather than creating a corps of federal auditors.

The colloquy between Senator Reynolds and Colonel Carter is, however, relevant to the larger theme of the evolving role of the independent auditor in strengthening public confidence in the integrity of financial reporting. For one thing, the

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*/ Hearings Before the Committee on Banking and Currency on S. 875, U.S. Senate, 73rd Cong., 1st Sess. 59 (1933).

enactment of the federal securities laws, and the demand which those statutes created for a sophisticated and reliable private auditing profession, are, in large measure, the genesis of the size, prestige and economic rewards which the profession in America enjoys today. To put it bluntly, the profession's franchise is based upon the federal securities laws enacted in 1933 and 1934.

Moreover, while the nature and definition of the auditor's responsibilities have changed substantially during the past four decades, the growth and development of the auditor's role can best be understood if the implications of Senator Reynolds' suggestion that auditors be federal employees are kept in mind. In certifying financial statements under the federal securities laws, the private auditor performs a kind of quasi-public function. And, with that role go special responsibilities -- responsibilities which might not exist if the auditor-client relationship were purely one of private concern. To examine whether auditors are meeting the expectations of the users of their opinions, and of the public, is a task in which the profession must be constantly engaged.

<u>Legal Requirements v. Public Expectations</u>

The rationale for the auditor's work -- indeed, the justification for the existence of the profession -- arises from the need for reliable financial information in order for our economy to function smoothly. Obviously, if users of financial data, who often may have little or no contact with the business in question, could not trust in its financial statements, capital formation and lending, as we know it in the United States, could not be carried on as they are today.

In exploring the auditor's responsibilities for the level of trust in the business community's financial reporting, the perspective of the 1930s is a useful one for another reason. Today, although economic and social conditions are radically different than they were in 1933, public confidence in our economic institutions, including the corporate community, has again eroded. For example, the incidence of significant, unexpected failures by major corporations, as well as revelations, incident to the Watergate investigation, of corporate political and other dubious payments, both in America and abroad, have caused questions to arise concerning the auditor's role in detecting improper corporate financial transactions and bringing them to light. The result has been the intense Congressional scrutiny which the profession in the United States has experienced in the past several years.

I have no simple answers to the question of how the auditing profession should respond to these new pressures, nor, in the final analysis, can government be expected to provide those answers. Indeed, in my judgment, one of the factors which serves to obscure the auditor's proper role is confusion between the level of conduct which the law demands, and the level of conduct called for by changing economic conditions and by user and public expectations. Increasingly, we tend to conform our conduct to the law and ignore the latter. Yet, I believe that, at the same time that the American courts are responding to the increased litigiousness of our society by drawing what may seem to be arbitrary and often inconsistent lines to define the auditor's exposure, the public and its representatives in the Congress are raising their expectations of the role of the accounting profession.

The Auditor's Role

The audit is crucial to the objective of full and accurate disclosure which is the hallmark of the federal securities laws and an indispensible prerequisite to our system of capital formation. Through his audit and certification, the accountant provides the means for independently checking and confirming the information reported by corporations. If he cannot be expected to ensure disclosure of material information of which he is aware, then the significance of the auditor's work is greatly lessened, and the public's reliance on the audit certificate may well be misplaced.

An accountant who gains knowledge of material, undisclosed facts shoulders important disclosure obligations.

At first blush, this would hardly seem a controversial proposition. Simply stated, the Commission's position is that accountants have an affirmative duty to take action consistent with their professional obligations as independent auditors when asked to certify financial statements which they know contain material omissions. Rather than respond to some undefined and indefinite public service obligations, independent auditors are required, under the anti-fraud provisions of the federal securities laws, to conform to generally accepted auditing standards. Those standards require that, where the independent auditor believes that material matters are omitted from the financial statements, "the material should be included in [the independent auditor's] report and he should appropriately qualify his opinion." */

The United States Supreme Court's decision in Ernst & Ernst v. Hochfelder **/ may, however, have provided a somewhat confusing signal on the role and responsibilities of the independent auditor in America. The Court there held that an accountant would not be required to respond in monetary damages under the Commission's general anti-fraud rule -- Rule 10b-5 -- to a third person who had relied on the

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*/ Statement of Auditing Standards No. 1, Section 430.02, (1972).

