

SEC Historical Society
Interview with Mike Sutton
Conducted by Gary Previts, on June 14, 2005

GP: Thank you for having me here in Williamsburg. It's June 14, 2005. This is Gary Previts, a faculty member at Case Western Reserve University in Cleveland. And today I'm interviewing Michael Sutton, Chief Accountant of the SEC in the period of—roughly 1995 to 1998. And today we're going to have a conversation or two about the philosophy, the events, the issues, the people, the activities that occurred in the Office of the Chief Accountant when Mike was in office in that period of time. Good morning Mike.

MS: Welcome Gary. Glad you're here. And I look forward to our conversation.

GP: Well for an opening question: How does one become the Chief Accountant of the SEC? How does that happen, in your case?

MS: My stock response to that question, when I was asked it, was that I became Chief Accountant because I was asked. Now, being asked is a story unto itself. After Walter left the Commission, there was a period of time when Chairman Levitt was searching for a replacement—searching for another Chief Accountant. And during that process, for some reason my name came into play, along with others. And so, I have never known for sure what the source of that was, but in any event; I received a call from him one day, and we began a dialogue that took place over a roughly three-month period. And at the

conclusion of that three-month period, I agreed to come down and to take the Chief Accountant's position for some undefined period of time.

GP: Is there a tipping point in your own thinking—it's got to be somewhat flattering to have the Chairman of the Commission call you and engage you; obviously show interest and respect for your thinking—but, you'd spent thirty years in the profession at that point in time approximately, and were the senior technical partner for a major firm at that point in time—what causes you to really start to think about this? I mean what's the motivation?

MS: Well, the motivation, I think, for everyone that goes into the position—certainly for me, having spent the time in the profession, you think you have a pretty good understanding of what the problems are, and have some ideas about what some of the solutions would be. So the opportunity to have that policy-making role, and perhaps influence the course and direction of financial reporting in the profession, is quite appealing. The only reluctance I had was that it—quite honestly - came at not the best time. It came when I was fifty-five, rather than fifty-eight; and so it would have been an easier decision if I were a little older, because of what I was doing at the time, and where I was in...

GP: In your career.

MS: ...in my career. But in any event, I ultimately made the decision to do it, and never regretted it for a day.

GP: Now, when you make that decision, and you pass that point; do you start putting together an agenda of things that you'd like to do when you're at the Commission? And having had these opportunities to talk to the Chairman, and get a sense of alignment of priorities, and kind of do a little bit of planning in advance of taking over the assignment?

MS: Well absolutely. And in fact, the first thing that Chairman Levitt asked me to do was to put together such an agenda—if you call it an agenda—but a list of the issues and the problems that I thought the Commission would either encounter, or should be addressed. And I did that; and we had a number of conversations about that.

GP: So, there you report for duty the first day, and what happens?

MS: Well, I think every Chief Accountant probably would tell you the same thing; you report for duty, and the day's events sort of take over. And so, while you've given a lot of thought to a lot of issues that you would like to think about and work on, what you work on immediately is the issue that's on the Commission's table at that point.

GP: So, there you are. You're a responder to circumstances in some ways; and yet there's a philosophy that you bring with yourself to the job, based on your experience, based upon background and values, and training. What are the particulars of that philosophy? What

is it about the role of an accountant in our free market system that was kind of the glue that held your thinking together?

MS: I view—and have always viewed—capital markets as being the real national treasure. And the success of those capital markets, as I saw it—and as I see it—is built on confidence. It's built on the confidence of investors, and the public, in the fairness of the markets. And it's that point of view that led me to the belief that the pursuit of financial reporting that provides full and fair disclosure of the underlying economic performance of companies is critical to the successful regulation of the markets. And it also led me to the belief that rigorous independent oversight of the financial reporting process is critical to assuring investors that the information they receive provides a reliable basis for making investment decisions. So I see it as part and parcel of the success of the markets.

GP: It sounds to me—perhaps my interpretation of this is—that a lot of this sense of what's important has to come not just from your experience, but also from particulars in your background—your hometown, family, education, schooling. What are the particulars of all those particular parts of your pre-professional life?

MS: Well, I grew up in a small town in east Tennessee—Maryville, Tennessee—and spent my first eighteen to twenty years there; and then went to the University of Tennessee in Knoxville, where I received a BS degree, and then an MS degree, in accounting. That was in 1963 - I completed my Master's Degree, and took employment with an

accounting firm that was then known as Haskins & Sells, which is now Deloitte & Touche. And I went to Atlanta, and came up—if you will—sort of came up through the ranks there. I became a partner in 1974, and served a number of clients—a range of clients—in the Atlanta office.

GP: Now, somewhere along the line you met Becky, right? Is it...

MS: Yes. We met in school, and we married in 1962, as I was in the midst of my Master's Degree—and we have two children, and three, and soon four, grandchildren.

GP: Now, at the University of Tennessee; you mentioned that you did both a bachelor's degree and a master's degree—master of science degree, I believe—to be correct. How was that educational experience—between the bachelor's and the master's degree—how did that affect you, influence you—or did it?

MS: Well, it did. I was influenced by the head of the department there—John Ross, who many academics would remember and know. He was head of the department. And he was working on the idea of the fifth year of education for accountants; and encouraged me, and a few of the other students, to consider staying on for an additional year to experiment with—if you will—a master of accountancy program, which ultimately became part of the curriculum. I was glad that I did that; I'm still glad that I did, because as I look back, that fifth year is sort of where everything came together for me about what

accounting is all about, and its role in society. I found it to be a very useful, very valuable experience.

GP: Were there any particular interests in that curriculum? Was it subdivided—you know, traditionally, I would guess, in the '60s you'd think about taxes being not quite as high a profile then as it is now. Would you typify what your study program was it focused on financial accounting and auditing? Was that pretty much what it was?

MS: From Day One, I guess, in my experience, or my education in accounting, I was drawn to financial reporting—particularly financial reporting for public companies. And auditing was—in my mind at that point—a significant part of that. And so then I was also drawn to the auditing profession.

GP: Can we spend some time talking about those years—you mentioned you were working out of Atlanta until you went to the national office. Now was the national office in Manhattan at that time?

MS: It was.

GP: Before the Wilton transfer?

MS: Yes.

GP: How many years in Atlanta? And perhaps, you know, some of the client experience that you had that would have, again, kind of built the base for qualifying for the responsibilities you ultimately take on as Chief Accountant.

MS: Well, I was in Atlanta from 1963 to 1978, so about fifteen years. As a senior accountant, as a manager, and as a partner, I served a large variety of companies, including some large public companies in broadcasting, and cablevision, manufacturing, and utility industries—among others. By the time I had been a partner a few years in that environment, my interest in financial reporting and accounting continued to grow. And in 1978 I had the opportunity to transfer to the firm's executive office in New York, to head up what we called an accounting research group, which wasn't research in an academic sense, but was a more pragmatic kind of research of literature and practice to find solutions to problems.

GP: Now who would have been in that office—who was managing partner of the firm at that time?

MS: Managing partner of the Atlanta office?

GP: Yes.

MS: That would have been Ladenhead at the time I left—yes.

GP: I remember his son, Gary—ran into him at one point in time. All right. So, was Oscar running the shop in New York?

MS: Oscar was the head of the accounting and auditing practice about the time that I went up there; but shortly afterwards, Oscar retired; and Ken Stringer took over as the head of the accounting and auditing practice.

GP: And were the assignments there—you mentioned it wasn't academic research; it was very technical, and maybe client-specific assignments? Is that right?

MS: Yes. Typically client-specific—not unlike the registrant inquiries that we received at the SEC, or that other firms receive in their technical group.

GP: Yeah, so there was almost a kind of a separating, or preparing, here for the types of technical questions and issues—global companies involved in a lot of these assignments?

MS: Yes. And of course, the questions that would come to the research department would be the ones where there wasn't an obvious solution on the surface, and it required more intensive technical and experience skills than might be found in the practice office.

GP: And these are the early years of the FASB, right? The late '70s, early '80s?

MS: Right.

GP: Do you have—are you drawing committee assignments nationally, or within the firm, or—because, you know, I think you have to have a considerable—I would say—network; and you develop that, I suppose, out of the national office. But...

MS: You do.

GP: What types of assignments came out of this responsibility?

MS: Well, in 1980—I'd been there about a year and a half, two years—I went onto the Accounting Standards Executive Committee, which at that time, was working out—I would say, the AICPA/ACSEC—we were working through our relationship with FASB, and sorting out the agenda of what ACSEC would work on.

GP: Who was going to do what?

MS: Right. So that was an interesting experience. Then in 1983, I became a member of the Financial Accounting Standards Advisory Council, and served on that for three years. It was then that I had a career break, if you will, in the sense that I returned to practice. I

went out to Detroit office and served as the lead client service partner on the General Motors engagement for three years. And then I came back to executive office—national office—in 1987, and resumed my career path in accounting and financial reporting.

GP: So that's a pretty high-profile assignment—major responsibility in the firm. You deal with folks like Gene Flynn.

MS: Right. Yes indeed.

GP: Yes indeed.

MS: Gene's a good friend. We don't agree on a lot, but he's a good friend.

