REMARKS OF THE HONORABLE JOHN E. MOSS

IN LOS ANGELES

AT THE CALIFORNIA STATE UNIVERSITY

KEY ISSUES LECTURE SERIES

ON

FEBRUARY 25, 1978

I AM VERY PLEASED TO BE IN LOS ANGELES TO PARTICIPATE IN THE CALIFORNIA STATE UNIVERSITY, KEY ISSUES LECTURE SERIES AND DISCUSS, AS YOU HAVE TERMED IT, POLITICS AND ACCOUNTING WITH EMPHASIS ON RECENT CONGRESSIONAL HEARINGS ON THE ACCOUNTING PROFESSION.

THIS IS PROBABLY THE FIRST TIME I HAVE SPOKEN TO MANY OF YOU. BUT THE FACT THAT YOU INVITED ME HERE INDICATES THAT YOU HAVE BECOME AWARE OF MY CONCERNS ABOUT THE ACCOUNTING PROFESSION AND HAVE RECOGNIZED THAT I DO INDEED CONSIDER ACCOUNTING TO BE A KEY ISSUE WITH NATIONAL RAMIFICATIONS.

THERE ARE 25 MILLION OR MORE INDIVIDUALS IN THE UNITED STATES WHO OWN STOCK IN PUBLICLY-HELD CORPORATIONS. MANY ARE SMALL INVESTORS, WHO MAY BE AN ENDANGERED SPECIES. AT LEAST THAT IS WHAT SOME ECONOMISTS ARGUE, CITING A RECENT NEW YORK STOCK EXCHANGE "CENSUS OF SHAREHOLDERS", WHICH REPORTED AN APPROXIMATE 18.1 PERCENT DECREASE OF INDIVIDUAL INVESTORS DURING THE PERIOD 1970 THROUGH 1975.

A DECLINE IN THE NUMBER OF INDIVIDUAL INVESTORS PORTENDS OTHER FAR-REACHING ECONOMIC EFFECTS BECAUSE THE NATION'S SECURITIES MARKETS, WHICH ARE ESSENTIAL FOR THE PROPER FUNCTIONING OF OUR FREE ENTERPRISE SYSTEM, ARE ALSO SERIOUSLY AFFECTED.

IN A CAPITALISTIC ECONOMY, THE EFFICIENT ALLOCATION ON OUR SCARCE CAPITAL RESOURCES IS PARAMOUNT. A FREE MARKET REQUIRES MANY INDIVIDUAL BUYERS AND SELLERS TO FUNCTION EFFECTIVELY AND IN THE CASE OF THE NATION'S SECURITIES MARKETS, A DECLINE IN THE NUMBER OF INDIVIDUAL INVESTORS OR SHAREHOLDERS WORKS COUNTER TO THE GOAL OF EFFICIENT CAPITAL ALLOCATION.

A SIGNIFICANT DETERMINANT OF THE SMALL INVESTORS' WILLINGNESS TO OWN SHARES OF CORPORATE STOCK IS THE AVAILABILITY OF ACCURATE, RELEVANT AND TIMELY INFORMATION. CONSEQUENTLY, THE QUALITY OF INFORMATION DISSEMINATED IN THE SECURITIES MARKETS IS IMPORTANT FOR THE EFFICIENT ALLOCATION OF CAPITAL.

IT IS NOT DIFFICULT TO CONCLUDE THAT THE PROBLEMS OF INDIVIDUAL SHAREHOLDERS, LEFT UNRESOLVED, COULD SERIOUSLY JEOPARDIZE THE PROPER FUNCTIONING OF OUR CAPITAL MARKETS AND OUR SYSTEM OF FREE COMPETITION ENTERPRISE. IN ORDER TO ATTRACT A LARGE NUMBER OF SMALL INVESTORS INTO THE SECURITIES MARKETS, THE PUBLIC'S CONFIDENCE IN THE SYSTEM OF CORPORATE ACCOUNTABILITY MUST BE STRENGTHENED.

A RECENT STUDY ASKED A LARGE SAMPLE OF SHAREOWNERS WHETHER THEY THOUGHT THE CONGRESS CARES ABOUT STOCKHOLDERS' INTERESTS. THE RESPONSES WERE: 57 PERCENT "NO", 36 PERCENT "SOMETIMES" AND 7 PERCENT "YES." I CAN ASSURE YOU THAT THE CONGRESSMAN WHO STANDS BEFORE YOU CARES A GREAT DEAL ABOUT THE INVESTING PUBLIC AND WILL DO EVERYTHING IN HIS POWER TO PROTECT THEIR INTERESTS.

IN THE LATE 1960S AND EARLY 1970S, THERE WERE A NUMBER OF CORPORATE FAILURES, RESULTING IN VAST LOSSES TO INVESTORS. IN MANY OF THOSE CASES, QUESTIONS WERE RAISED AS TO WHETHER THE INDEPENDENT ACCOUNTANTS HAD FAILED TO DETECT THE GROWING PROBLEM OR HAD ACTIVELY PARTICIPATED WITH CORPORATE MANAGEMENT IN A FRAUD. THE DEBACLES OF PENN CENTRAL, STERLING HOMEX AND EQUITY FUNDING ARE BUT A FEW THAT COME TO MIND. AND CONCERN FOR THE ADEQUACY OF THE ACCOUNTANTS' PERFORMANCE GREW WITH THE DISCLOSURE THAT MANY OF THE NATION'S LARGEST CORPORATIONS HAD MADE QUESTIONABLE AND ILLEGAL PAYMENTS ABROAD, WHICH WERE EITHER MISREPRESENTED OR KEPT OFF THE CORPORATE BOOKS ENTIRELY.