**/ 425 U.S. 185 (1976).

results of his audit, absent a showing of scienter -- that is, intent to defraud. The Court's message there, I believe, was primarily that it would not countenance monetary liability which seemed to be wholly disproportionate to the task which the auditor had undertaken. The point was not that the auditor's duty to the users of his audit -- in that case, one of his client's customers -- is any the less. Those who take comfort from the decision should study the transcript of my appearance last year before a Subcommittee of the Senate Governmental Affairs Committee at which Senator Thomas Eagleton urged the Commission to formulate a legislative response to Hochfelder and inquired rhetorically whether any other profession in the United States is immune from liability for the consequences of its negligence.

Thus, the auditing profession must be cautious in interpreting its role and responsibilities. The objective should be to ensure that the profession matches its standards of conduct to comport with the changing expectations and needs of users of financial information and of the public -- not merely to the letter of the law. Those expectations tend to change more rapidly than does the law; the signals which the legal system gives off may not always correspond fully to emerging expectations.

But, in the long run, it is those expectations, rather than the law, which are more likely to prevail. The gap will be closed in one of two ways: either the auditing professional will, timely and on its own initiative, shape its standards to conform, or it will risk legislation that will ultimately compel change. Legislation will, however, be less well tailored to the problem, more burdensome and pervasive, and likely to increase the federal presence in business regulation. Many federal regulatory statutes now on the books reflect this type of process. It would be unfortunate if the accounting profession in the United States found itself the next illustration of this phenomenon.

The Role of the SEC

Because financial statements certified by independent public accountants are central to the corporate disclosure system, the Commission must ensure that the attest function is meaningfully performed and that the independence of the accountant is not compromised. To date, the Commission has not, however, felt it necessary to define, by rule, the specific procedures to be followed and the judgments to be made before an accountant can properly assert that an audit was performed in accordance with generally accepted auditing standards. The key issues are professionalism and judgment. The possibility of professional disciplinary proceedings against individuals, as well as the fact of peer reviews conducted under the auspices of the AICPA, private litigation, and Commission enforcement actions -- either in federal court or under its own Rule 2(e) to deny accountants the privilege of practicing before it -- add to the impetus for the profession to ensure that audits are conducted thoroughly and thoughtfully.

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As was the case with respect to accounting principles, some, including members of the Congress, have questioned whether the responsibility for establishing, improving and ensuring compliance with auditing standards should remain with the profession, or whether the government should become more directly involved. Thus far, the Commission has concluded, as it stated in its first two annual reports to the Congress on the accounting profession, that this initiative also should remain in the private sector, subject to continuing Commission oversight. Thus, the American auditing profession's goal must be to ensure that the standards to which it holds itself match, not merely what the law requires, and not simply what government officials advocate, but also the legitimate needs and expectations of the users of financial information and of the public. Following the theme Colonel Carter sounded in 1933, auditors have resisted the notion that they should be conscripts in the federal service. Nonetheless, in the final analysis, the United States Congress, by enacting the federal securities laws, has called the American auditing profession into the service of the investing public. The profession's future as an independent and privately-controlled institution will depend on its continuing success in meeting that challenge.

III. THE U.S. EXPERIENCE WITH PROFESSIONAL SELF-REGULATION

I want next to turn to the evolution of professional self-regulation. During the past several years, public and Congressional attention in America has been focused to an unprecedented degree on the accountant's role in promoting public confidence in the integrity of financial reporting. The incidence of significant, unexpected failures by major corporations, as well as the disclosure of widespread questionable payments and illegal acts in the 1970s, have raised concerns about the integrity and credibility of financial controls and reporting by publicly-owned companies. Consequently, the role and responsibilities of the accounting profession have come under increasingly careful scrutiny. The profession's response has been to create a new mechanism for self-regulation.

As a result of heightened public and Congressional concern, in September 1977, the AICPA established a new Division of CPA Firms, and within that Division, an SEC Practice Section. The Section includes as one of its components the

Public Oversight Board, a body composed of distinguished individuals from outside the profession. This newly-established self-regulatory program has the following objectives:

- Improving the quality of practice by CPA firms before the Commission through the establishment of practice requirements for member firms;
- Establishing and maintaining an effective system of self-regulation of member firms through mandatory peer reviews, required maintenance of appropriate quality controls, and the imposition of sanctions for failure to meet membership requirements (including audit partner rotation and second partner review); and
- Enhancing the effectiveness of the Section's regulatory system through the monitoring and evaluation activities of an independent oversight board composed of public members.