GP: Well, Gene—that reminds me of the comment that I've heard often about very strong individuals—that he may be right, and he may be wrong; but he's never in doubt.

MS: Exactly.

GP: And—well that, essentially, does place you in another step toward dealing with not only client issues, but global issues, and issues that are kind of generic.

MS: Yes.

GP: So that is—I think, describing it as a career break is clearly—it’s a career-directing event.

MS: Right.

GP: So after three years at GM, what happens next?

MS: Well, I came back to the national office, as I said, and resumed my path of pursuing financial accounting and reporting, and consultation with practice offices, and that function within the national office.

GP: How big a group is this technical group that you’re a part of now as a partner? At this point in time, the mid to late ‘80s?

MS: The research function itself—I guess you would have to break it down a little bit, because the research function itself involved two or three partners—three or four partners—and a significant staff—say ten, twelve, fifteen managers, who came to these assignments as part of their career development, on a temporary basis. But beyond that, as I moved up in responsibility, other aspects of the firm’s practice—the auditing group, the SEC group, and what ultimately became the professional practice directors network in the field—all came under my supervision during that period of time.

GP: Now, is this Charlie Steel, managing partner, period?

MS: Charlie Steel was the managing partner until Mike Cook came in as managing partner, which would have been probably about the time that I came back from Detroit.

GP: Okay. So you're increasing both the level and the—kind of—decision level focus of the work that you're doing at national office. And I suspect now some other things are happening with regard to your career, in terms of national service involvement—right? Things begin to happen here as well?

MS: National service...

GP: I'm thinking of the Jenkins committee, for example.

MS: Yes. Well, other things were happening. One is that the area of my responsibility was broadening to include not only accounting and financial reporting, but auditing and SEC practice, as well. And then...

GP: So that's pretty significant. That's a major—that's a big hat to wear.

MS: And then—somewhere in that timeframe—the EITF was born, in what—'85, '86...

GP: I'm thinking mid-eighties.

MS: And so, when I came back—one thing I did was become the firm's representative on the Emerging Issues Task Force. And also, during that time there was quite an undercurrent to rethink the role of financial reporting, and to take a forward-looking view, if you will, of what financial reporting and the profession should be all about.

GP: There's an intersection here between Treadway, which is really about fraudulent financial reporting, and a movement toward fixing the model.

MS: Right.

GP: Which kind of intersect toward the end of the '80s, after the Treadway Commission is out, and before the—what is now called Jenkins Committee is formed.

MS: Right. It was in 1991 that that dialogue that led to the formation of the Jenkins Committee, which Ed Jenkins chaired.

GP: You were vice-chair, as I recall.

MS: Yes.

GP: At the same time that you're involved in these profession-wide and major service roles—maybe back up a little bit, and talk about the EITF, if you would—as to what kind of experience that was. This is the formative years of the EITF. The EITF today, I think, is a little bit of a different creature, and yet it's still patterned after the way it was formed twenty years ago. It's just that an emerging issues task force with a notion of consensus being not necessarily binding, but strong guidance in emerging issues—right?

MS: Right. Well, it became binding because of the SEC's posture that unless otherwise directed or determined, an EITF consensus would be considered GAAP by the SEC staff. But the EITF really grew out of a dissatisfaction, if you will, with two things. One is the pace of resolution of issues—practice issues—and the other was the process around that. And so EITF was born with the specific objective of not being encumbered by all of the due process requirements that are necessary in setting authoritative standards; but the idea was to provide a more nimble process, if you will, for getting practice to a consensus position that would be acceptable to practitioners, to the registrants, and also, importantly, to the SEC.

GP: This notion of consensus—and I can think of one other discussion I had at this point in time about consensus—also had the value—or *did* it have the value—of heading off, you know, multiple competing, conflicting practices that might cause difficulties with comparability down the road.

MS: Yes, it did. The firms tried to do this informally, but the process suffered in a couple of ways. One is, it couldn't involve all the participants. It was a common part of our consultation on difficult problems to call around and talk to your peers about how they viewed the problem, what they thought the solution was, and to try to informally develop a consensus for practice. That was a very difficult process, and was vulnerable to opinion-shopping; it was vulnerable to competition for accounting solutions, if you will, among practitioners. And so, clearly, that was one of the underpinnings of the formation of the EITF.

GP: So how long do you serve on the EITF, Mike?

MS: I was there until 1995, when I left the firm to go to the Commission.

GP: So that's almost a ten-year period of service. It's a very—and right in the point where all the things are happening; because there's no way the FASB would have opined on these items yet, and in some ways these are all, literally, the hot topics.

MS: Right. Well, at the outset, philosophically, the desire was to have EITF made up of the more senior partners from the firm, so that it would speak with greater authority, and would clearly have the backing and support of the firms behind it. I think over time that has evolved to having a more diverse representation on the EITF, and not necessarily the senior, technical partner of the firm.

GP: So I guess at this time, also, you're dealing with GAAP hierarchy, and the EITF merging as a fully recognized weight in the statements of auditing standards hierarchy for GAAP, and...

MS: But in essence, the EITF drew and now draws its authority from the policy of the SEC to participate in the process, and to—if you will—declare EITF consensus to be GAAP for public companies.

GP: So this would have been the period as well where some of the first issues about related entities, and so on will come up—right?

MS: Yes.

GP: That you'll deal with later when you're at the Commission.

MS: Right.

GP: Now, and one bright morning at the EITF did you ever think to yourself, well, this is good training for my potential services, you know, as a person in the OCA—was there ever—you know, I mean when—you're working with people at the Commission who are observing at the EITF meetings—does that thought ever strike you that this might be—

make sense for a role that you might have some day at the Commission? Or was that just never on the radar screen?

MS: It never was on the radar screen until that spring morning when I got a call from Chairman Levitt.

GP: Well, I bring that in because—for those who might be listening, and hearing us talking about EITF; they're going to say: What's this got to do with the Office of Chief Accountant? I think it's got to do with the process by which a person becomes respected and qualified for that position; and apparently it doesn't always happen because someone puts it on their chart when they're starting in the profession, that I want to be Chief Accountant some day.

MS: Exactly.

GP: The process of getting to the EITF, remaining on the EITF, managing your responsibilities with the firm, and also getting involved in the Jenkins Committee—brings us up to the early '90s. And the Jenkins Committee is about a two-year project?

MS: Well, it was—actually it was longer than we thought. It started in '91, and we finished up in '94; so it was nearly three years, I think.

GP: And maybe later—you know, toward the end of our conversations, we can talk about whether or not that is still, you know, an unfulfilled promise, or whether there have been some steps taken; because there have been subsequent actions. And in your term of office, I suspect that there were some discussions about the financial reporting model that we'll come to. But clearly, Jenkins was an attempt to kind of shake things pretty hard, and look at the focus of user needs. I remember that word being very key in the charge of, and the work that was being done for the committee.

MS: Right. And that was—sort of at the outset, we decided—very early in the process - that what we needed to do was to go out to users, and try to figure out what they want, what they need, how they use information; because for us, as a committee, to sit back and try to answer those questions from our own experience was not the right way to go about it. So we expended a vast amount of effort in trying to understand what users want, and how they use the information.

GP: Again, this is largely a private sector initiative, with SEC observers.

MS: Right.

GP: But essentially, this is, again, a private sector activity; I think, which traces back to that Warden meeting that was held, and convened, and—you know, people said, you know, the process is kind of—it needs to be re-looked at; and then the Jenkins Committee is

formed, and it produces its report; and it's got this strong user needs message. Does that reflect, you know—was that pretty much a consensus view of the committee members for Jenkins—that that was the focus? Or was that more him than the committee?

MS: No. It was—clearly was the majority of the committee. I think of people like Bob Elliott and myself—as well as Ed—who had a pretty strong view that we needed to go in this direction. The other committee members, by and large, were supportive of that view.

GP: When you were studying in Knoxville; and mastering worksheets and manual activities—the technology was pretty simple. I mean it was a ten-key adding machine, and sometimes it was a crank adding machine.

MS: Right.

GP: And now over the past decades we've come across a whole retinue of technology. Where does technology enter into your—you know, as a challenge, as an aid, as a factor—you know—in your administration of, in your addressing, technical issues? Was there ever an experience—one experience in particular that just kind of stood out where you said: Wow, you know, this is—this is a point that is a transition.

MS: Probably the closest to that, Gary, would have been during the special committee process, as we looked at and learned more about technology, and the directions of technology. I

was impressed with the possibilities coming down the road for how information could be gathered, and summarized, and analyzed, and presented in more ways than were feasible at the time I started out in the profession.

GP: This is pre-net, isn't it? I mean the process ends up in '94, and I think by—depending on whether or not you believed the—you know—the Al Gore book or not, sometime in '95, '96 you start seeing the Web coming on the scene; and as we were commenting this morning, now the business publications are saying there's one billion people on the planet that have instant access to the Web, and make use of it. So technology is certainly a factor, and this committee is sensitive to it.

MS: Yes.

GP: Perhaps as a particular.

MS: Yes. And there were some of the members that were much more in tune with the potential of technology than others; but the committee, as a whole, was persuaded.

