

## **SEC Historical Society**

### **Fireside Chat on the SEC Office of the Chief Accountant April 21, 2009**

**THERESA A. GABALDON:** Good afternoon and welcome to today's Fireside Chat focusing on the SEC Office of the Chief Accountant, broadcast by the Securities and Exchange Commission Historical Society on [www.sechistorical.org](http://www.sechistorical.org). I am Theresa Gabaldon, Lyle T. Alverson Professor of Law at the George Washington University School of Law and moderator for the program. The SEC Historical Society preserves and shares the history of securities regulation through its virtual museum and archive at [www.sechistorical.org](http://www.sechistorical.org). The museum is free and accessible worldwide at all times. The virtual museum and archive as well as the Society are separate from and independent of the U.S. Securities and Exchange Commission and receive no government funding. We thank the many institutions and individuals whose gifts and grants make possible the growth and outreach of the virtual museum and archive to over 8,000 visitors each month.

Today's program continues the SEC Historical Society's look at some of the major divisions and offices at the SEC as part of the Society's commemoration of the SEC's 75<sup>th</sup> anniversary this year. The SEC Office of the Chief Accountant is one of the original SEC offices and today's chat will examine its work, staff and impact over the last seven decades. I am delighted to welcome Jack Albert, currently serving as Senior Associate Chief Accountant in the SEC Office of the Chief Accountant; and Gary Previts, Professor of Management at Case Western Reserve University and former President of the American Accounting Association. Their remarks today are solely their own and are not representative of those of the SEC or of the Society. They cannot give legal or investment advice.

Before we begin I would like to thank the Office of the Chief Accountant Committee which has been assisting the Society for many years to ensure that information and materials relating to OCA and accounting regulation are added to the Museum collections. This Committee has been chaired by Linda Griggs and Scott Bayless, as well as co-chaired in the past by Gary. Jack has been member as well as Jimmy Barge, Bob Colson, Terry Iannaconi, Bob Kueppers and Mike Sutton. The committee has been instrumental in shaping today's program and I am grateful for all of its input and support. Jack and Gary welcome.

**JACK ALBERT:** Thank you very much Theresa; it's a pleasure to be here.

**THERESA A. GABALDON:** Jack, I understand that you have a significant amount of personal history with OCA, could you take just a moment to tell us a little about it?

**JACK ALBERT:** Certainly Theresa, thank you. And just to expand upon the standard caveat, not only am I not qualified to give investment and legal advice but also I am not qualified to speak on behalf of the agency. I think those of you who are familiar with presentations by SEC speakers over the years will recognize the fact that these views are my own, do not reflect on the Commission and do not necessarily reflect the views of any of my colleagues on the staff of the Commission. Just as a bit of a background, the Office of the Chief Accountant of course is part of a larger government agency, the Securities and Exchange Commission and as a government agency what we do is we have a lot of meetings. In our office we like to refer to these meetings as registrant meetings. They are very interesting meetings. They are certainly not perfunctory and basically the purpose of the meeting is to discuss the particular accounting treatment that has been followed by an SEC registrant with the concurrence of the registrant is certifying accountants. One particular meeting stands out in my mind and I still remember it to this day. It was a late afternoon meeting involving a Fortune 500 type company represented by a major accounting firm. The meeting started with the representative of the company giving quite a detailed background of his personal history. It was kind of Chamber of Commerce like and the chief accountant at that time interrupted him and pointed out that he had something to do at the close of business that particular day and so he recommended that the person cut to the chase so that they could resolve the matter by close of business. The person was very apologetic and pointed out that the reason he did this was because his advisor at the time, a prominent accountant from PriceWaterhouse, advised him to establish some credibility. So what I am trying to do here is establish some credibility as to what I am doing here this afternoon. Basically, I have been in the Office of the Chief Accountant for an extensive period of time, starting in 1979 with Clarence Sampson as the chief accountant, and more recently when Conrad Hewitt was presiding. In the interim there have been six other chief accountants: Ed Coulson, Walter Schuetze, Mike Sutton, Lynn Turner, Bob Herdman and Don Nicolaisen. At the present time the position is vacant and the initial reaction may be that's great, you have a little break and you don't have a boss at the time. However, that's not the case, for during the various transitions we have had acting chief accountants who were extremely capable. Presently that position is being served by Jim Kroeker, before him among the acting chief accountants have been George Diacont, Scott Taub, Jackson Day and others. So basically this is my pitch for credibility and we are certainly happy to be with you today.

**THERESA A. GABALDON:** I don't think that either one of you needs to burnish your credibility but I am going to ask Gary to take a little bit of time as well to describe his familiarity with the office.

**GARY PREVITS:** That's great Jack, a good way to get started. Since 1978 I have been writing materials and presenting materials that deal with the chief accountants. Just for the record. Beginning in August of 1978 in the Journal of Accountancy there was a piece that covered the contributions of the first five chief accountants. Also in July of 1984 when it was the 50<sup>th</sup> anniversary of the SEC I co-authored a piece in the Journal of

Accountancy on the 50 years of SEC's regulation and the accounting profession. Then more recently in 2005 I published and co-authored a piece called 'Keeping Watch' which deals with the last 25 years of the Office of the Chief Accountant up to 2001. So I have been writing and researching in this area since 1978 at least and that's a few of my credentials.