In fulfillment of a commitment made in testimony at the Metcalf hearings, the Commission has submitted two reports to the Congress on the accounting profession. Congress, in turn, has responded with hearings to examine the issues discussed in the Commission's reports. In 1978, this task was performed by a House Subcommittee chaired by then Congressman John Moss, and, in 1979, by a Senate Subcommittee chaired by Senator Thomas Eagleton.

The Commission stated in its 1978 Report that it was not wholly satisfied with the profession's efforts at self-regulation, and that it was too early to assess whether those efforts would prove effective over the long run. Based upon its review of events during that initial period, the Commission concluded that the profession's efforts showed sufficient promise to be permitted to continue to evolve. The Commission was not at that time convinced that comprehensive direct government regulation of accounting or accountants would afford the public either increased protection or a more meaningful basis for confidence in the work of public accountants.

In its 1979 Report, the Commission again concluded that, although it was still too early to reach any definitive judgments concerning the ultimate success of the accounting profession's self-regulatory efforts, nothing had happened which was inconsistent with continued support for the profession's program. The Commission also recognized, however, that the process of implementing a self-regulatory structure had not been -- and would not be -- an easy one. The profession had no model to follow, and thus the implementation process was essentially one of trial and error. Accordingly, in its 1979 Report, the Commission concluded that at least one additional year of experience was necessary before the Commission would be in a position to observe how the profession handles the difficult issues that the peer review program entails.

During the course of implementing its self-regulatory program, the profession has encountered, and will continue to encounter, both conceptual and practical obstacles. The successful resolution of these difficulties will demand strong leadership. Perhaps most crucial to the success of the profession's efforts will be the effectiveness of the Public Oversight Board (POB). The Commission believes that the POB is in a position to fill the necessary leadership function. The POB must, however, be sufficiently detached from the accounting profession to be able to guide objectively the efforts to ensure that the profession does not lose sight of the goals which it must achieve. While the Board's authority is advisory only, it can and should -- by virtue of its stature -- serve as the conscience, critic and leader of the profession.

If the accounting profession's initiative is not successful, a regulatory or legislative alternative, based upon actual experience and aimed at specific problems, may be required. Even if the profession's self-regulatory program <u>does</u> develop in a satisfactory manner, it may become necessary to consider supportive legislation designed to provide a more adequate legal foundation for the system or to confirm its place in the regulatory system. However, since the program presently is evolving, the Commission stated in both of its first two reports to the Congress that regulatory action or legislation is as yet premature. Nonetheless, four primary concerns regarding the AICPA's self-regulatory program are clear -- membership, the ability to evaluate the peer review process, the scope of a peer review, and the effectiveness of disciplinary mechanisms.

First, with respect to the membership issue, the SEC Practice Section's 230 member firms audit almost 9,000 public companies, including virtually all companies listed on the national stock exchanges and a significant portion of NASDAQ-traded companies. However, approximately 600 accounting firms that have at least one SEC audit client have not yet joined the Section. The AICPA has undertaken to identify these firms and to ascertain the reasons why they are not yet Section members. In response to concerns raised about cost, particularly for smaller firms, the Section has recently taken action to reduce its insurance and dues requirements. The effects of these changes remain to be seen. If the Section functions as it is intended, however, there will be increasing pressure on all firms with public clients, regardless of size, to join the SEC Practice Section -- or possibly some similar group with comparable standards. Membership in such an organization -- with the attendant peer review requirements -- should provide a basic level of assurance of quality audits.

Accordingly, the onus is shifting to the firms with SEC clients which have elected not to participate in a self-regulatory program. Inevitably, as time passes, either their clients or others will raise questions as to why they have not yet joined. Moreover, it may be important for investors to be informed as to whether the auditor of a given issuer has been subject to a peer review. The Commission's staff is presently considering this issue and may recommend that the Commission propose rules which would require disclosure on this point from issuers.