GP: Now this is pretty heavily focusing on all your professional service involvement: Does this line up pretty much with where your practice responsibilities were as well? In other words, taking on issues that had to do with development of—if you will—the future

reporting and auditing and regulatory model issues—or did this become—I mean of the hundred and fifty percent of your work, how much was each part?

MS: Yeah. Well, I would say the—it was pretty evenly split between practice responsibilities within the firm, and external being all of these other professional activities that I was involved in. But it's hard to separate the two, because one builds the other; in other words, the practice experience enables you to understand and focus on what the policy issues are, and vice versa.

GP: The Jenkins Committee winds up in '94; and you get the call within, perhaps, about a year.

MS: Well there's one other thing that happened after Jenkins, and just before I went to the Commission—if you recall, during Walter's tour, there were some pretty serious charges raised about the profession.

GP: The cheerleading charges.

MS: The cheerleading charges. And that brought focus to the role of the EITF; and so there was a decision made by, I think, FASB—Denny leading that decision—to take a fresh look at the EITF process. And so I chaired a committee to review the Emerging Issues Task Force, where we just took a fresh look at the process, recommended some changes,

discussed it with the SEC, and ultimately got a concurrence on what refinements needed to be made in that process.

GP: Anything in particular that sticks out in in these refinements, as you've put it?

MS: Well, the thing that sticks out is that there was a real hard focus on whether the EITF was really operating independently, or whether it had lapsed into what Walter called the cheerleading response.

GP: Okay. Because they're the one that was most directly connected with immediate issues that were firm-based.

MS: And most directly connected with various client bases and industry groups, who had a vested interest in the outcome of the issue. So, it was a very important thing to look at, and to try to strengthen—if you will—as much as you can, through process and procedures—the decision-making process of the EITF.

GP: And you mentioned Denny before—and just for the record, that's Denny Beresford, who served ten years as chair of the FASB; I believe from approximately 1987 to '97, if my memory serves me correctly.

MS: That's close.

GP: Okay. So now it's probably time to talk about—we've mentioned background issues; hometown, family, schooling, some of your early professional experiences and client responsibilities—any other elements that—anything that, upon some reflection—you know, thinking about parents, and others, that were important in this background of putting together someone—you know—as a career professional accountant who is willing to step up and accept this responsibility. Because it's nice being asked, but you don't have to say yes?

MS: I don't think of anything other than growing up. I was fortunate to grow up in a small town that had a lot of support for the people growing up there, it had an excellent public education system, and a culture and environment where things were pretty simple. When I say things, I mean things like ethical responsibilities, and decisions—I never felt were very complicated; they always seemed to be quite simple if you looked at them closely enough.

GP: So it's that kind of a foundation that gets you into the profession, and brings you along to this point. Now, you mentioned that there was a period of time from when your name might have been put into consideration, and then you're contacted—but, as I was hinting at just a minute ago, you don't have to say yes.

MS: Right. In the first conversation, I thanked Chairman Levitt profusely for thinking of me, and I explained to him that I was at a point in my career where that really didn't fit. If I were three or four years older that would be a much more palatable or a much more exciting opportunity. And so I thanked him, and declined. If you've ever worked with Chairman Levitt, he's a very persuasive guy, and he accepted my decision for about a week. And then he contacted me again to say, well, I think we ought to talk about this some more. So we did.

And I think the discussions, as I said, went on for—oh, two or three months. And they ended up with a visit to his home in Connecticut, on a Sunday morning, and ultimately a decision that I would do this for a period of time. I told him at that time I had in mind two years, but not more than three. And so, my time in office came out to about that.

GP: Now, as we look at the history of the Commission at this point in time, with Arthur Levitt as chair; Walter had left, and there was an interim—or an acting—chief accountant. I think John Riley was acting prior to your coming in as Chief Accountant. So there were some issues that were going to be before you—as you say, you have this agenda; and then you come in and you find out that there's also some things left on the table that you have to deal with. And to some extent, there were other issues—events, and/or issues—I think that's a good way of structuring it—and of course, the Independent Standards Board's going to be one of those.

MS: Yes.

GP: I remember seeing you at that conference at the AICPA, where it was held in the AICPA boardroom—I remember Chairman Levitt was there for the inaugural event of that board, in '97—I believe, October of '97—so that's coming up; and that's going to go on during your term of office. What are some of the early issues that you had to wrestle with, that were put in front of you?

MS: Let me go about it chronologically, because, as I think I said at the outset, while you may have a clear vision of what you think are important issues, in reality, the issues define themselves. They present themselves; you don't present the issues. So, at the time I went into the office, two things were still smoldering. One was the wrap-up of the stock compensation project, and that was a situation that was perplexing to the Commission, and perplexing to Chairman Levitt, but as you know, it ultimately ended up in a decision to issue a disclosure standard, and not require mandatory recognition.

GP: Right. And I will say that in readings that I think are valid attributions, the Chairman—maybe in his book, the book that he published after he finished his term—indicated that for whatever reason—and maybe this doesn't bear on it, but I wanted to share it because it *might* be relevant—he did not either feel he had, or could expend the political capital, at that point in time, on that issue.

MS: Yes. That was just before I came, and that was during the end of Walter's tour; but yes, he said that often, and he often expressed regrets.

GP: Some frustration.

MS: And I think it was one reason why he wanted very much to have someone with professional background to succeed Walter; because he could see the need for maybe a little stronger hand in dealing with some of these issues.

GP: Well, there are two things you said that are smoldering; and I certainly want to make sure we don't lose track of that; but your other comment here causes me just to do a little—I guess, if you're doing a play-by-play, I'll do the color on this—comment that if you look at the history of the appointments of chief accountant; it is a kind of a turning point here, because Clarence had a long term of service; and when he concludes, he goes to the FASB for a term.

But he had kind of grown up in the Commission, worked under Sandy Burton for a while; and then when Sandy leaves in August of '78 or so, Clarence comes in as acting, and then is appointed. And so you have a career SEC person there. And Ed Coulson follows him in kind of the same vein. Then we have Walter coming on board, with a strong professional background—former member of the FASB—strong technical background;

and then succeeded by you. So we've got a change of pace here. We do have the strong technical kind of background individual.

MS: And I think it says something about the issues that were emerging, and the issues that were presenting themselves; and the difficulty—not just technically, but politically—of dealing with those.

GP: Now there's an interesting word. I don't think I've heard that word in an accounting environment before—politically.

MS: Well, politically in the sense that—and I'm not thinking Washington politics necessarily—but politically in the sense that you have constituents. You have a sharper division between what constituents want, and what the standard-setters think ought to be done, and what the Commission sees as its responsibility.

GP: Now that might be something—without bearing sharp sticks down it—we can reflect upon a little bit more in the conversation, because the term “political” can have so many connotations; and maybe there's a certain way of identifying the political connotations of accounting standard-setting that aren't necessarily negative; I mean they're just actual. I mean that they're reality—and getting a clearer grasp of what that reality is would serve to help people better prepare to address issues fully.

MS: Right. And they're drawn from the conflicting interests that are placed in the marketplace—the interests of those who are issuing stock, versus those who are buying stock; the interest of constituents who are reporting, versus those that are auditing, or those that are regulating. So it's not politics in an evil sense; it's the politics of reality that there are these divisions of interest; and they have to be managed as best the Commission can—in the best interest of investors and the markets.

GP: We go back to the two smoldering issues for a minute: One, you say, was stock compensation...

MS: Right.

GP: Or—how do we say it in the U.K. now—share compensation, or whatever.

MS: Yeah.

GP: There's a little different—but it's the same thing.

MS: But by the time I got there, the Commission and Chairman Levitt had crossed the bridge on disclosure versus recognition. So it fell to me to really work through that project with the FASB, and bring it to a conclusion, which we did. The other issue that I described as smoldering was actually heating up, as opposed to turning down, and that was

derivatives. If you recall, it was in—I think—the first quarter of 1994 that the big surprises came—a series of big surprises—huge losses in derivatives that weren't readily apparent from the financial reports, or otherwise, in the marketplace.

GP: Yeah, I mean we run risks here of—we don't have consulting material in front of us; but I'm thinking Orange County and Gibson green cards, and those kinds of...

MS: Proctor and Gamble.

GP: Yes, Proctor and Gamble.

MS: *Huge* surprises, in terms of losses—and this, again, just before I came. As I understand it, what typically happens in one of these financial crises, is that the Chairman of the Commission gets hauled up to Congress to explain what the Commission is going to do about this. So, we were in the process of discussing—okay, what should the Commission do about this.

GP: Now, this 'we' is your office.

MS: Well, the Commission as a whole, but the focal point is my office.

GP: But the hot potato is coming your way...

MS: Yes.

GP: And now, you're in an environment where you're working with people who are somewhat new to you; although I suspect long-term—whether it's Larry Soper, or Jack Albert and Bob Burns—there are people that have been there career-wise as well. Maybe just a comment about how you get yourself into being an effective leader and colleague, coming, essentially, from them that *are* being regulated to them that is doing the regulating.

MS: Right.

GP: How do you manage that? How does that come about?

MS: Well, my approach to that is through inclusion. So I would get everybody involved in all of the major projects, and try to be as inclusive as possible—not just within the office, but with the Commissioners and their staff, and with the Division of Corporation Finance and its staff—that takes a lot of time, and a lot of effort.