IN OCTOBER 1976, THE SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS, WHICH I HAVE THE HONOR OF CHAIRING, PUBLISHED A REPORT ENTITLED

FEDERAL REGULATION AND REGULATORY REFORM WHICH INCLUDED A SECTION ON CORPORATE ACCOUNTABILITY.

IN DECEMBER 1976, THE STAFF OF THE SENATE SUBCOMMITTEE ON REPORTS, ACCOUNTING AND MANAGEMENT (CHAIRED BY THE LATE SENATOR METCALF) PUBLISHED A STUDY HIGHLY CRITICAL OF THE "BIG 8" ACCOUNTING FIRMS AND CONCLUDED THAT THEY DOMINATE THE ACCOUNTING PROFESSION, THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AND THE PROCESS BY WHICH STANDARDS ARE SET AND ENFORCED WITHIN THE PROFESSION. THE STUDY RECOMMENDED BROAD FEDERAL INVOLVEMENT IN THE REGULATION OF ACCOUNTANTS.

FOLLOWING EXTENSIVE HEARINGS IN THE SUMMER OF 1977, THE SAME SENATE SUBCOMMITTEE UNANIMOUSLY ISSUED A REPORT WITH A NUMBER OF DETAILED RECOMMENDATIONS, INCLUDING THE BASIC RECOMMENDATION THAT A PROGRAM DESIGNE TO MEET PUBLIC CONCERNS SHOULD START WITH AN ORGANIZATION OF ACCOUNTING FI

THAT SERVE OR WANT TO SERVE AS INDEPENDENT AUDITORS FOR PUBLICLY-OWNED CORPORATIONS.

AND I STATED REPEATEDLY THROUGHOUT 1977 THAT IF THE ACCOUNTING PROFESSION CANNOT ADDUCE PERSUASIVE EVIDENCE THAT IT IS TAKING EFFECTIVE STEPS ON ITS OWN TO IMPROVE THE QUALITY OF AUDIT WORK AND THE RESPONSIVENES OF ACCOUNTANTS TO PUBLIC NEEDS, I WOULD INTRODUCE LEGISLATION TO CREATE A SELF-REGULATORY ORGANIZATION UNDER DIRECT OVERSIGHT OF THE SECURITIES AND EXCHANGE COMMISSION.

BEFORE PROCEEDING, I WOULD LIKE TO ENTER A DISCLAIMER BY INFORMING YOU THAT I AM NOT AN ACCOUNTANT OR AN AUDITOR. BUT BEFORE I BECAME AN ELECTED LEGISLATOR 29 YEARS AGO, MY BACKGROUND WAS AND STILL IS THAT OF A BUSINESSMAN. FOR MANY YEARS I HAVE BEEN INTERESTED IN THE USE OF ACCOUNTANTS' AND AUDITORS' SERVICES BY LEGISLATORS, INVESTORS, CORPORATE

AND GOVERNMENT MANAGEMENT AND CONSUMERS. IT IS IN THESE AREAS THAT I HAVE CONCERNS AND SHARE THE CONCERNS OF OTHERS THAT THERE ARE PROBLEMS WITHIN THE ACCOUNTING PROFESSION THAT MUST BE SOLVED IF THE INTRODUCTION OF REGULATORY LEGISLATION IS TO BE AVOIDED.

UNFORTUNATELY, I HAVE BEEN SKEPTICAL, AND AM EVEN MORE SO AFTER MY SUBCOMMITTEE'S RECENT HEARINGS ON THE AICPA'S SELF-REGULATORY MEASURES, THAT THESE PROBLEMS CAN BE SOLVED WITHOUT LEGISLATION TO REGULATE THE ACCOUNTING PROFESSION. MY SKEPTICISM IS BASED ON THE LACK OF ANY DIRECT ROLE FOR THE SEC IN INITIATING REFORMS WITHIN THE ACCOUNTING PROFESSION AND ENSURING QUALITY AUDITS; THE CONTINUED TREND TOWARD CONCENTRATION OF THE ACCOUNTING INDUSTRY AMONG A FEW LARGE ACCOUNTING FIRMS; THE RESULTING ANTI-COMPETITIVE IMPLICATIONS FOR SMALL ACCOUNTING FIRMS; THE SPLITTING OF THE AICPA INTO FIRST AND SECOND CLASS MEMBERS; AND THE DUBIOUS EFFECTIVENESS OF THE AICPA'S SELF-REGULATORY PROGRAM.

