

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
(202) 755-4846

OUR ATTITUDE TOWARD THE ACCOUNTING PROFESSION

An Address By

Ray Garrett, Jr., Chairman

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It has often seemed to me that one of the more quiet curses of the present age has been too much introspection. Excessive self-examination is surely a road to despondency if not madness. So I have urged young people to resist the modern teachers' obsession with self-examination and proclaimed the lately popular identity crisis as neurotic hogwash. One learns who he is and his relation to other people and the world not by brooding over unsolvable enigmas but by doing. Adulthood arrives when we find ourselves worrying more about the welfare of other persons - - spouses, children, parents, customers, clients, etc. - - than of ourselves. Only in this direction does one find health, reasonable happiness and the moral life.

As my lecture continues, I point out that the learned professions have these important qualities in abundance. They inevitably lead to a more healthy, happy and moral life for the professional man because he is compelled to the outward-directed life of caring about others and has little time to stew over who he really might be.

Now I discover how naïve I have been all along. What can I say when one of our eminent accounting firms finances a study on whether people like accountants and then devotes an entire morning to a morbid examination of the findings? The only thing worse is that the study also found that people generally like securities regulators a good deal less than they do accountants. Now, of course, that shows how little people understand the difficult job we are trying to do for their benefit - - how hard we work, how diligent we are, how we suffer when they are injured. They cannot possibly understand how it hurts to learn of their lack of appreciation, their base ingratitude, in response to such self-sacrifice. Perhaps this was all a foul plot by your managing partners to embarrass us long-suffering servants of the people. Since the findings cannot

possibly be correct, we ought to investigate and spread the true story before the American people, who have a right to know whether they like SEC Commissioners.

But we won't investigate, because, you see, we really don't care. We are mature professionals who simply do our duty as we see it, obviously oblivious to the passions of the mob. We constantly strive for this sublime attitude - - especially when we flunk a popularity contest. Furthermore, we learn from experience, including the experience of others. If we ever finance a survey on the popular attitude toward federal securities regulators, we are going to hear the results in a sound-proof room before letting them get any further. We want to be certain that the scientific survey was properly conducted.

In view of our predilection today for staring at the mirror, rather than attempt further to embellish the subject of what other people think of accountants, I would like to talk about what we at the SEC think of you. In fact, I was rather invited to do this by Harvey Kapnick. When he explained what you would be up to all morning and then suggested this, I was reminded of the pre-war movie star who was conversing with a friend and carried on a thirty minute monologue about her joys and triumphs and pains and defeats on and off the silver screen. Finally she turned to her companion with a sigh and said, "But enough about unworthy me! Let's talk about you for awhile. What did you think of my latest picture?"

And so it goes, in the accounting profession as well as the lively arts. But I'm not going to talk specifically about Arthur Andersen & Co. It is tempting to do so. Your firm was very much with me in my years of practice in Chicago, and had been with my father and our clients and friends. I could tell many a tale of great diligence and labor, of outstanding pig-headedness when your men couldn't see the superior quality of my

views, and heroic capacity for whiskey at midnight at the printers. These are doubtless the more important things in life, but to reminisce in such a vein would scarcely contribute to the serious deliberations of your annual meeting.

So let me share a few observations on the relationship of the SEC to accountants and the accounting profession. There are times when we have let passions and suspicions and recriminations run pretty high in many areas, and I think it is appropriate to look back as well as forward and consider the ties that bind as well as the forces that pull as apart. I am really appalled at the growing strength of separatist movements in more and more areas of modern society - - ours and those of other nations. At the very time when we are becoming more and more involved in each others welfare and even survival, it is depressing to find this urge to break off into smaller and inevitably hostile units.

We cannot afford any separatist movement between accountants and the SEC. I cannot quite say that we were born together. The accounting profession predates the creation of the SEC in 1934 by many decades. But if memory serves, Arthur Andersen & Co. was a couple of dozen people in the early 30's and to an important degree made its reputation working with the FTC and later the SEC in auditing the shambles of the public utility holding company systems of that era. In any event, we and the accounting profession have grown up together and need each other. IT is inevitable that we should continue to quarrel. If you didn't think we should go soak our head, and tell us so, from time to time, we wouldn't know that you really cared. But we must not become permanently estranged.

We were in fact made partners by the Congress in 1933 and 1934. There were persons in those days who thought this was too much, and even today, there are those

who would put us asunder. I am not referring to persons who thought then, or think now, that our authority over accounting principles and practices and over accountants is too heavy. Rather, I am referring to the view of the early 30's, which had some force behind it, that public accountants could not be trusted to audit and report on publicly-held companies. This function, it was urged, must be performed by the government. That view did not prevail at that time, fortunately, but it is by no means dead. We at the Commission have seldom if ever been called to task by Congressional committees for wielding too heavy a hand in the accounting area, but we have been, and are, repeatedly asked to justify our reliance on the profession and our relative forbearance.

In this important respect we have been and continue to be a strong supporter of the independent accounting profession. One of my first tasks when I became Chairman was to explain to an important Senator why I did not think it wise for the SEC's staff to undertake the audit of all defense contractors, and the issue is not wholly in repose.

Of course, our first answer to such a proposal is that we don't have the "resources", as we like to say in Washington, meaning we don't have enough qualified people or money. And that is a truthful answer, as far as it goes. But it is also true that we don't want the resources. We are traditionalists in this regard. We continue to believe that as a matter of fundamental policy it is wrong for the government to undertake the auditing and reporting responsibility for American industry or any segment thereof. Surely the accounting profession concurs in this position, but I must add that it is easier to defend this position when the public accountants perform well than it is when they don't. Needless to say, we are only asked to defend it in the harder situations where they haven't - - where we are forced to argue, as we have, that, even though in the particular

case, typically some dramatic catastrophe, the independent accountants have blown one, it is still better policy to rely on them, day in and day out, than on government auditors.