The second important but unresolved element in the profession's voluntary self-regulatory program is the peer review concept. Commitment to meaningful, in-depth peer reviews by independent and objective reviewers is a prerequisite to the success of the profession's voluntary self-regulatory program. During 1978 and 1979, only a limited number of peer reviews were conducted; to date, not enough peer reviews have been performed to formulate any definitive conclusions about the program.

Another open issue which is affecting the ability of the Commission to evaluate the peer review process is the Commission's lack of access to the workpapers generated by the process. While the Commission can rely on the POB's supervision of the peer review process to a great degree, it is necessary for the Commission's own staff to have sufficient access to permit an evaluation of the adequacy of the peer review process. If the Commission were forced to rely exclusively on the Board's assurances that the process is working effectively, it would simply not be in a position to satisfy itself, and apprise the Congress, as to whether the SEC Practice Section is an effective mechanism for professional quality control.

The third issue is the extent to which audit work performed outside the United States should be encompassed in the scope of peer reviews. This is a complex problem, and continuing efforts must be made to seek an effective resolution. Where investors are asked to rely on an audit report based even in part on work performed overseas, they are entitled to expect, and should receive, the same level of professionalism and judgment in both the foreign and domestic phases of the audit.

While a worldwide peer review process that concentrates on each firm's quality control system -- regardless of the physical location of the firm -- may be the ideal way to provide investors with this assurance of audit quality, I recognize that differing legal and professional environments make the problem a particularly sensitive one and may make progress toward this goal difficult. One way to address the issue of worldwide peer review would be an engagement-oriented focus, i.e., a United States firm, as part of its quality control or audit standards, could be required to perform certain procedures where a significant portion of the audit work was performed outside the United States. These procedures, which would be documented, should be designed to provide assurance, at least in the context of the particular engagement reviewed, that the quality of financial reporting is consistent; that audit quality with respect to all phases of the audit is uniformly high; and that all aspects of the audit were conducted in accordance with professional and regulatory standards applicable to United States firms. Using this approach, the peer review process would concentrate on the firm's overall policies and procedures for reviewing audit work performed outside the United States and, in my view, would be a satisfactory interim resolution.

Finally, the nature of any audit or system failures which are detected in peer reviews, and the profession's ability to handle such situations promptly and effectively, will play a large part in determining the ultimate success of the program. A meaningful system of professional self-discipline will be the key to the success of the accounting profession's self-regulatory efforts.

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The process of demonstrating that accountants themselves, rather than government, should retain primary authority to regulate the profession, ensure and instill confidence in its objectivity, and maintain control over the quality of the work of its members and discipline those who fail to adhere to its standards, is one which will demand the profession's and the Commission's continued commitment. The need for leadership regarding these essential issues is great. Whether the private sector will effectively provide that leadership is not yet certain. The Commission stands ready, however, to consider all reasonable alternatives to achieving the essential objectives of this process.

IV. CORPORATE ACCOUNTABILITY AND THE ACCOUNTING PROFESSION

The issues presently being widely discussed under the rubrics of "corporate governance" and "corporate accountability" relate to corporate power, whether it is being misused, and to whom it should be accountable. Perceptions that business does not attempt to balance its interests with those of the public have resulted in an erosion of confidence in the private enterprise system. Because a viable private business sector is an essential element of our free society, this phenomenon must be faced and resolved.

Appropriately, the search for solutions has largely focused on the corporate board of directors and its practical capacity to monitor and oversee management. Direct governmental interference in the corporate accountability and operating processes has, thus far, been avoided. There appears to be a consensus -- if not unanimity -- among the participants in this debate that this should remain the case if at all possible. Accordingly, I want briefly to outline the role which the accountant's art must play in retaining the basic accountability framework in the private sector.

A Foundation for Change

To date, the single most significant federal legislative initiative directed at the corporate accountability issue has been the Foreign Corrupt Practices Act of 1977 (FCPA). The focus of that Act is not on corporate governance directly, but rather on the tools necessary for meaningful corporate accountability. Appropriate implementation of this law can provide an important foundation for restoring the credibility of American business.