GP: What are the workdays like when you're doing this?

MS: Well it's just from morning till you're so tired that you think it's time to go home. So it is a non-stop—it's a very demanding environment. Although I understand that there are significant additions to staff resources today, I'm sure that if you talked to Don Nicolaisen today, he would tell you that that hasn't changed. There always seems to be more issues than resources.

GP: So one smoldering issue that crossed the bridge—and they're now looking at the derivatives issue, and you come into this—it's not an inherited issue, it's kind of your issue, because these things are going on now.

MS: Right. It's the first big issue that comes to me directly.

GP: How do you—and you're talking about inclusion, and working with folks in an inclusive basis—how do you get a handle on—I suspect that there's a lot of intuition here, a lot of experience that kicks in—but is the point of view—I mean you've got this philosophy that you expressed earlier; and that seems to synch with what the full and fair disclosure responsibilities are for the Commission—but do you sense that you find yourself maybe looking at things a little bit differently?

MS: You do. You obviously do. I'm never surprised by how people will adapt to new responsibilities, because I think that it's human nature to do that. If you're given a job, it's human...

GP: ...and that you find a way—you're in a transitioning environment, but you're adjusting to it and its responsibilities.

MS: Right. I've always said that one of the real positive aspects of working at the Commission is that it has a very clear, and a very simple, mission and mandate.

GP: How do you espouse that? How do you articulate what you see that to be?

MS: Well, it's espoused on the website as, "We are the investors' advocate." In the financial reporting—accounting and disclosure—context, it's espoused as full and fair disclosure to the marketplace to provide the level playing field you possibly can to market participants, and particularly to investors.

GP: Is there a story about derivatives from this point forward to—you know—your term of service and resolution—about complexity, about the politics of this particular issue now that it can be told in kind of a comprehensive way, in a summary way?

MS: A few things come to mind, Gary. One is that it was complex, both technically and politically, in the sense that there was a clear expectation from policy-makers—that's shorthand for Congress—that the Commission would deal with this. We looked at our role, and our relationships with the FASB, for example, and said to ourselves, well, we

need to work with this in a way that preserves and maintains the partnership that we have with FASB, particularly, and the private sector, generally. And yet, still be sure that what needs to be done gets done in a timely fashion.

GP: And that seems to be an issue; because timely sometimes isn't—in fairness—isn't always something that the FASB *can* address.

MS: Exactly. And that's part of the difficulty. But anyway, the first thing I did—at the request of Chairman Levitt—was to put together a strategy for how we were going to approach this, and that was mid-July of 1995. And in simple terms, I broke it down this way. One is, we would leave the accounting part of the equation—that is, how do you account for derivatives, how should they be accounted for—we're going to leave that on the FASB's plate, and work with them to try to get their process functioning in a timely and responsive way.

And then the second part of that was what led to what I call the disclosure aspect of it; and that led to the decision to develop, and issue, a market risks release that some would call additional MD&A. Others look at it as a separate source of information, but in any event, it's modeled after MD&A. We looked at it from the Commission's standpoint: Okay, what kind of disclosure should registrants be making about the market risks that are inherent in their activities, and in their balance sheets, and their portfolios.

GP: Isn't there a certain kind of perplexing quality about derivatives that can either put off or confuse people? You've got this advocate of investors—and yet there are different constituencies of investors. As we talked about before we went on tape before—there are price-takers and there are price-makers, and there's all sorts of different folks. When you start honing in on who it is that this disclosure is going to be communicating with, do you have to kind of adjust yourself issue by issue? Or is there some sweet spot that the staff kind of just begins, as a team, to have the same mental software about?

MS: Well, I think the target, generally, is those—whether they're institutions, or they're individuals—that are using financial information—accounting information—to make investment decisions. It's very difficult to segment it into individuals versus funds, versus retirement systems, so we tend to look across that, and say, okay, who is the target for this information? And in some contexts, we call them external users; in other contexts we look at them as being people, or organizations, that are using financial information, using financial disclosures, to make investment decisions.

And the key distinction between what we ask the FASB to do, and what we took on, through a disclosure release—the FASB we asked to take on, okay, let's get the accounting right, and that's what we want you to focus on. And we took on the other aspect of this. If you remember those derivatives were a big surprise, and so, you might think of our release as focused on what might happen. And if interest rates again jumped a point and a quarter, or dropped a point and a quarter, what would happen to your

company in that event? And so that became the focus of what we were trying to do; and we saw those as complementary. Get the accounting right, and also get better disclosure of what the underlying risks are in the companies' financial statements.

GP: You've been very specific, using the term 'derivatives'; but in another sense, financial instruments, as an issue, are born here in a way—I mean we've always had financial instruments—preferred stock—I mean it was a headache for J.P. Morgan a century ago—but it seems to me that this issue really kind of matures at this point in time.

MS: You're right. I refer to it as the derivatives release, and that's solely because that's where we started. But if you look at the end result, it was a market risks release. We saw pretty early on that this was a broader issue than just derivatives, and that it should be focused on market risks, and not just exclusively on derivatives.

GP: Now you have the benefit of hindsight now; we're here in the year 2005; these events are now going on a decade or so, and you have a little chance to do a little second guessing about whether you got most of it right; whether, if you had another crack, you might tinker with this or that—I think it's not unfair to think, you know—what about this? How do you feel about the issue now? It's really still with us; it's an evergreen issue, as I like to refer to it; so it's not that you're going to inoculate this thing, and it's going to go away.

MS: No. And one thing that I—and I'm not conversant in the current state of academic research—but one of the things that we hoped would happen—and we did involve a lot of academics in our process—was that there would be research—good research—to help answer that question - does there need to be a Chapter Two, or a Chapter Three, or is this a sufficient level of disclosure of market risks?

GP: And I suspect that if there's one thing that's probably more time-dependent and slow to develop are long-term academic studies. So we may still be waiting.

MS: Right.

GP: For better or for worse.

MS: I think the answer—I don't think we know the answer to your question yet.

GP: And I think that's a fair response. And too often, we have great methodology on the academic side, but not a full appreciation for the issue. I see hopeful signs that academic research is beginning to become more sensitive to—but often, it's a major educational project just to get thirty-three and thirty-four issues clear in the minds of a lot of academics. Although, I think in the last—in the last several years, we've seen improvement in the understanding of issues and so maybe it is still, you know, on the horizon to be hoped for. So that you had—the two smoldering issues now: One is in the

background, and you know—share compensation will come back; financial instruments, derivatives, market risk—you know—will have a life of its own; but that's not all that you had—there were some challenges to the independence of the FASB that are going on here. Or is there something else that's more in order for discussion?

MS: No. There was another undercurrent that emerged, and that was there was a lot of dissatisfaction in the business community with the FASB, and that began to appear in press articles, and began to appear in speeches, and editorials in the FEI magazine, and that sort of thing. And in the fall, we became aware of some rather overt actions being taken to try to—if you will—capture the FASB, or to significantly increase the business community's ability to influence their process, influence their decisions; and particularly, to influence their agenda.

GP: I think this was about the time I was involved in the AICPA board; Mike Cook is Chairman of the Foundation at this point in time, or just about to be.

MS: Dennis Dammerman from GE was the Chairman at this time.

GP: So the undercurrents are strong; there's dissatisfaction with the board, which is not a new topic in its nearly thirty-year plus history—what happens next?

MS: The pressure to deal with derivatives and market value accounting issues only exacerbated the concerns that you would hear from the business community. Any time market value accounting gets on the agenda, it generally elicits rather a strong negative response. Anyway, we learned that a series of process changes at the FASB were going to be considered by the foundation, at the recommendation of some task force of FEI, I believe it was.

We tracked that down, tried to formulate an assessment of the situation - we judged it to be quite serious; we were quite concerned about this; and saw not just talk, there's always talk—we saw the possibility—the specter of some overt action to try to compromise the processes of the FASB. That led to a meeting in mid-December of 1995 of Chairman Levitt and I, with the trustees, in Norwalk. And it was in that meeting that—if you will—he sort of laid down the law that we're not going to do anything that would impair the integrity, or the independence, of the standard-setting process. And he really challenged the board of trustees to do what they should be doing, and that is providing support for the FASB, rather than catering to the interests of the business community.

GP: So there's a very difficult period here dealing with the representational structure of the board, and a number of different points of view as to what would be an appropriate public interest representation, as well; as I recall.

MS: That meeting, in December, then led to a dialogue, and then at some point after that, Mike Cook came in as the new chair of the foundation. But it led to some analysis of the composition of the foundation, the entities that it represented, and the realization, if you will, on the part of the Commission—and certainly on Chairman Levitt’s part—that the composition of the foundation was a problem in and of itself—that it didn’t have sufficient public interest representation to be effective in doing its job.

GP: Well, and that—of course, the foundation is the parent organization for the board—not just the Financial Accounting Standards Board, but the Governmental Accounting Standards Board—and without taking us too far off track, who knows what other types of boards? So, you know, that may gravitate—certainly that model has been adapted, or adopted, somewhat by the International Accounting Standards Board; so clearly, the integrity of it is important. And there are events that occur—I guess I would like to know if your assessment of this event—you know, is it—it was one of the major activities that took place that may not have been quite readily perceived as such—was it more behind the scenes than in the public view?