THE FEDERAL SECURITIES LAWS HAVE, SINCE 1934, AUTHORIZED THE SECURITIE AND EXCHANGE COMMISSION TO ENSURE THAT PUBLICLY-OWNED COMPANIES REPORT FINANCIAL DATA IN SUCH DETAIL AND SUCH FORM AS THE COMMISSION SHALL PRESCRIBE, AND AUTHORIZED THE AGENCY TO PRESCRIBE THE METHODS TO BE FOLLOWE IN THE PREPARATION OF REPORTS. IN THE 44 YEARS SINCE ITS CREATION, HOWEVE THE SEC HAS RARELY USED ITS AUTHORITY OVER ACCOUNTANTS DEFERRING IN THE MA TO THE PRIVATE SECTOR. AS A RESULT OF THIS NEGLECT, MY SUBCOMMITTEE CONCLUDED THAT THE SEC SHOULD PRESCRIBE A FRAMEWORK AND ESTABLISH THE GUIDE LINES WITHIN WHICH THE PRIVATE SECTOR DETERMINES ACCOUNTING PRINCIPLES AND SETS AUDITING STANDARDS. THE SEC SHOULD SUGGEST PRIORITIES BASED UPON NATIONAL AND INTERNATIONAL NEEDS. AND THE SEC SHOULD EXERCISE IN A MUCH MORE VIGOROUS FASHION ITS OVERSIGHT OF PROPOSED PRINCIPLES AND STANDARDS

AND THE OPERATION OF THOSE ALREADY IN PLACE, EXERCISING ITS RIGHT OF PRE-EMPTION WHEN NECESSARY. UNDER PRESSURE FROM THE CONGRESS THROUGH RECOMMENDATIONS SUCH AS THESE, THE SEC HAS STEPPED UP ITS INVOLVEMENT IN THE REGULATION OF ACCOUNTANTS, BUT THE PREVAILING PATTERN AT THE SEC CONTINUES TO BE ONE OF DEFERRING TO THE ACCOUNTING PROFESSION TO SET AND ENFORCE ITS OWN STANDARDS. DURING OUR RECENT HEARINGS, CHAIRMAN WILLIAMS WAS ASKED HOW LONG THE SEC WAS WILLING TO WAIT TO JUDGE THE EFFECTIVENESS OF THE NEW AICPA SELF-REGULATORY PROGRAM. HE WAS ALSO ASKED IF THE SEC HAD AN ALTERNATIVE PROPOSAL THAT COULD BE OFFERED IF THE AICPA EFFORTS FAILED. DESPITE THE SERIOUS RESERVATIONS AND STRONG OBJECTIONS RAISED BY THE SEC ABOUT MANY ASPECTS OF THE AICPA'S PROGRAM, CHAIRMAN WILLIAMS INDICATED THAT HE HAD NO TIMETABLE FOR JUDGING THE PROGRAM'S EFFECTIVENESS AND HAD NO ALTERNATIVE PROPOSAL. IT MAY WELL BE THAT LEGISLATION MANDATING

THE USE OF THE SEC'S AUTHORITY IS THE ONLY SOLUTION TO THE SEC'S RELUCTANCE TO USE ITS DISCRETIONARY AUTHORITY IN REGULATING ACCOUNTANTS.

THE ACCOUNTING PROFESSION IS ESSENTIALLY AN OLIGOPOLY, IN WHICH THE LARGEST EIGHT FIRMS COMMAND BY FAR THE BULK OF THE BUSINESS. THE DEGREE TO WHICH THE PROFESSION IS CONCENTRATED IS BEST DEMONSTRATED BY THE DISTRIBUTION, AMONG ACCOUNTING FIRMS, OF AUDIT CLIENTS REGISTERED WITH THE SEC. SEC REGISTERED CLIENTS TEND TO BE THE LARGEST AND AMONG THE MOST HIGHLY VALUED CLIENTS OF ACCOUNTING FIRMS. CURRENTLY THE LARGEST 16 ACCOUNTING FIRMS HAVE AS CLIENTS 72 PERCENT OF THE MORE THAN 10,000 CORPORATIONS REGISTERED WITH THE SEC. EVEN MORE DISQUIETING IS THE FACT THAT THE "BIG 8" ACCOUNTING FIRMS NOW HAVE AS CLIENTS 94 PERCENT OF THE CORPORATIONS LISTED ON THE NEW YORK STOCK EXCHANGE, CLEARLY COMPRISING THE VAST BULK OF THE NATION'S LARGEST AND MOST POWERFUL CORPORATIONS.

A GREAT MANY FACTORS SEEM TO HAVE CONTRIBUTED TO THIS CONCENTRATION. WE HAVE BEEN TOLD THAT UNDERWRITERS AND BANKERS INSIST THAT THE CORPORATIONS WITH WHICH THEY ARE INVOLVED USE ONLY "BIG 8" FIRMS. THE AUDIT COMMITTEES OF CORPORATE BOARDS OF DIRECTORS ALSO INSIST ON USING ONLY "BIG 8" FIRMS FOR FEAR OF LIABILITY. THAT RESTRICTIONS ON PROFESSIONAL ADVERTISING AND SOLICITATION OF OTHER FIRMS' CLIENTS HAVE WORKED TO THE ADVANTAGE OF THE LARGEST FIRMS, BECAUSE THEY ARE BY NATURE MORE VISIBLE THAN SMALL FIRMS. THAT SEC WORK REQUIRES AN EXPERTISE WHICH ONLY THE LARGEST FIRMS HAVE THE RESOURCES TO DEVELOP. THAT ONLY A VERY LARGE ACCOUNTING FIRM CAN AUDIT A VERY LARGE CORPORATION. THAT THE LARGER FIRMS HAVE THE RESOURCES FOR MORE SKILLFUL MARKETING, REGARDLESS OF ANY REAL DIFFERENCES IN THE QUALITY OF AUDIT WORK. AND THAT THE LARGEST FIRMS EMPLOY UNFAIR TACTICS, SUCH AS OFFERING TO PERFORM AN INITIAL AUDIT AT

UNECONOMICALLY LOW FEES IN ORDER TO LURE CLIENTS FROM OTHER FIRMS. WITH RESPECT TO MANY OF THESE SUPPOSED CAUSES, WE HAVE ALSO HEARD VIRGOROUS DENIALS.