The accounting profession has also generally favored our policy of restraint in setting accounting principles, though not all accountants all the time, especially when one firm becomes exasperated at its fellows. We understand the exasperation, but we continue to believe that restraint is wise.

By restraint, of course, I mean the Commission's failure to exercise the full powers given it by the securities laws to determine accounting principles and procedures. It was decided at the very beginning not to exercise these powers on the ground that, given the complexity and changeableness of American economic activity, in the long run sounder principles, and more willing acceptance of them, would be developed by putting the primary burden on the profession, and that is what we have done and continue to do.

There is some concern abroad that in practice we are abandoning this policy of restraint. We don't think so. Obviously, the Commission has become more active, aggressive, if you will, in prescribing disclosures as to financial matters, some of which involve notes covered by accountant's reports. But we have stopped short of prescribing accounting principles.

A year or so ago there was some alarm that we were bent on torpedoing the Financial Accounting Standards Board before it was really underweigh by purporting to resolve matters presumed to be on its agenda before it had a chance to act. Since this was never our intention, we spent much time in conference with the FASB to be sure we understand each other, including a day that all of us on the Commission spent with the FASB at their new headquarters in Stamford, Connecticut. We think we now do

understand each other. We stay in close touch with each other, and we think they are making good progress. In view of the time, money and good faith that the accounting profession has invested in the FASB, it must be given a chance to work. And because we continue to believe that accounting principles should be established by the private sector, the FASB currently appears as the last best hope.

Historically, the Commission has consistently and strongly supported a legislative and administrative policy of placing primary reliance on the accounting profession. And we agree with the view expressed in the survey that the profession is performing better today than it ever has in the past.

If that is true, you may well ask, why are we suing you all the time. Perhaps you would prefer less admiration and affection and more mercy or a nice long period of benign neglect.

Well, first of all, for what it is worth, we aren't suing you all the time. In the past two years, we have brought a total of six cases in which major public accounting firms were named. From your side that may seem like six too many, but at least it isn't as many as the publicity attracted to them probably led you to expect.

As to these cases and any others that may follow, it is the Commission's view that critical importance of accountants in our capital markets requires that deficient performance must be challenged and in a public way. While I have agreed that the overall performance of the profession is good and improving and justifies a policy of primary reliance upon it, we have encountered cases in which this has not been the at all. We have brought civil cases only where we believe that there is evidence of gross disregard for professional responsibilities, and we have suggested that criminal cases be

brought only where we believe upon the evidence available to us, that the auditors certified financial statements knowing them to be false. Before any case is brought, or any criminal reference made - - since criminal indictments can only be brought by the Department of Justice through a grand jury - - they are extensively reviewed not only by the staff but also by the five Commissioners.

Obviously, it sometimes happens that when we think we have a case, the jury doesn't, and anyone who is acquitted in a law suit, especially a criminal one, is entitled to his day of rejoicing, but we have no apology to make for our policies and procedures in these matters. We think they are sound.

More than this, we think that our enforcement efforts overall have improved the performance of accountants, most noticeably in auditing procedures. We look forward to the day when the program has worked so well that no more cases need be brought.

In addition to, and apart from, our enforcement program, we have become more active in the area of financial disclosures, and we will continue to be. We do not believe that faith in the accounting profession implies a Commission that does nothing but observe, investigate and litigate. While some fundamental propositions of disclosure are most forcefully established and impressed upon the profession, and the financial executives with whom they deal, by litigation, it is a blunt instrument and, if not carefully used, can be unfair in its retroaction effect. Our primary tool, therefore, in fashioning policies to meet disclosure objectives in ever-changing conditions is not the law suit but rule-making and the publishing of views as guidelines.

Through this process we expect to continue to press for improved corporate financial disclosure in the areas of - -

accounting alternatives and their effect on financial statements:

interest capitalization; and

interim financial reporting.

As to the last of these - - interim reporting - - we expect to encourage increased auditor involvement. The association of the auditors with interim statements, as in your opinion on Precision Polymers; reports on internal controls; statements as to preferred accounting approaches, such as The Price Waterhouse report stating a preference for an alternative method; are all on the list of developments that we believe are progressive.

We also realize that greater involvement by auditors, while increasingly valuable to investors, brings greater responsibility and consequently greater fear of liability for real or apparent derelictions. We realize that our efforts frequently strengthn your hand in your relations with corporate executives - - which is an important part of our purpose - - but they do not help you when you face claims for money damages.

While we are unwilling to let the fear of increased exposure to liability stifle the increased involvement of auditors when such involvement is important for the benefit of investors, we are sympathetic to the problem involved. While we have not taken the initiative in devising new legal formulas that might temper the financial exposure of accountants and other professionals when dealing with affairs so completely beyond their personal fortunes, we would be interested in cooperating in such an endeavor.

In closing, let me state once more the importance to our economy of having a strong, proficient and independent accounting profession, imbued with a deep sense of responsibility not just for the corporate managers who pay the fees, but for the

shareholders and investors who look to you for information and protection. If we in the profession - - lawyers as well as accountants - - fail in this most important role, confidence in our companies and the capitalist system will suffer and the public response will surely be more government intrusion to the ultimate detriment of us all. Our economic system is under severe threats from many quarters. About the worst of these - - inflation, high interest rates, low stock prices, shortages of critical materials - - accountants, like lawyers and SEC Commissioners, can do very little in a direct way. But in the vital area of public confidence in the basic fairness of our system, including the availability of fairly presented financial conditions and operating results, we can do a great deal and we must.