In order to understand why this is so, it is beneficial to focus briefly on the genesis of the Act and its corporate accountability purposes. The origins of the FCPA can be found in the May 1976, "Report of the Securities and Exchange Commission on Questionable and Illegal Corporate Payments and Practices," */ and in the corporate activities

*/ Report of the Securities and Exchange Commission on Questionable and Illegal Corporate Payments and (footnote cont'd)

which provided the impetus for that report. While the May 12 Report set forth numerous instances of corporate bribery and similar concealed, improper applications of corporate assets, the most significant aspect of the Commission's findings was -- not the bribery per se -- but rather "the fact that so many companies have been able to elude the system of corporate accountability * * *." */

The Commission's legislative proposals accompanying the Report responded to this facet of the questionable payments phenomenon; the more widely known anti-bribery prohibitions, on the other hand, were not a Commission initiative. The Commission recommended the so-called "accounting provisions" because of a larger concern that, in the circumstances where they were needed most, the information sources and controls relied on by directors and managers had failed or were circumvented. It was in this context that Congress enacted legislation requiring public companies to "make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer * * *," **/ and to

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(footnote cont'd)
Practices Submitted to the Committee on Banking, Housing and Urban Affairs, United States Senate (May 12, 1976).

*/ Id. at a.

**/ Section 13(b)(2)(A) of the Securities Exchange Act of 1934.

"devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances" that specified objectives are met. */

These provisions are consistent with, and supportive of, precepts of good management. Both directors and managers -- in making decisions -- are limited by the quality of the information on which they act. Rational implementation of the FCPA accountability provisions contributes to the quality of such information, as well as to the safeguarding of assets and the preparation of reliable financial statements. Similarly, mechanisms for monitoring the quality of corporate information -- the accounting and internal audit functions and

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*/ Id. Section 13(b)(2)(B). Those objectives are that access to

(i) transactions are executed in accordance with management's general or specific authorization;

(ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets;

(iii) access to assets is permitted only in accordance with management's general or specific authorization; and

(iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

the independent auditor -- assume a recordkeeping system which accurately reflects the nature and substance of corporate transactions.

The Debate Over Implementation

Unfortunately, the focus on the recordkeeping and internal accounting control provisions has been marked by a lack of thoughtful consideration of their corporate accountability purposes. If meaningful implementation is to be achieved, a review of the law from a corporate accountability perspective must be undertaken.

First, the accounting provisions of the FCPA must be read outside the context of the anti-bribery prohibition. While the accounting and anti-bribery provisions had a common legislative birth, the former clearly reflects a much broader concern than preventing improper corporate foreign payments. Accordingly, the focus in implementing the Act should be on fostering and maintaining a control environment which will enable directors and managers to rely on the corporate information systems in fulfilling their responsibilities -- not merely on preventing bribes.

Second, the concept of corporate accountability goes well beyond the disclosure framework which pervades much of the balance of the federal securities laws. Efficient management, as well as effective corporate accountability, depends on a reliable information flow at levels of responsibility where, individually, the conduct of corporate employees and the results of that conduct may have little or no disclosure significance. But, because the whole is at least the sum of its parts, accurate records and effective controls must be present at all levels in order that the objectives of the internal accounting control provisions can be achieved.

This explains, in large part, why there are no "materiality" limitations in the accounting provisions of the FCPA. The corporate accountability purposes of these provisions are inconsistent with "materiality" -- a disclosure concept which is narrower than the broader objective of corporate accountability. This is not to say that the accounting provisions are limitless. The internal accounting controls requirement is couched in terms of "reasonable assurance." Reasonable assurance is a cost-benefit criterion, which management must consider with respect to controls at all levels within the organization, and with respect to all corporate transactions. The books and records provision is modified by the phrase "in reasonable detail"; reasonable detail must be judged in relation to the nature and purpose of the records. Disclosure -- and, therefore, materiality -- is only one aspect of the nature and purpose of corporate records.

Finally, it is important that common sense be brought to bear in analyzing the requirement that corporations maintain accurate books and records. This recordkeeping provision is designed to protect the integrity of specific entries in the accountability system, but it must be construed in light of the companion internal accounting controls provision which sets out the objectives for the accountability system as a whole.

Of course, there is no such thing as a perfect system of records, and every set of books will contain information which is, in some sense, "inaccurate." In order to harmonize the statutory mandate for accurate recordkeeping with this fact, the Commission has taken the position that a negligence standard will govern civil injunctive actions brought to enforce the accounting provisions of the Foreign Corrupt Practices Act. */ Stated differently, it is departures from the standard of reasonable care which may result in issuer culpability under the Act's accounting provisions -- not the mere fact that deficiencies exist in the system of internal accounting controls or that recordkeeping inaccuracies have occurred.