I DO NOT MAINTAIN THAT SUCH CONCENTRATION IS IN ITSELF UNDESIRABLE. WHERE CONCENTRATION DEVELOPS NATURALLY WITHIN A FAIR FIELD OF COMPETITION, IT REFLECTS THE PROPER REWARDING OF THOSE WHO PERFORM BEST. THE QUESTION, HOWEVER, IS WHETHER THE COLOSSAL SIZE OF THESE FEW ACCOUNTING FIRMS ACTUALLY REFLECTS A SUPERIOR ABILITY TO PROVIDE EFFICIENT AUDIT WORK WITHOUT COMPROMISING PROFESSIONAL STANDARDS. HAS A STRUCTURE EVOLVED IN WHICH THE LARGEST ACCOUNTING FIRMS ARE LIKELY TO ENTRENCH THEMSELVES IN THEIR DOMINANT POSITIONS, TO THE DETRIMENT OF SMALLER FIRMS, REGARDLESS OF THE QUALITY OF THEIR WORK? THE CONCERN EXPRESSED BY REPRESENTATIVES OF SMALLER FIRMS DURING OUR RECENT HEARINGS SUPPORTS AN AFFIRMATIVE

ANSWER TO THIS QUESTION, AS DOES RECENT SEC ACTIONS AGAINST "BIG 8" FIRMS.

JUST A FEW WEEKS AGO IT WAS REPORTED THAT THE SEC CHARGED HASKINS AND SELLS AND THREE OF ITS PARTNERS WITH DEFICIENCIES IN THE AUDIT OF FOUR CORPORATE CLIENTS. IN AN ADMINISTRATIVE PROCEEDING AGAINST HASKINS AND SELLS, THE SEC CHARGED THAT PROPER APPLICATION OF QUALITY CONTROL PROCEDURES COULD HAVE PREVENTED MOST OF THESE DEFICIENCIES. AND LAST MONTH PRICE WATERHOUSE WAS CHARGED WITH FAILING TO DISCOVER THAT TWO OF ITS CORPORATE CLIENTS WERE MAKING FRAUDULENT CLAIMS OF PROFITABILITY TO STOCKHOLDERS. WITH THESE ACTIONS, HASKINS AND SELLS AND PRICE WATERHOUSE JOINED PEAT, MARWICK AND MITCHELL AND TOUCHE ROSS, TWO OTHER "BIG 8" ACCOUNTING FIRMS THAT HAVE BEEN DISCIPLINED BY THE SEC UNDER ITS POLICY THAT ACCOUNTANTS SHARE CULPABILITY WITH THEIR CLIENTS IF THEY FAIL TO DISCOVER AND DISCLOSE FRAUD AND QUESTIONABLE PAYMENTS.

A HARMFUL RESULT OF THE HIGH DEGREE OF CONCENTRATION AMONG THE LARGE FIRMS IS THE BITTERNESS DISPLAYED AT OUR RECENT HEARINGS BETWEEN THE LARGE AND SMALL FIRMS. THE DIVISIVE ALLEGATIONS AND CROSS-ALLEGATIONS WHICH PERMEATED OUR HEARINGS SURELY TAKE A TOLL ON THE PUBLIC'S PERCEPTION OF THE PROFESSION. MORE IMPORTANTLY, THE CURRENT ATMOSPHERE OF TENSION AND DISHARMONY JEOPARDIZES THE EFFORT AT SELF-REFORM, WHICH, AS ANY FULLY SELF-REGULATORY PROGRAM, RELIES HEAVILY ON VOLUNTARY COMPLIANCE. SUCCESSFUL SELF-REFORM IS A DIFFICULT UNDERTAKING EVEN IN A SPIRIT OF MUTUAL TRUST, AND IT MAY BE IMPOSSIBLE WHERE A SIGNIFICANT NUMBER OF PARTICIPANTS THINK THE GAME IS RIGGED FROM THE OUTSET.

THE FRAGMENTATION OF THE AICPA, THE ANTI-COMPETITIVE IMPLICATIONS FOR SMALLER ACCOUNTING FIRMS, THE LACK OF THE FORMAL ROLE FOR THE SEC

ARE BUT A FEW OF THE CONCERNS I HAVE REPEATEDLY EXPRESSED SINCE THE AICPA DIVISION OF FIRMS WAS ADOPTED IN SEPTEMBER OF LAST YEAR.

THE DIVISION IS SUBDIVIDED INTO AN SEC PRACTICE SECTION, FOR FIRMS WHICH HAVE OR HOPE TO HAVE AS CLIENTS CORPORATIONS REGISTERED WITH THE SEC, AND A PRIVATE COMPANIES SECTION, FOR FIRMS WITH CLIENTS WHICH ARE PRIVATELY OWNED. EACH SECTION HAS AN EXECUTIVE COMMITTEE, A PEER REVIEW COMMITTEE AND VARIOUS OTHER COMMITTEES DEVOTED TO SPECIAL PROJECTS. THE SEC PRACTICE SECTION ALSO HAS A PUBLIC OVERSIGHT BOARD, COMPRISED OF MEMBERS OF THE PUBLIC WHO ARE EXPECTED TO OVERSEE THE SECTION'S ACTIVITIES AND ASSURE RESPONSIVENESS TO PUBLIC EXPECTATIONS.