MS: It was more behind the scenes, but there was considerable press around the activities that were taking place.

GP: I remember on the composition there was a lot of press.

MS: And to me, it was one of the threshold events, if you will, during my time at the Commission, because there was a real threat—if left unchecked - that could have led to undermining the FASB, or even the demise of the FASB, if the business community had been successful in its efforts. So, in my mind, its significance is that it put the FASB back on its feet, if you will, in the sense of having the support and the strength that it needed to do its job effectively.

GP: Well, I'm aware that in the interim between Walter's term of office and yours, when there was an interim period—there were some latent issues about scope of services and auditor independence that were brewing.

MS: Yes.

GP: Going back probably to Walter's term, and I'm not precise—maybe even into Ed Coulson's term—I think it was more Ed's term—Arthur Andersen had petitioned for—along with, I think, maybe two other firms—some relief with regard to independence relationships with their then consulting arm. There were a number of attempts that were unsuccessful; they subsequently got a 'no-action' letter; and so there was sort of a competition here among firms that the SEC was asked to straighten out: When are certain relationships independent, and when are they not?

And while the firms came together—at one point in time, three of the firms came forward; subsequently Andersen comes back separately—but there's competition here for the Commission to sign off, or—if you will—to approve or indicate support for independence relationships that are taking place in due process, but maybe in the twilight of it, not in the full development of it yet. I think an issue comes forward for you almost immediately on that—does it not?

MS: It does. It comes to me in a number of—or in more than one way. I guess the issues that were raised during Walter's term about the performance of the profession, and examined by the Kirk Panel...

GP: Right.

MS: ...left some of the Commissioners scratching their heads as to being able to understand the behavior that was taking place. Why is this behavior taking place? And then they're also seeing increases in enforcement actions involving accountants, and they're looking for explanations to why this is happening.

GP: Could I kind of pursue that a little bit, because this is this market to mandate shift that's going on. In the background—you know, the Securities and Exchange Commission is such a powerful force when you think of public accounting, particularly for publicly held companies. But in our regulatory scheme of the Federal Trade Commission, there's no

light weight. And of course, the Federal Trade Commission had been very active, beginning in the early '80s, remodeling, if you will, the—what we used to call the code of ethics, which is now the code of professional conduct; which essentially was encouraging competition as a means of reallocating the way in which we employed our intellectual resources. So you're in the midst of the maturity of the firms adapting their service behavior to a more aggressive posture; expanding their scope of services, not necessarily limiting it—and you're coming right four-square in the middle of that.

MS: That's—I think it was 1996 was the year that the source of revenues went from being predominantly audit to predominantly non-audit.

GP: Yeah, that's—that *is* the tipping point.

MS: And that, in and of itself, raised questions. And put that in the context of the Commission seeing what they viewed as inexplicable professional conduct.

GP: Enforcement releases, and so on.

MS: And so, one and one—does one and one make two? When I went in, I tended to—at the outset—to view the independence issue as first, an ethics or professional conduct issue, and secondarily as a scope of services issue. That was my background, that's where I came from. And as we went along, and particularly after we passed this tipping point—it

was in that timeframe that, in my own mind, I began to put one and one together, and come up with two. I was seeing—the behavior of the leadership of the firms—their focus, their direction, their messages to the organizations about what their organization should be doing—it became clearer and clearer to me over that first year that I was there, that this scope of services really is an issue.

And I gave a speech about that in 1996. And if you read that speech, I ask more questions that I gave answers, because at that point in time, I was still sorting through in my own mind exactly how deep this problem was, and what ought to be done about it. The intent of the speech was to stimulate the profession to look at this and consider it an issue, and to try to address it. It had the opposite effect. It had the effect of putting the Commission in the position of—in the view of the profession—they saw the Commission as attacking the profession. Where the intent was to get the profession to step up and address the issues professionally as they should, in their role.

GP: So this is a 1996 speech. There are all sorts of market-based attempts—I'll describe them that way—to suggest that, we have a Financial Accounting Standards Board; why don't we replicate that process for setting independence standards, because the poor practitioner has professional standards about independence—well, you can include the GAO—you've got the SEC, and of course you've got all the AICPA code of conduct independence items. And as I recall, the criticism was that a lot of the standards that SEC was employing for independence were really of vintage 1975; they need to be

modernized. So out of this kind of a market response, comes a proposal for a new board—right?

MS: Right.

GP: And you're in the middle of all that.

MS: Right. And that was what we began—the profession, the leadership of the profession - wasn't going to take this on. We pleaded with the leaders of the six firms, and the AICPA, and they weren't going to take this on. They saw it as being an unwarranted incursion of the Commission into their business and activities—and inappropriate.

GP: It's a difficult issue, because the Federal Trade Commission clearly had blown away all the old behavioral guidance, and said go out and compete; and see how far you can go before. In some ways the Federal Trade Commission is—Chief Justice Burger said, never, never, never hire an attorney who advertises—or words to that effect. So that the legal profession had been drawn into this openness—dentistry had been drawn into this—accountants were part of this professional community which had been looked upon as being, perhaps, price exclusive, and having monopolistic powers, and not necessarily responding to market needs. So, drawing—how do you balance that? I mean that's really what you're facing, isn't it?

MS: It is. And as I saw it—and I was not successful in persuading the profession to see it that way—I saw it as a conflict management problem. What I mean by that, or what I meant by that, was that almost anything you do, whether it's business or profession—accounting or law—there are certain conflicts of interest. And they exist. And they're natural to the environment. And so the scope of services issue, in my mind, clearly presented a conflict of interest. It was a conflict between the expected behavior of an auditor, and the desired behavior of an organization that's principal focus is making money.

And so what I thought had to be done, was to examine that conflict of interest, and come up with a way of managing it. And in a simplistic way, that's what led to the idea of Independent Standards Board. The firms, the AICPA, were not going to take this on. So we came up with the idea of forming a new independent group that could step back from all of this, and take an objective look at the various conflicts of interest, and develop some standard for the practice of the profession.

GP: For the sake of getting clear—what's the genesis of the idea of the Independent Standards Board? Is it part—is there a Sunday morning meeting in Connecticut, or is there—

MS: No.

GP: It's just an eureka...

MS: Remember, we're coming off of this—we have now restructured the FAF.

GP: Yeah. That's right.

MS: We have a real good idea about what we think needs to be done to make effective private sector organizations that will perform in the public interest. And so, having just come through that, the idea comes—well, why don't we—one idea was, why don't we give the problem to the FASB, and quickly we said: No, no, no. That's overload. And so the idea was: Well, what about something like the FASB that would be independent, would have an objective outlook, and could step back and take a look at these issues and develop some objective standards.

GP: Now this has got to be a hard sell. Or is it?

MS: It is a hard sell. And the only way to sell it, at the end of the day, was to have a balanced representation—a number of members from the profession equal to the members from the public interest side, if you will. And that ultimately led to its—in my mind, it sort of led to its grinding ever so slowly, until it just became ineffective.

GP: But there are very high profile individuals, including John Bogle, who sign up for this—certainly an investor advocate if ever there was one, from the point of view of—what was his firm?

MS: Maybe a little naïve at the time was the idea that the managing partners of the firms could rise above their interests and look at this in an enlightened self-interest.

GP: Philosophical way.

MS: Or in an enlightened way. You can't eliminate the self-interest, but we hoped that they would be able to rise above that. But it became quite clear that any meaningful change was going to be faced with a six/six vote. And so, the standards that the ISB issued, if you look at them—they're not dealing with any serious conflicts of interest; they're dealing with rewriting some rules for auditors.

GP: So the—you know, the ISB essentially—it draws a policy release about it being recognized and so forth, but it's kind of a short leash; and I'm not sure if that's issued while you're still in office, or afterward. But the Board eventually does—is wound up in 2000, 2001, as I recall.

MS: Yeah. It grinds to a halt. I drafted, and Lynn issued the accounting series release that was a pair, if you will, to the FASB release, where it said the SEC would look to the ISB to develop standards in this area; which is what we did with the FASB—or Sandy Burton did with the FASB.

GP: So, just—again, we have—we’ve talked about derivatives and so on, and you know—ten years later looking back on it. Now you’ve had an experience that didn’t work out maybe with the expectation, but doesn’t necessarily mean the model’s flawed. It clearly had a composition that maybe ended up being predisposed to gridlock.

MS: And the profession—looking back—wasn’t ready for this. They had not yet—and maybe they haven’t today—seen that there was an issue here, that there was an issue of not just independence, but of confidence in the profession.

GP: In scope of services, and all the other issues, because after your term was over, but clearly, you know, by 2001, all but one of the firms—your own former firm—have spun off, or sold off their consulting practices. So there’s a huge response to this that maybe we need to talk about in terms of the multi-disciplinary firm and lawyers, and so on, later. But it is part of it.

MS: You’ll need to pick up with Lynn. This is one that...

GP: MDP is...

MS: ...was on the table when he came in.

GP: I think MDP is more on his watch. That’s Cognitur and all those...

MS: He came in shortly after the accounting series release on the ISB was issued.

GP: Now, there is an instrument though, or there's an episode or an event that you have to deal with; and that's Baymark.

MS: Right.