[June 28, 2009 Addendum from Gary Previts]

I also wrote a brief biographical piece in January 1982 after Carman Blough passed away, for the Journal of Accountancy. W.D. Cooper, who studied Carman as the subject of his Ph.D. thesis, published a paper on this research in the Accounting Historians Journal in 1982 (Vol. 9, No. 2). The SEC Historical Society archives also contain Interviews with many of the Chief Accountants, and a videotape Interview of Andrew Barr among the items in the collection.

**THERESA A. GABALDON:** It sounds like we are going to hear from the authorities today. And I would ask one of the authorities to start us off by explaining the relationship of the Office of the Chief Accountant with the chief accountants in the other SEC divisions.

**JACK ALBERT:** I will be happy to start with that, Theresa. The Office of the Chief Accountant is the principal advisor to the Commission on matters of accounting policy and as a result the Commission leans very heavily on the chief accountant. It is interesting the SEC historically has been a lawyer dominated agency. Over the 75 years I think there has been one CPA that's been sitting on the Commission. As a consequence of that, the chief accountant and the Office of the Chief Accountant have a great deal of authority within the agency to speak on and to help develop accounting policies. We don't do that in a vacuum of course and the other divisions within the agency all have very capable chief accountants on their own, so there's very much a collegial aspect to the process. The chief accountant of our office will co-ordinate with the chief accountant in the Division of Corporation Finance, will co-ordinate with the chief accountant within the Division of Investment Management, will co-ordinate with the chief accountant within the Division of Enforcement on enforcement related matters and will deal with the chief accountant within the Division of Trading and Markets which was previously referred to as Market Regulation. However, in the area when disputes do exist it has generally been traditional for the Commission to look to the advice provided by the chief accountant and in many instances there will be discussions that involve various parties to the process and it isn't a fait accompli that the view of the chief accountant will always carry the day. However, we do go in with that particular advantage of the fact that the principal advisor to the Commission is the chief accountant on accounting matters.

**THERESA A. GABALDON:** Next I am going to ask something that maybe a little trickier which is for one of you or if it takes two, both of you to explain the relationship of the office with the alphabet soup in no particular order, the IASB, the FASB, PCAOB and AICPA?

**JACK ALBERT:** Well, let me start on that. In addition to being a typical agency that has a lot of meetings, we also refer to other organizations in acronyms and initializations. So that's kind of the standard group of organizations we deal with. Now the relationship with the FASB is a longstanding one. There is a memorable, notable accounting series release, accounting series 150 that was issued at the time that the FASB was established in the early 1970s. At that time the SEC acknowledged or recognized the FASB as a pre-eminent standard setter in the private sector and basically gave a lot of impetus to the work of the FASB which was just starting in the early 1970s. Interestingly enough with the Sarbanes Oxley legislation, among other things, Sarbanes Oxley actually established law as to what would qualify as a private sector standard setter. The SEC looked at the infrastructure, voting arrangements, and operations of the FASB. Financial reporting release 70 essentially reinforced the position that had previously been expressed in ASR 150 to look to the FASB as the pre-eminent standard setter in the United States. Now subsequent to that, there were a lot of developments in the international area whereby the international accounting standards has been given prominence. As you are well aware there has been a view towards eventually converging accounting standards because of the benefits that would accrue to the marketplace by having one set of accounting standards, that's the IASB. The SEC has a very broad project on ultimately possibly converging accounting standards. There is a so-called "road map" that identifies a host of issues that would need to be addressed before it could be possible that the International Accounting Standards Board would be recognized in the same fashion as the FASB is today for United States Accounting Standards. At the same time the Sarbanes Oxley legislation established rules for what the FASB needed to do to qualify as an accounting standard, they also established the PCAOB for disciplining and inspecting the work of the accounting profession and that is done under SEC oversight.

**THERESA A. GABALDON:** Well, Gary, I think that he all of them except the AICPA, would you like to introduce us to that entity as well?