MY CONCERNS ABOUT THE AICPA PROGRAM CENTER ON THE CONTROL OF SEC SECTION'S EXECUTIVE COMMITTEE BY THE LARGEST 16 ACCOUNTING FIRMS, THE EFFECTIVENESS OF THE PEER REVIEW PROCEDURE, AND THE COMPOSITION AND EFFECTIVENESS OF THE PUBLIC OVERSIGHT BOARD.

THE SEC HAS ITSELF POINTED TO A NUMBER OF POTENTIAL PROBLEMS WITH THE AICPA PROGRAM. IN MANY RESPECTS I SHARE THOSE CONCERNS, PARTICULARLY ABOUT THE ORGANIZATION AND OPERATION OF THE 21-MEMBER EXECUTIVE COMMITTEE OF THE SEC SECTION. OF THE MORE THAN 400 MEMBERS OF THIS SECTION, ONLY THOSE FIRMS WITH 30 OR MORE SEC CLIENTS HAVE AUTOMATIC REPRESENTATION ON THE EXECUTIVE COMMITTEE AND THE SMALL FIRMS ARE REPRESENTED BY ONLY 5 MEMBERS. AND SHOULD THE CURRENT TREND TOWARD MERGERS CONTINUE SO THAT MORE FIRMS REACH THE LEVEL OF 30 SEC CLIENTS, THE NUMBER OF LARGE FIRMS REPRESENTED WILL INCREASE WHILE THE NUMBER OF SMALL FIRMS MEMBERSHIPS WILL REMAIN AT FIVE.

ALSO, A CLOSE LOOK AT THE EXECUTIVE COMMITTEE'S QUORUM AND VOTING REQUIREMENTS RAISES TROUBLING QUESTIONS. A SIMPLE MAJORITY OF 11 OF 21 MEMBERS WOULD NORMALLY CONSTITUTE A QUORUM. HOWEVER, 13 MEMBERS OF THE

EXECUTIVE COMMITTEE OR THEIR DESIGNATED ALTERNATES MUST BE PRESENT TO CONSTITUTE A QUORUM. WHEREAS 11 AFFIRMATIVE VOTES ARE REQUIRED FOR ACTION ON MOST MATTERS, 13 AFFIRMATIVE VOTES ARE REQUIRED TO AMEND MEMBERSHIP REQUIREMENTS AND DETERMINE SANCTIONS TO BE IMPOSED ON MEMBER FIRMS. BY RAISING THE QUORUM REQUIREMENTS TO 13 RATHER THAN 11 ARE REQUIRING AFFIRMATIV VOTING, THE LARGE FIRMS DOMINATING THE COMMITTEE HAVE GUARANTEED THAT NO MEETINGS CAN BE HELD, MEMBERSHIP REQUIREMENTS CHANGED OR SANCTIONS IMPOSED UNLESS THE LARGE FIRMS ARE IN CONTROL.

MY DISSATISFACTION WITH THIS SET-UP WAS COMPOUNDED WHEN THE CIRCUMSTANCES, UNDER WHICH THE SECTION'S MEMBERSHIP CRITERIA WAS ESTABLISHED, WERE DISCLOSED DURING OUR HEARINGS. ON JULY 7, 1977, AN AICPA ADVISORY GROUP CONSISTING OF TOP EXECUTIVES FROM THE 16 LARGEST ACCOUNTING FIRMS MET AND THEN SCHEDULED A MEETING FOR REPRESENTATIVES OF THESE 16 FIRMS AND FIVE SMALLER FIRMS.

ON JULY 28, 1977, THESE 21 FIRMS MET. THE ULTIMATE RESULT OF THIS MEETING WAS - THIS 21 MEMBER ADVISORY GROUP ADVISED THAT IT SHOULD BE THE SEC SECTION'S EXECUTIVE COMMITTEE. THE ADVICE WAS ACCEPTED BY THE AICPA BOARD OF DIRECTORS WITHOUT OBJECTION, BUT WAS RATIFIED AT THE AICPA'S SEPTEMBER CONVENTION WITH A GREAT DEAL OF OBJECTION. APPROXIMATELY ONE-THIRD OF THE MEMBERSHIP STOOD AND WERE COUNTED IN OPPOSITION TO THE AICPA PROPOSAL.

THE OBJECTIONS WERE RAISED PRIMARILY BY MEMBERS REPRESENTING THE SMALLE FIRMS WHO CLAIMED THAT THE PROPOSAL FOR A DIVISION OF FIRMS COULD NOT BE ADOPTED WITHOUT A CHANGE IN THE INSTITUTE'S BY-LAWS AND SUCH A CHANGE REQUIRED THE APPROVAL OF TWO-THRIDS OF THE MEMBERSHIP BY WRITTEN BALLOT. TRADITIONALLY, THE AICPA HAS BEEN MEMBER ORIENTED. TO UNITE CERTIFIED PUBLIC ACCOUNTANTS AND TO ADOPT A FORM OF ORGANIZATION BEST DESIGNED TO

MEET THE NEEDS OF ALL ITS MEMBERS ARE STATED GOALS. THE RECENT SPLIT WITHIN THE AICPA CAN HARDLY BE CONSTRUED AS FURTHERING THESE GOALS.