GP: That's sitting there waiting for you when you come in; that's another one of these events, right? Or was it?

MS: This happened in '96—this would have been well along in my tour. And I remember the scene, and I don't remember the day—exactly when—but someone, one of the staff members came in with this disclosure in a filing by Porta Systems that laid out what they saw as a clear violation of the independence standards.

GP: Essentially arguing that one of your subsidiaries cannot take on an action that you yourself can't take on. So you can't veil it.

MS: Right. We had to decide what to do about that, because we had a registrant involved - who some would view as being an innocent party—not knowing that they, technically, don't have audited financial statements. It was a 10K filing. It was not a registration...

GP: No, I think it is a 10K.

MS: It was a 10K filing. But in any event, we had to decide how are we going to deal—not just with Peat Marwick—KPMG—but also with Porta Systems. We looked at it—and this is a process of getting information from the registrant, getting information from KP&G - and got to the point where we concluded that we just had no choice but to declare Porta System’s financial statements as unaudited. And then, that led to a dialogue with KPMG—not just about Porta Systems, but their philosophy - about their practice, what they were doing...

GP: Scope of services.

MS: Well we found that this idea that you could do things through affiliates or subsidiaries that you couldn’t do directly was more widespread than we had thought—than we had imagined - that it would be. And so, that was a difficult time, and difficult discussions with KPMG; but we ultimately decided that we needed to maintain what we saw as the integrity of the independence requirements, and to take action against KPMG.

GP: I suspect that’s a full chapter in a book somewhere, some time.

MS: Yes, it probably is.

GP: Because of the appeals that go on, I think the case isn't finally fully resolved until 2001 or 2002, by the time all the appeal processes are exhausted.

MS: I think most people are aware that the cases that the SEC brings—the enforcement cases—are generally viewed as being—they're not just violations - but there's something more important there.

GP: There's an issue.

MS: There's an issue; there's a policy issue that's involved. And this was one of those cases.

GP: The controversy over international standards, and the core standards project is an important event that occurs in the late '90s as well. And there's a special report to Congress that the Commission—you were involved in the center of that as well, right?

MS: Yes. The core standards project has a history of its own, so maybe need to back up a few spaces to get that story. But the core standards project preceded my coming to the Commission in a certain sense; and that is the process was already in place to try to address differences between U.S. GAAP and international accounting standards, with the hoped-for objective by—at least by others—that would lead ultimately to acceptance of international standards in filings with the Commission.

GP: Now, in this particular point, were there any particular Commissioners that had this as a point of focus—anyone that you were working with? Was this Chairman Levitt's focus?

MS: Yes. Very much so. Other Commissioners were interested; and Commissioner Hunt, for example, had an interest in the international.

GP: Isaac Hunt.

MS: Chairman Levitt was leading this effort; and it was Chairman Levitt and myself, and Linda Quinn—who's the Division of Corporation Finance—and it was really Linda who had the lead on this up until this point in time, and was responsible for the primary interaction with the IASC—with the support of my office.

GP: So what was the outlook, or what were the hoped-for objectives in the time space that you were involved?

MS: Again, everything really focuses on an intense desire on the part of foreign registrants, and the stock exchanges in the U.S. to make it easier for foreign issuers to come to the U.S. market. There were all kinds of concerns about the U.S. market losing its pre-eminence and more capital going into the London markets, and that sort of thing. I always viewed that as largely a red herring, but...

GP: So that's where Dick Grasso would come in on weighing on that issue.

MS: Right. And the stock exchange lobbied rather heavily to influence the Commissioners to accept—at least to get on a path to accept international standards in U.S. filings. And the core standards project was a way of not necessarily accomplishing that, but establishing a process by which—it was in my mind—establishing a process by which there was a critical analysis and a critical look at the important differences between U.S. standards and international standards.

GP: I know that in one of the presentations that was made during this period—and I can't honestly recall—I'm going to take a quick look at some notes here—if it was your comment, or Commissioner Hunt's comments about some attributes that would be necessary—or key elements that would be necessary—and as I read them, they're, the core standards is the first element; the course of the standards that constitutes a comprehensive, generally accepted basis of accounting; and then standards of high quality that result in comparability and transparency, and provide for full disclosure; and then last: Rigorous interpretation and application of the standards. That's from, I think, one of your speeches—now that I do have my notes in front of me.

MS: Yes. And that's text from the press release that was issued around the time of the core standards project. Let me give you a little of the story there. Once the Commission

decided to enter into this core standards effort and initiative, then of course the immediate question coming back was, okay, how do we know when we're finished?

GP: Are we there yet?

MS: And by what standards are we going to be judged? The office of Division of International Affairs, which was then led by Michael Mann, and I worked on—jointly—on a press release that has been widely reviewed and discussed, and our office developed the three criteria. And the objective of that was to establish a framework for dialogue about what was acceptable and what would not be acceptable when the day came that the ISC said, we're finished now. And you're going to evaluate the standards; how are you going to evaluate them?

GP: So in this context—here's a philosophical question for you. In this context, essentially the SEC's endorsement of international standards create public company GAAP.

MS: Right.

GP: And at the same time, you've got ASR150 out there, plus the most recent reaffirming FRR; how do you reconcile those? I mean what was your thinking—was that part of your thinking as to—okay, we would have—if ISB recognized with the IASB—then, I

guess, IASC—be comparable, equivalent—how is that—I mean in the GAAP hierarchy, where does that go?

MS: Well, the end objective for those who are subject to the SEC rules—the end objective would be—was, and would be—to have those two standards equally acceptable, so that a foreign company could file in accordance with international standards, and a domestic company can file in accordance with the U.S. standards; and either of those would be acceptable to the Commission. That was the objective of the foreign registrants, certainly, and of course, the Exchange's, and those who had an interest in making the markets more available to foreign issuers.

GP: Now this was already on the table when you get there, right—the issue? Develop the extent of core standards?

MS: The SEC staff, through Linda Quinn's office, was already participating in the ISB process and was reviewing and commenting on standards that were being developed. But it was not—at the time I came in, there wasn't any commitment, if you will—if you call it commitment—to do anything beyond that. And the political pressure—or the pressures from the exchanges and from others—was, okay, you're going to participate, but how do we know you're not going to just sit there for two years, and then walk away? And so that led to the dialogue, okay, how *are* we going to measure these standards, and it *is* reasonable for others to expect that they understand what the grading curve is going to be,

and what will be demanded at the time that they bring forth international standards, and ask the Commission to consider and accept them.

GP: So where are these—the three criteria that I read, that you said were kind of verbatim from the press release, which goes back to the materials that you and Michael put together—where are those criteria, you know, in the stream of things—fast forwarding to today’s environment—do they still represent kind of the reasonable set of expectations for determining acceptability?

MS: Yes, I think they do. I haven’t heard that there’s been any change philosophically—and they really are philosophical statements - they’re not hard standards by any means.

GP: The fun—in quotes—would be the interpretation of—of demonstrating how that’s been achieved.

MS: When I was giving speeches like that, the question at every turn was, “well, when will you accept international standards in foreign filings?” And I said that, philosophically, I believed that they would be accepted by the Commission when the users of financial statements—that is, when investors - are indifferent about which standard is being used. And philosophically, that’s how I still feel about it. As long as the Commission is told—by either foreign filers, or by U.S. filers— that there’s some important difference—or by investors—and investors have...

GP: I was going to get to filers in a minute.

MS: Excuse me.

GP: Okay.

MS: But if the investors are saying to the Commission that there's an important difference that they're unwilling to give up, in my mind, it would make it very difficult for...

GP: We're not there yet.

MS: We're not there yet.

GP: What about filers? Now I'm going to castigate Gene Flynn. I can envision Flynn hearing this from you, and saying, well, what about us? You really got two different games going on here, our standards are more rigorous here in the States, they're more expensive, they're more costly. Isn't there a risk that there's going to be perceived as being discriminatory in favor of foreign filers if this is not done right?

MS: That goes to the same point. If U.S. filers feel discriminated against, it's going to be very difficult for—in my mind—for the Commission to accept what is believed to be a lower

standard. So getting the international standards elevated to a point where they—either through convergence or whatever process—to the point where the investors are indifferent—don't care which standards you're using...

GP: I think that's a good philosophical—you know—way of looking at it. If you've reached indifference in economic terms, you've reached equilibrium. Now, was there ever, in the back of your mind, anything that approached even a range of time tables, or is that really getting into a trap, because if you start saying, well, by this particular date this can happen, you're creating expectations. Or is it a question of, well if this happens—if this particular process happens, and that particular process happens, those are healthy signs. How do you view that? Or how *did* you view that when you were addressing this?

MS: We simply would not speculate about when that might be. Now that was not a very popular response, because it had the appearance of being withholding, as not really being serious about the project. But on the other hand, the Commission, in my view, couldn't commit to something that they didn't have control of the timing.

GP: Certainly not the resources to invest in it.

MS: Right.

GP: And if you think about the changes that have occurred in the process since then, you could argue—despite some of the E.U. feedback recently—that they’re on the right path.

MS: Right. It was clearly in my mind, at the time, not a short-term project; but one—a journey - that was important, and that was going to take time to complete. And it involved not just the technical issues about the standards, but it involved such issues as the process by which the standards would be set, and the independence of the standard-setting process. And as you know, when Lynn came in and—a year or so later—that did become an issue that needed to be resolved.