The question of whether an issuer has violated the books and records requirement cannot be determined solely by

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*/ Securities Exchange Act Release No. 14478 (Feb. 16, 1978).

looking at the inaccuracy in question and the events which led to its entry in the corporate records. The efficacy of the internal control system in affording management reasonable assurance that inaccuracies will be brought to its attention is also important, as is management's response when such flaws are discovered. Thus, responsible corporate officials should not hesitate to take corrective action when inaccuracies are unearthed. Assuming these officials have otherwise discharged their obligations in a prudent manner, the prompt correction should constitute evidence of reasonable care. The failure to take prompt corrective action, on the other hand, will be an important consideration in determining whether there has been a departure from the reasonableness standard.

In summary, responsible corporations, proceeding in accordance with the dictates of good management, have little to fear from the accounting provisions of the Foreign Corrupt Practices Act. Indeed, these new statutory mandates should serve to stimulate constructive thinking and analysis concerning how an environment can be created in which corporate accountability -- and broader public trust in the integrity of corporate management -- can be fostered.

The Intersection of Law and Management

What then should be the impact of the accounting provisions of the FCPA? First, they should encourage management to review, systematically, the control procedures by which it and the board of directors ensure that corporate assets are expended in accordance with the policies which top management and the directors have promulgated, and that corporate records accurately reflect corporate activities.

Second, the accounting provisions should encourage a searching analysis of the attitudes and institutional dynamics within which the issuer's recordkeeping and internal control mechanisms operate. The key is an approach on the part of top management which makes clear what conduct is expected, and that conformity to those expectations will be rewarded, while breaches will be punished.

Third, the accounting provisions should encourage management to document its control system in order to assess the system and conclude that it satisfies the requirements of the Act. Without the discipline of documenting the system and identifying its potential areas of weakness, it is difficult to understand how any management could satisfactorily assess compliance.

Finally, the process of reviewing and, if necessary, strengthening accounting controls should ultimately enhance public confidence in the corporate sector. It will enable the corporation and the business community to separate more clearly those incidents which reflect upon accountability from more isolated instances of system subversion or human frailty -- two inherent limitations which mean that no system is fail-safe.

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Enhancing both the reality and perception of corporate accountability -- and thus reducing pressure for a governmental role in corporate decision-making -- is a vital goal. Directors, managers and other corporate representatives must participate in the process of enhancing accountability. The FCPA's corporate accountability provisions provide a framework for that process.

V. INTERNATIONAL HARMONIZATION

The next topic I want to discuss is the need for the harmonization of the accounting standards of the various industrialized nations. That objective is worthwhile if, for no other reason, than because it can contribute to the efficiency of national and international trade and the flow of capital.

To date, the International Accounting Standards Committee (IASC) appears to be the most influential agency involved in the harmonization effort. Despite the work that remains, substantial progress has been made, primarily through IASC's efforts. While the Financial Accounting Standards Board is not a member of the IASC, United States accounting standards and IASC accounting standards are in substantial conformity. Additionally, as I understand it, the London Stock Exchange requires foreign companies to prepare financial statements in conformity with the IASC's, and Japan has recently required consolidated reporting, partly as a result of the issuance of IASC's Standard No. 3.

Certainly, much remains to be done. The professional accounting bodies around the world which constitute the IASC membership are not required to incorporate the IASC recommendations in their national accounting standards, and it remains to be seen whether the efforts by other bodies, such as the United Nations and the Organization for Economic Cooperation and Development, can command general international agreement.

Government involvement in many countries is another impediment to harmonizing international reporting and accounting. In many countries of the world, other than the Commonwealth countries and the United States, accounting standards are determined largely by government rather than private bodies. In many instances, this authority is employed to serve purposes, such as social and tax philosophy and policy, as well as revenue-raising considerations, which have no necessary relationship to accurate determination and reporting of financial performance. For this reason, it is difficult to prevail upon governments to change their local legislation so as to conform to IASC standards or, indeed, to engage in any activity which might be interpreted as conceding their powers to outside groups.