ONE NEED ONLY READ THE TORTURED OPINION FROM THE AICPA'S COUNSEL TO AGREE THAT THOSE OPPOSING THE NEW DIVISION OF FIRMS HAVE A VALID CONCERN. SUCH PHRASES AS:

> "IDEALLY, A PROPOSAL [TO ESTABLISH A DIVISION OF FIRMS] WOULD MOST SUITABLY BE ACCOMMODATED BY AMENDMENT OF THE BY-LAWS, TO REMOVE ANY DOUBTS AS TO THE AUTHORITY OF THE NEW DIVISION TO FULFILL ITS INTENDED PURPOSES AND TO FULLY DISCHARGE ITS RESPONSIBILITIES."

AND QUESTIONS SUCH AS THE LEGALITY OF SANCTIONING FIRMS AND LEVYING FINES WITHOUT A CHANGE IN THE BY-LAWS ARE REPLETE THROUGHOUT HIS OPINION. NOTABLE IN THIS REGARD IS THE REASON WHY MEMBERSHIP IN THE SEC PRACTICE SECTION IS VOLUNTARY RATHER THAN MANDATORY. MANDATORY MEMBERSHIP WOULD BE A CLEAR VIOLATION OF THE AICPA BY-LAWS. A KEY AREA OF AGREEMENT

BETWEEN THE METCALF SUBCOMMITTEE AND MYSELF IS THAT MEMBERSHIP IN ANY REGULATORY ORGANIZATION OF SEC FIRMS MUST BE MANDATORY. THIS POINT WAS REEMPHASIZED BY SENATOR PERCY DURING MY SUBCOMMITTEE'S RECENT HEARINGS AND IS THE ESSENCE OF ANY REGULATORY PROGRAM.

ON JANUARY 5, A GROUP OF AICPA MEMBERS REPRESENTING THE SMALLER FIRMS FILED SUIT IN NEW YORK ON THE GROUNDS THAT THE NEW DIVISION VIOLATES THE AICPA BY-LAWS AND CREATES CLASSES OF MEMBERSHIP WITHIN THE INSTITUTE. THE QUESTION OF LEGALITY MAY NOW REST WITH THE COURTS. BUT THE QUESTION OF EFFECTIVENESS MAY HAVE TO BE DECIDED BY THE CONGRESS.

WITH RESPECT TO THE EFFICIENCY OF PEER REVIEW, I SERIOUSLY QUESTION THE OBJECTIVITY AND WILLINGNESSS OF ONE FIRM TO CRITICIZE ANOTHER, PARTICULARLY THE LARGE FIRMS. THE SEC, WHICH HAS HAD EXPERIENCE IN THIS

AREA, HAS EXPRESSED SIMILAR VIEWS. I AM ALSO CONCERNED THAT THIS PEER REVIEW CONCEPT WILL OFFER IN REALITY LITTLE MORE THAN THE AICPA'S VOLUNTARY QUALITY REVIEW PROGRAM, WHICH AFTER A YEAR NEVER GOT OFF THE GROUND AND WAS CONSIDERED BY MANY IN THE PROFESSION AS SHEER "WINDOW DRESSING" INSTITUTED TO THWART CONGRESSIONAL ACTION. IT IS THE INTENT MORE SO THAN THE VENEER OF REFORM THAT MUST BE SCRUTINIZED. AND BEING SOMEWHAT OF A SKEPTIC AFTER ALMOST 30 YEARS AS A LEGISLATOR, I WONDER IF THE INTENT BEHIND THE NEW PEER REVIEW STRUCTURE IS ANY MORE SUBSTANTIVE THAN THE OLD. HERE, MY CONCERNS AGAIN CENTER ON DOMINATION OF THE PEER REVIEW PROCESS BY THE LARGE ACCOUNTING FIRMS. FOURTEEN OF THE 15 MEMBERS ON THE COMMITTEE REPRESENT_ LARGE FIRMS, INCLUDING 7 OF THE "BIG 8". IT IS ENVISIONED THAT ONLY LARGE FIRMS WILL CONDUCT PEER REVIEWS OF OTHER LARGE FIRMS SINCE THE FIRM BEING REVIEWED, RATHER THAN THE PEER REVIEW COMMITTEE, WILL

SELECT THE REVIEWING FIRM. AND SHOULD THE COMMITTEE "POOL" BE USED, IT IS ENVISIONED THAT THESE POOLS WILL CONSIST PRIMARILY OF EMPLOYEES FROM LARGE FIRMS. ALTHOUGH THE PEER REVIEW STANDARDS HAVE NOT BEEN DEVELOPED, THE "BACK-SCRATCHING" IMPLICATIONS IN THIS PROCESS, SHOULD IT REMAIN UNCHANGED, ARE INESCAPABLE.