GP: The relationships with other securities regulators in this area—I’m thinking of IOSCO, in particular—is this a period of development, or a period of kind of steady state—were you involved heavily, directly or indirectly, working with organizations like IOSCO in this area?

MS: Yes. Once this project started, I became considerably more active in that process. I actually attended some ISB meetings, and the meetings of the IOSCO working group—I forget the proper title for that. But as it began to develop, it was clearly calling for more and more attention, so I established a new position in the office to devote full-time to this international accounting standards project; and Mary Tokar was the first to hold that position. And she became the U.S. representative on this working group.

GP: In speaking about personnel and resources—that’s something that I made reference to very early on about—and you commented about being inclusive—what’s happening to your staff and resources at this point in time? And what’s the profile of the group that you’re working with? Are they—you know there are professional accounting fellows; I think there’s an academic fellow that comes in, rotating—how do you—how many people did you have access to use in your domain? And how much turnover did you experience? And where were people coming from when they joined your staff, and so forth?

MS: Well the total staff was about thirty, and I think we had ten or twelve practice fellow positions, and one academic fellow. The academic fellow position generally focused more on the policy issues, for example, Tom Linsmyer was one of the key drivers and authors of the market risk release. Terry Warfield was involved in the auditor independence issues, among others, and so there’s a really very key role that the academic fellows play in this process, and most of them, I think, find that to be a very useful experience.

GP: This history of that position is—of course, traces back to Clarence. And I think—there have been a number of phone calls over the years, as you think about the various Chief Accountants, and often that position was one of the first to feel the tender touch of the ax, but there’s—the Chief Accountant is always kind of—let’s see if we can’t—and so I

think the appointments have been fairly regular and continuous on the academic side.

And of course, the paths, I think, date back to Sandy Burton, if I remember correctly.

MS: Yes. Sandy started that program.

GP: Those are two very important elements of resources. When you think about outreach and you think about all the different thoughts that you have to disseminate and coordinate with the practice committee, you do have limited resources. And so making use of people who are coming from the practice and the community seem to be a sound ... How did you use conferences in that regard? I mean there are always a couple of key conferences each year, and you did a lot of speaking and traveling—how did you decide which ones to go to, and which ones not to, and were certain ones “got to be there” type of events?

MS: Without going through the list, some of the conferences I had knowledge of and understanding of beforehand, and others I took up based on recommendations from people—an assessment of who the audience would be, and who the other participants would be. But we did—yeah, I did quite a bit of that, and I found that to be an essential part of the process, because people want to hear what the Chief Accountant has to say, and more importantly, they want *him* to hear what *they* had to say. And so, it really is an integral part of the regulatory process.

GP: What would be your estimate of how much time you spent traveling?

MS: Maybe 30 percent, 35 percent.

GP: International as well?

MS: International - less conferences and more IOSCO kinds of activities and ISB activities.

GP: And any feel at all—I know it would be speculation—about whether that’s a changing part of the job—participation in outreach and international activity?

MS: You mean today?

GP: I mean versus what Walter may have done, and what Ed Coulson may have, and Clarence—because sometimes it’s a function of personality. Some people just don’t want to travel, but there are certain things you just got to do by being someplace else.

MS: Right. I didn’t sense that there was a dramatic change. Clearly, some were more active than others. But, as you say, some of the conferences are just—you just have to be there, like the annual AICPA/SEC conference; it’s not really optional, and the banking conferences, and various industry groups that have an expectation, and a right to expect that they will have participation from the Chief Accountant.

GP: I don't want to stray away from the international issue, if there's still one or two—you know—points that you may be thinking about—but I wanted to go back a little bit in this context of how you communicate the role in decisions, and issues, and how you listen to the community; and talk a little bit about whether or not—how technology might have affected that, or *if* technology affected it; because you're sitting there at the dawn of the Web, you know. I'm not even sure—I'm thinking about EDGAR filings—whether at this point in time they were fully—they were fully mandated by '98, perhaps?

MS: Right.

GP: So, you had—gosh, I can remember trying to draw EDGAR filings off in the early years; and you used two trees, printing it out. Now, of course, everything is wham, instant, and relatively easy to access. Did you get involved in any of the discussions; did you have a role in thinking through some of these technology implications, or was that just more Commission-wide?

MS: It *was* Commission-wide; but it was on my list. And I mentioned, some items on the list we never got to simply because of the press of events. So that's one of those longer-range issues that is important, and we thought about it, but it wasn't something that commanded immediate attention, so it tended to drop back, or drop off of the agenda.

GP: I guess you could argue that today—if you went into this position today, it would be a card already played; and certainly would have to have—I would suspect—implications for decisions you'd make—particularly about disclosure, because dissemination now is so global and so instant. And that seems to put pressure on you for acting in global ways, and maybe even sometimes acting more precipitously.

MS: Could be. Clearly, it's going to have—if I were going into the job today; clearly, it would fall higher on the list, I think, of things that are more important than others. But back at the time, and in connection with the Jenkins Committee; there were then suggestions about the impact of technology on financial reporting, and even suggestions to the effect that maybe someday that financial reporting would be a flexible database that people could access and manipulate, and draw information from. Those ideas, at the time of the Jenkins Committee, sounded pretty far-fetched.

GP: Far-fetched.

MS: But they don't sound so far-fetched anymore.

GP: That maybe does give us a segway into the changing model issue, which—now it has been ten years; and I think there's an important code word change, when you change from financial reporting to business reporting. You're signaling a broader domain; you're signaling—in the ten key elements of the business reporting model—you know,

the financial reports are part one or part two, at the most; everything else is forward-looking; it's non-financial in character. What's your thinking now about whether you guys got it right? I mean whether that was the right model, and are we moving now toward more of that type of a model?

MS: I don't know that we're moving more towards that type of a model. I think we got it right, in a philosophical sense. But what I came to understand and realize was that the idea of a broader business model carried with it many, and many more of the issues that we have with respect to the current model; that is, what information and how do you assure its reliability going to the marketplace. And we were at a point where: Yeah, it sounded like a great idea to have an expanded business model, but we can't even get the accounting model right; how are we going to get a broader model right?

GP: You've got all the issues of educating, preparing, testing, and continuing education for this broader information model.

MS: Right.

GP: But philosophically, you remain—I guess the Commission never really—what did the Commission do, with regard to the business reporting model?

MS: Well, I don't know that anything has been done.

GP: I'm going to say this advisedly, and it's very tongue-in-cheek, and maybe it's inappropriate, but it's not intended to be that way. In some ways you could say, gee, Mike Sutton, vice-chairman of the Jenkins Committee, Chief Accountant of the SEC; that means the business reporting model's coming. Did you hear any of that?

MS: Yes. Heard that, got lots of questions about that, lots of concerns from some parts of the community that that was what the SEC was up to. It wasn't what the SEC was up to. But clearly, it raised questions in people's minds.

GP: Some particular issues—outside of the business reporting model and Jenkins—business combination accounting, pooling, special purpose entities; these are all three in the same household. Were there important issues that you had to address in these areas? Special purpose entities comes a little bit later, I guess, because it's the Enron issue, in some respects. What about business combinations and pooling, in terms of issues that you had to face?

MS: Well, business combinations—poolings—rose on my list of priority items in significant part because of what I saw in terms of the resources required from the Commission to deal with those issues, once I got there. And I think I made the statement in speeches and articles that I found that roughly thirty percent of the staff time on registrant inquiries was devoted to pooling of interest accounting.

GP: *Thirty* percent.

MS: I think that's the right figure. It could be twenty-five. It's in one of my speeches, so whatever it was. But it was very significant. And I said to the staff when I got there—I knew that this was a difficult area of practice, as a practitioner - but I said, this is requiring far too much time and effort. There must be something wrong with the model. They said, yeah, there's something wrong with the model. And I felt that there was something wrong with the model. It was a model that, philosophically, I never liked because it had alternative accounting that was based upon criteria that were not necessarily substantive criteria.

And so, it was an area of practice—leases is another area of practice - where things that are very much alike economically get accounted for differently because of minutiae at the edge. And so, we're having very significant economic effects reported in financial statements that really aren't based on economics; they're based on whether or not you met a certain criteria—a transaction that is structured in a certain way.

GP: Structured transactions.

MS: So I took this up to—with the FASB, and made the case that it needed to be added to the agenda. And it was, and the outcome of that was the new standards for business

combinations. I feel the same way today about lease accounting; I think we've got it wrong.

GP: And it's back in the news. I mean I think the current holder of the Chief Accountant's position has gotten headlines in at least one recent issue of *Accounting Today* over lease accounting. And that's all kind of popped up since February of this year; so it's back, as they say, in the vernacular. A couple of other items that are kind of on the outline for today that I'm looking at, and one is the Public Oversight Board, which of course, declared itself out of business in 2001, or 2002—2001, I believe—toward the end of that year—and some of the—you know—the very strong members of that—we talked about Bob Mouts today briefly, when we were off-line, but Don Kirk and Chuck Bowsher—you had an active interrelationship with the Public Oversight Board; and if so, what issues were engaged?