Another obstacle to harmonization is the different national viewpoints on the relative importance of the various financial statements. In some countries, the balance sheet is generally considered to be the most significant financial statement. In the United States, however, the income statement is generally viewed to be of primary importance. To the extent that this kind of difference in emphasis continues, progress towards harmonization will be impeded.

The only effective solution to these problems will entail a strong standard-setting body with a transnational perspective. I would be prepared to recommend and support such a body to establish minimum international standards; perhaps, the IASC might be the appropriate organization to accomplish this objective. Those standards would serve as benchmarks and would not preclude individual countries from establishing more stringent, or where necessary, different requirements so long as appropriate disclosures are made regarding material effects of any standards which are inconsistent with the IASC's pronouncements. If measures of this nature are not undertaken, however, further meaningful progress toward harmonization is likely to be slow.

VI. FUTURE TRENDS IN FINANCIAL REPORTING

The coming decade will surely witness intriguing and important financial reporting developments. The forces of change are pulling -- or, more appropriately, pushing -- us somewhere, although the final destination is not fully clear. In this context, I would like briefly to share my views on some of the directions in which financial reporting appears to be heading.

First, there is an unmistakeable trend -- recognized in the FASB's first statement of financial accounting concepts -- toward an increasing emphasis on the needs of users of financial information. To be truly useful, financial reporting must assist in an assessment of the amounts, timing and uncertainty of prospective cash flows. It must also assist users in making business and economic decisions. While the traditional financial model -- that is, historical, cost-based accounting -- does provide some assistance in making these assessments and decisions, there exists a growing recognition of the need for more relevance in financial reporting, even if it means some sacrifice in the reliability of the information reported.

In my view, this trend toward more useful information will necessarily lead to the reporting of more "soft" information; more future-oriented information; and more disaggregated financial information. Conversely, there will be less emphasis on the "bottom line" and earnings-per-share and more on the key components which may be better reflections of the operating results and cash flows of a business entity. These trends will require better accounting methods which more appropriately reflect economic substance. I believe that users are beginning to demand this kind of financial information.

To accomplish this end, I see a framework slowly developing. In the first place, there is a move toward more continuous reporting of financial information. The Commission presently has requirements for the filing of registration statements when securities are issued, as well as annual, quarterly and "current" reports. These reports provide a good nucleus for the kind of timely reporting which I envision. The private sector should consider refining and formalizing such a continuous reporting system.

Second, to accommodate more reporting of "soft" information, a distinction is being drawn between financial statements and financial reporting. Again, the FASB has recognized in its first concept statement that some useful information is better provided, or can only be provided, by means of financial reporting other than in the confines of the financial statements. The FASB's recently-issued changing prices standard represents the first time that a private sector standard-setting body has established a standard for financial information to be reported outside the primary financial statements.

I foresee an increasing use of this medium for the reporting of financial information -- an approach which the accounting profession has historically resisted.

Third, the auditing profession, like the FASB, has begun to recognize the increasing expectations regarding its role in the broader area of financial reporting. Auditors are already, to some degree, associated with disclosures outside the primary financial statements. Recently, professional standards have been developed with respect to the limited review of, and reporting on, information required by the FASB outside the financial statements. I believe that in the near future -- and, in my view, appropriately -- we will see auditors issuing explicit reports which explain their level of association with financial information presented in the broader confines of financial reporting -- that is, outside the financial statements.

I am pleased to note that most of the initiatives which I have discussed are emanating primarily from the United States accounting profession, rather than from the Commission. Nonetheless, the Commission's statutory responsibility for the integrity of the financial information disseminated by public companies requires its continuing concern with the accounting principles by which the information is reported, the auditing standards by which it is reviewed, and the independence and competency of the profession which performs that review.

My own preference is, however, to emphasize the role of nongovernmental bodies in resolving accounting and auditing issues. But, the "government" in the United States is not unanimous in this philosophy. Rather, the condition is fragile, and it is, therefore, incumbent upon the profession in America to face squarely and timely the difficult issues confronting it.

* * *

We are in a period of dramatic evolution within the United States accounting profession, and the profession deserves congratulations for the strides which it has made. At the same time, however, accountants must recognize the importance of ensuring that the momentum continues. The framework designed during the 1970s must stand the test of the 1980s and beyond.