MOREOVER, THE PEER REVIEW COMMITTEE CAN ONLY <u>RECOMMEND</u> SANCTIONS TO THE EXECUTIVE COMMITTEE WHICH MAKES THE FINAL DETERMINATION AS TO WHETHER SANCTIONS SHOULD BE IMPOSED AND PUBLICIZED. AND WHERE SANCTIONS AR WARRANTED, IT IS NOT MANDATORY THAT THE PEER REVIEW COMMITTEE MAKE SUCH RECOMMENDATIONS. THUS, IN ADDITION TO THE EXECUTIVE COMMITTEE'S QUORUM AND VOTING REQUIREMENTS ON SANCTIONS, IT APPEARS THAT THE PEER REVIEW PROCESS INCLUDES ANOTHER SUBTLE SAFETY VALVE WHEREBY

THE LARGE ACCOUNTING FIRMS DOMINATING THE EXECUTIVE AND PEER REVIEW COMMITTEES CAN INFLUENCE OR PREVENT DISCIPLINARY ACTIONS AGAINST DEFICIENT FIRMS. WHETHER THIS BE THE CASE IN FACT OR APPEARANCE, IT LEAVES GRAVE DOUBTS AS TO THE VALIDITY OF THE PEER REVIEW PROCESS.

IN MARCH OF 1975, MAURICE STANS PLEADED QUILTY IN FEDERAL DISTRICT COURT TO CRIMES INVOLVING THE ACCEPTANCE OF AND ACCOUNTING FOR ILLEGAL CORPORATE POLITICAL CONTRIBUTIONS. LAST MONTH THE NEW YORK STATE BOARD OF REGENTS UNANIMOUSLY AFFIRMED THE DECISION OF THE NEW YORK STATE BOARD OF PUBLIC ACCOUNTANCY IN CENSURING MR. STANS. A YEAR EARLIER, THE ACIPA CONDUCTED AN INVESTIGATION OF MR. STANS, ITS FORMER PRESIDENT AND "MAN OF THE YEAR" IN 1954, AND GAVE HIM A CLEAN BILL OF HEALTH. IF THIS IS AN EXAMPLE OF THE INSTITUTE'S DISCIPLINARY PROWESS, THEN REGULATORY LEGISLATION SHOULD BE INTRODUCED IMMEDIATELY.

I HAVE STATED ALONG WITH OTHERS THAT THE SUCCESS OR FAILURE OF AICPA SELF-REGULATION MAY HINGE ON ITS PUBLIC OVERSIGHT BOARD. AGAIN, I SHARE THE SEC'S VIEW THAT THE QUALITY, STATURE, AND BACKGROUND OF THE INDIVIDUALS SELECTED TO SERVE AS MEMBERS OF THE BOARD AND THE RESOURCES AVAILABLE TO IT ARE CRITICAL. TO THIS, I HAVE ADDED THAT IT SHOULD BE A FULL-TIME JOB FOR THE MEMBERS, THEY SHOULD BE FULLY COMPENSATED, THEY SHOULD HAVE A FORMAL, MANDATORY PROCEDURE FOR REPORTING AND COMMUNICATING WITH THE SEC ON FINDINGS AND ACTIVITIES, AND THE BOARD'S BUDGET SHOULD BE SUFFICIENT TO HIRE ITS OWN STAFF OF HIGHLY COMPETENT PROFESSIONALS. MOREOVER, I HAVE EXPRESSED STRONG RESERVATIONS ABOUT THE SELECTION PROCESS AND TENURE OF THE PUBLIC OVERSIGHT'S BOARD'S MEMBERSHI THE EXECUTIVE COMMITTEE APPOINTS BOTH THE BOARD'S MEMBERS AND ITS CHAIRM

THE TERMS OF THE MEMBERS ARE 3 YEARS, RENEWABLE "AT THE PLEASURE OF THE EXECUTIVE COMMITTEE." THAT A PUBLIC OVERSIGHT BOARD SHOULD PLEASE AN EXECUTIVE COMMITTEE HAS IMPLICATIONS WHICH BOTHER ME A VERY GREAT DEAL AND TESTIMONY BEFORE MY SUBCOMMITTEE DID LITTLE TO ALLEVIATE MY CONCERN. WHEREAS THE BOARD MEMBERS WILL BE GENEROUSLY COMPENSATED AND ABLE TO HIRE THEIR OWN STAFF, THEY WILL BE EXPECTED TO WORK ONLY 30 TO 40 DAYS A YEAR, THEY WILL STILL BE APPOINTED BY THE EXECUTIVE COMMITTEE, THEY WILL HAVE NO FORMAL, MANDATORY RELATIONSHIP WITH THE SEC AND THEIR TERMS OF OFFICE WILL BE FOR 3 YEARS, STILL "RENEWABLE AT THE PLEASURE OF THE EXECUTIVE COMMITTEE". PERHAPS MY BIGGEST CONCERN ABOUT THE PUBLIC OVERSIGHT BOARD STEMS FROM OUR HEARINGS AND FOCUSES ON THE ABILITY OF ITS MEMBERS TO SUSTAIN THE DEGREE OF INDEPENDENCE ESSENTIAL TO ACHIEVE THE BOARD'S OBJECTIVES.

THE THREE MEMBERS APPOINTED TO DATE ARE UNQUESTIONABLY MEN OF IMPRESSIVE STATURE AND BACKGROUND WITH YEARS OF DISTINGUISHED SERVICE AND EXPERIENCE. BUT THE TWO MEMBERS OF THE BOARD APPEARING AT OUR HEARINGS SEEMED TO LACK THE UNDERSTANDING AND PERCEPTION OF AN EFFECTIVE OVERSIGHT FUNCTION. FOR EXAMPLE, BOTH MEN WILL CONTINUE TO SPEND MOST OF THEIR TIME IN LAW FIRMS CARRYING THEIR NAMES AND DID NOT FEEL THAT THE BOARD'S INDEPENDENCE WOULD BE ENHANCED IF MEMBERS COULD BE DISMISSED ONLY WITH THE APPROVAL OF THE SEC. I BELIEVE THE BOARD MEMBERS SHOULD SELECT THEIR CHAIRMAN, APPOINTMENTS SHOULD BE FOR A PERIOD OF 3 TO 5 YEARS, AND DISMISSAL SHOULD BE FOR CAUSE ONLY AFTER REVIEW AND APPROVAL BY THE SEC.