MS: Well, the professional issues relating to the profession were issues that we had dialogue with the POB. POB found itself with the same problems that the ISB found itself with, in my opinion; and that is, it was trying very hard—the POB was trying very hard to establish improved standards of practice within profession that was very reluctant to seek improvements in practice. And the programs of the POB were largely educational—that is the peer review—and no criticism of educational programs; but it was quite apparent that that wasn't—that was not what was needed; what was needed was a real disciplinary process. But the practicing profession was simply unwilling to take that on, or unwilling

to submit to that; and so the ability of the POB to fulfill the mission that the Commission certainly expected, and others expected, just wasn't there.

GP: And of course, today's environment reflects an alternative, that is now underway.

MS: That experience, Gary, is what persuaded me to support the statutory self-regulatory organization that became the independent...

GP: The PCAOB?

MS: The PCAOB.

GP: Market value accounting. I don't think you can have a discussion where passions don't rise to the surface very rapidly; because in Walter's mind there is only true north, which is—I think that's what he calls it, true north—and that's market value. As recently as—a letter to the editor in Barron's some time this spring—he's once again advocating that belief. Where is the market value model in—philosophically and practically—you know, there are many great academic writers—Ray Chambers being among them—that it made the most defensible set of philosophical arguments for what he called continuously contemporaneous accounting, or co-co. And clearly; Edwards and Bell, and others, have been recognized for tackling the economic theory of market value. Certainly, with all the

experience you've had; you've got to be seeing plus and minuses there—what, from the policy point of view, was your market value take?

MS: I've talked to Walter about market value accounting fairly often—every time we see each other. And philosophically, we are very close on that issue. There's no question in my mind that market value is more relevant and more useful. But there's a whole series of issues that—when I was trying to advance—not market value accounting, per se, but consideration of market value—there's a whole series of issues that needed to be addressed, and need to be addressed now.

The model that I put forward for the—which ultimately was mark to market, but let's leave open the question about whether it goes into income or not. It was always, in my mind, an implementation tool. I didn't see that as philosophically the end result. But if you are sitting today in a largely historical cost attribute model; and we want to be in a market value attribute model—Walter would just turn the lights off over here, and turn the lights off over here.

GP: Right. He would do it cold turkey.

MS: Right. And I never thought that that was feasible. So my initial offering was, well, let's find a way that we can transition—I didn't call it transition, but that was what was behind the idea. I always felt that if we could get the market values out there, get them into the

financial statements, that over time, the market would begin to demand the measures of income that we thought were appropriate. That may have been naïve, but that was behind my thinking.

GP: The issues that I hear—kind of, you know, thinking about it as an observer, as an academic—are the difficulties on the audit side. If you presume though, that there are metrics that are established, recognized, and objective, that all goes away.

MS: Well, there are two pieces to that puzzle, in my mind. One is, what is market value? We know what market value is, but not everybody knows what market value is. So I saw a need, and argued—some years ago - that the FASB ought to be thinking about this; and maybe we need some market value standards to go along with the accounting standards, because there's a reliability question. Everybody keeps talking about the reliability of market value—well, I think that's largely a red herring; but you have to admit, if there are no standards for market value, there's at least the appearance of potential unreliability.

And then, as you point out, the other piece to this is, okay, how do we assure the reliability through attestation function? Now Walter would say, let the auditors audit cash, and get a market value specialist to audit the market values. He and I don't agree on that particular course of action.

GP: There's obviously going to be ongoing debate on subjects like when will international standards be ready to be accepted and recognized, and how far can you go in the market value model, given the concerns that you've just mentioned—standards or metrics or models, or something that would give you consistency and comparability, versus having potential for subjective abuse. I think of arguments that I've heard made—particularly from the preparer community—about the need for the historical cost control model; and yet I think about the arguments that Ray Chambers has made about the relevance of fair values; and we are really kind of stretched thin here, trying to do both with poor tools to do—particularly—currently, at least, the fair value.

MS: And the business community, particularly, way oversells the reliability argument of the historical cost model.

GP: Even in periods of low inflation, because we had historical cost pretty well blown away with the inflation rates in the '70s and '80s. Those accounting series release 190 and all the fun that was involved in trying to bring that into place. Were there any—I guess—we haven't said much about enforcement experiences—matter of fact, we haven't talked about it as a particular topic. When we sat down before the session, I was commenting on the relative rate of enforcement releases; we have talked about Baymark, which was an enforcement issue.

And we talked a little bit about financial reporting releases. And at that point you made a comment about staff accounting bulletins, which I thought was insightful, given the hierarchy and participants in standard-setting. But we haven't really talked about the kinds of enforcement experiences that you were drawn into, or had to become involved in; and if there were any times when you had some challenging experiences there.

MS: Generally speaking, the Chief Accountant is called on to weigh in on accounting issues that are involved in the enforcement context—called on generally by the Commission. So when the enforcement division comes forward with a recommendation that the Commission sue WorldCom for their accounting for line charges, or whatever it is that was; and alleging that that was false and misleading, and not in accordance with GAAP, the Commission normally will turn to the Chief Accountant and say – your opinion.

And that's a very important, and a very powerful position in some respects, because generally speaking, as a practical matter, the Chief Accountant's office has the last word on what is or isn't GAAP; so it's inconceivable that the enforcement case—or it was when I was there—would go forward with a lawsuit on an accounting issue that the Chief Accountant was saying to the Commission, no, that's a bogus issue. So as a practical matter, that just didn't happen. Which meant that we had a regular and continuing dialogue on cases as they were preparing to bring forward a recommendation to the Commission.

GP: There is a Chief Accountant in the Enforcement Division.

MS: Right.

GP: We've had practitioners in that position over the years. I think of Glen Perry, for example, who was in the Enforcement Division for a good number of years; Pete Maroch, KPMG; and of course, Walter did both. What kind of—what's the interface between these two Chief Accountants? Obviously they both have that term, but their roles are entirely different.

MS: Yes.

GP: And yet, I suspect when it came to enforcement matters, they were pretty close.

MS: Yes. Absolutely. And the Chief Accountant of the Division of Corporation Finance as well.

GP: That's right.

MS: So, that role is the principal resource—the key resource—accounting resource—for those divisions. And there is a regular dialogue between the Office of Chief Accountant and

those people as well. But on matters of policy, if it's controversial; generally speaking, the Office of the Chief Accountant has the last word.

GP: And in enforcement matters?

MS: On accounting issues.

GP: Accounting issues.

MS: So if an enforcement case is based upon an allegation that something is or isn't in accordance with GAAP, the Chief Accountant would not weigh in on the wisdom of the enforcement decision with the enforcement case; but would say, in my opinion, the position on this accounting issue is correct, or is not correct.

GP: Are there any top ten lists, in your thinking, about what were the one or two or three most important matters that you had to address? I mean—we talked about difficult to put things in order, and maybe things do tend to merge; but sitting back and reflecting a little bit.

MS: I think the things we've talked about today, Gary, really are pretty much a complete list. We talked about the challenge to the independence of the FASB; we talked about the controversy over derivative instruments, and what that led to; and the issues of

independence of auditors; and the issues around the international accounting standards, and the core standards project. Those really are the key policy issues, if you will, that were addressed on my watch. There's an endless list of more detailed practice issues that came up; and we talked about pooling and business combinations. There's probably a significant list that we could add to that. But I think those are really the key issues in the areas where I think I, perhaps, had the most influence and impact on the agenda.

GP: We're getting close to, I think, a pretty natural wind-up point here; and there are a couple of thoughts that I would maybe ask you to comment on. One is that, given the technology of this type of a session, we have no idea who might draw up and listen to this conversation X number of years henceforward, and so maybe there are some accounting students, or accounting faculty, or practitioners, or senior accountants, or someone who out of idle curiosity or worse, are thinking about listening to this, or are listening to this, and what do you say to them about the role and responsibility of the accounting profession from a point of view of a Chief Accountant, if you had the opportunity to try to say something to them that would be—we're here for an important reason, and what is it that your expectations are of an accounting practitioner—whether they're an auditor or a preparer, or even doing analytical work?

MS: Well, this capital market system that we have—that we value so highly, and should value so highly—doesn't work unless the information going into the marketplace is useful information, and also if it isn't credible information—and that is, if it's either incorrect,

or it's not believed to be correct. And that role for the auditing profession, just in my mind, cannot be underestimated. And the strength of our markets just really depends on that—on the reliability of that information. I have said to new students recently that this, in my mind, would be one of the great times to be entering the accounting profession.

We have been given, for the second time in our history, a broad mandate to perform at a level of responsibility that reflects the profession's commitment to the public interest, the commitment to the markets, and the commitment to investors. And I, personally, think it's a pretty exciting place to be right now. I don't know what you see in your accounting classes, and interest in accounting programs, but I would hope that people coming into the programs and profession would share the enthusiasm for the future.

GP: I think that's just a great thing that I would like my students to hear, and like some of my colleagues to hear. And I think it's an appropriate time to say thank you, on behalf of the SEC Historical Society for working with the members of the Chief Accountant's Office committee—both as a member, and as a participant in this archive series. And with that, I think, Mike, we're concluded.

MS: Thank you Gary. Thanks for coming down.

GP: My pleasure.