IT SHOULD BE OBVIOUS FROM WHAT I HAVE SAID THAT I AM BOTH DISAPPOINTED AND DISSATISFIED WITH THE SELF-REGULATORY PROGRAM INSTITUTED BY THE AICPA. DESPITE REPEATED WARNINGS FROM OTHER MEMBERS OF CONGRESS AND MYSELF, FEW

IF ANY DISCERNIBLE CHANGES HAVE BEEN MADE SINCE THE AICPA'S PROPOSAL WAS UNVEILED LAST AUGUST. EVEN MORE DISAPPOINTING IS THE SEC'S RELUCTANCE TO TAKE ANY POSITIVE PREPATORY ACTION EVEN THOUGH IT CONTINUES TO EXPRESS ITS DISSATISFACTION WITH THE AICPA'S PROGRAM. SUCH AN UNCONSTRAINED "WAIT AND SEE" ATTITUDE WITHOUT ANY POSITVE, WELL-PLANNED ALTERNATIVE IS NOT ONLY IRRESPONSIBLE AND UNCONSCIONABLE, BUT MYSTIFYING. I HAVE SCHEDULED A FINAL HEARING NEXT WEEK WITH CHAIRMAN WILLIAMS AND THE OTHER FOUR SEC COMMISSIONERS TO PROVIDE A FINAL OPPORTUNITY FOR THE SEC TO OFFER A POSITIVE, CONSTRUCTIVE PROPOSAL FOR TIMELY IMPLEMENTATION AS AN ALTERNATIVE TO THE AICPA'S PROGRAM. WHETHER OR NOT REGULATION OF THE ACCOUNTING PROFESSION IS ULTIMATELY LEGISLATED MIGHT VERY WELL DEPEND NOT SO MUCH ON THE ADEQUACY OR INADEQUACY OF THE PRESENT AICPA PROGRAM, BUT ON THE WILLINGNESS OF THE SEC TO EXERCISE ITS AUTHORITY.

UNLESS I CAN BE PERSUADED TO THE CONTRARY DURING THIS HEARING, I SHALL INTRODUCE LEGISLATION. THE LEGISLATION WOULD CREATE A BASIC SELF-REGULATORY STRUCTURE WHICH ALL ACCOUNTING FIRMS PRACTICING BEFORE THE SEC WOULD BE REQUIRED TO JOIN. IT WOULD BE PATTERNED AFTER THE ORGANIZATIO ESTABLISHED BY THE NATIONAL ASSOCIATION OF SECURITIES DEALERS AND TAILORED TO THE ACCOUNTING PROFESSION BY INCORPORATING THE MOST APPROPRIATE AND EFFECTIVE ELEMENTS OF THE MANY LEGISLATIVE SUGGESTIONS OFFERED TO OUR SUBCOMMITTEE.

YOU MAY HAVE HEARD, AS I HAVE, THAT WITH THE PASSING OF SENATOR METCALF AND JOHN MOSS NOT SEEKING REELECTION, LEGISLATIVE PROPOSALS REGULAT ACCOUNTANTS WILL NEVER BECOME LAW. DON'T BET ON IT! THERE ARE ALREADY BRIGHT, YOUNG, ENERGETIC MEMBERS OF MY SUBCOMMITTEE, AND OTHERS IN CONGRESS, WHO ARE PROFOUNDLY INTERESTED IN THE SUBJECT AND MORE THAN WILLING TO

CARRY THE BANNER. THE ACCOUNTING PROFESSION HAS FOR MANY YEARS ENJOYED A VERY LOW PROFILE IN TERMS OF PUBLIC ATTENTION. BUT THE PROFESSION IS NOW IN THE SPOTLIGHT AND A HEIGHTENED SENSE OF THE ACCOUNTANT'S ROLE AND HIS RESPONSIBILITY TO THE PUBLIC IS WELL UNDERWAY. THERE ARE IN EXCESS OF 25 MILLION INVESTORS IN THIS COUNTRY WHO, THROUGH THEIR POWER AT THE POLLS, WILL SEE TO IT THAT THE PRESENT INTEREST IS SUSTAINED AND INTEREST AMONG MORE MEMBERS OF CONGRESS IS GENERATED. IT HAS BEEN MY EXPERIENCE DURING THE PAST 29 YEARS THAT LEGISLATION INVOLVING A BROAD BASE OF CONSTITUENTS GATHERS MOMENTUM ONCE IT IS INTRODUCED. AND I INTEND TO BE VERY ACTIVE DURING THE NEXT 10 MONTHS TO DO WHATEVER MUST BE DONE TO ENSURE THAT EFFECTIVE, EVENHANDED, NON-BURDENSOME REGULATION OF THE ACCOUNTING PROFESSION IS EITHER ACHIEVED OR WELL ON ITS WAY.