**GARY PREVITS:** You have to go back pretty much to the origins of the Office of the Chief Accountant to look at the relationship between what we call the accounting profession organized in the private sector. Whether or not accounting principles and standards were going to be developed in the public sector in government or they were going continue to be made in the private sector was one of the key issues of the 1930s when the first chief accountant Carman Blough took office. The AICPA did exist in those days but under the name American Institute of Accountants. It undertook a name change in the 1950s to become AICPA. That organization represented the community of practitioners most likely to be involved with either the preparation and ordering of

publicly held company financial statements for public information. How the relationship has emerged over the years has been kind of a tennis match, that is to say, often times the Office of the Chief Accountant would lead the development of issues or would contest issues that were brought forth from the private sector. And the basis for this series as Jack has mentioned is recent statement number 70 and earlier accounting series release 150. But back in 1938, Carman Blough essentially established a policy that said that the Commission would look to the private sector and accept the decisions of the private sector. There was then established a term called substantial authoritative support but it was never clear in the minds of many people what was meant by the term substantial authoritative support. One of the pieces of research that ended up revealing some meaning to that was, I mentioned writing in January of '82 in the Journal of Accountancy. Under the Freedom of Information Act, one of the scholars, Professor W.D. Cooper, whose dissertation subject was Blough, discovered some correspondence between Blough and his successor Bill Werntz, the second chief accountant and gave a revelation as to the meaning of the term substantial authoritative support. Cooper found, quoting now from what Blough wrote to Werntz about the meaning of the term substantial authoritative support meant. As follows: "In my mind, it has meant authority of substantial weight rather than the predominance of authority." That is to say, it wasn't that 60% or 70% had to employ a method but you could have several different authorities or sources. Thus continuing the quote, "two contrary procedures might have substantial authoritative support so that no matter which registrant the registrant followed adequate disclosure and footnotes in the accounting certificates around the face of the statements as appropriate would be accepted without any changes being required in the body of the statements." Now that's 70 years ago, 1938. At the time that was very helpful because it was acknowledged that the private sector would have a role in developing acceptable approaches from the Commission's point of view and that the Commission was not going to singularly and in a doctrinaire way establish accounting practices. Over time, as Jack pointed out, by the 1970s the establishment of the Standards Board has taken the center stage in terms of what is an authoritative standard. But there has always been room in the history of the Commission for a new or a contested standard to be argued upon from the basis of substantial authoritative support. The early Commission from the time of Carman Blough on through Sandy Burton had indeed some difficult circumstances when there were differences of opinion, whether it was oil and gas accounting or whether it was investment tax credit accounting or whether it was simply the process of recognizing the all inclusive or so called current operating method. In all of those cases the SEC generally went with the substantial authoritative support approach, that is to say they allowed options rather than reducing to a single approach in the treatments of oil and gas or in the treatments of investment tax credits. In the case of current versus all inclusive, however, the Commission did come down very strongly in favor of an all inclusive approach to net income determination only slightly modified. So I guess the bottom line here, Theresa, is that the Commission and the private sector profession have continually been engaged in a partnership and that partnership has sometimes

been stronger on one side or the other depending on the political environment and the market circumstances.

**THERESA A. GABALDON:** Have there been any instances in which the SEC has flatly overruled the private sector standards?

**JACK ALBERT:** There is one classic and that has been revisited recently with the SEC revisiting its rules for oil and gas disclosures. But in the late 1970s the FASB issued statement 19 that basically chose successful efforts accounting as the preferred method of accounting by oil and gas producers over the then alternative being followed of full cost accounting. The SEC for its part was directed by Congress under a particular act to do a cold study of the particular issue. The SEC looked at the matter and concluded that neither successful efforts nor full cost accounting was the most desirable. Both were flawed and basic rationale there was that both full cost and successful efforts are based on the historical cost of finding oil and gas reserves. And really the most relevant information in an oil and gas production is really the finding of the reserves themselves and therefore the SEC overruled the FASB resulting in the suspension of statement 19 and embarked on a project to develop a new improved accounting system which was known as reserve recognition accounting or RRA. The goal of RRA was to estimate the amount of reserves, proved reserves that were in the ground and to develop an accounting methodology that would basically revolve around the discovery of reserves in the ground and the estimated expenses of ultimately bringing them to the surface and selling them, et cetera. After years of experimentation the SEC ultimately concluded that although all this information was very relevant, it was not reliably determinable and basically abandoned that RRA experiment to the effect that at the current time companies can choose either full cost or successful efforts in accounting and they do for oil and gas producers. So you find that at the current time although the major oil and gas producers fairly uniformly follow successful efforts. The medium sized firms, the predominant number will still follow full cost accounting and that alternative has existed for the past 30 years or so from when the SEC originally overturned FASB 19. That's an example of, it's a rare example but it is one where in the SEC chose to overturn the determination of FASB. I say the issue was revisited recently, the SEC recently revised its disclosures for oil and gas reserves which were outside the financial statements. So it remains in place, the ability to use either successful efforts or full cost accounting.

**GARY PREVITS:** Theresa, there are at least two other earlier episodes worth expanding upon just for historical information. One that goes back to the chief accountantship of Earle King which was from April '47 to November '56 involving accounting research bulletin No. 32, the treatment the committee for accounting procedure's endorsing the current operating concept of income. At that point when King had already indicated his preference for the all inclusive approach. He sent a letter that was published in the Journal of Accountancy in January of 1948 saying that the Commission has authorized the staff of the Commission to take exception to financial statements which appeared to be misleading even though they reflect ARB 32. It was a

very clear case of saying, we asked you to consider the all inclusive approach, you didn't, you are on notice that we are going to be watching very carefully. The CAP attempted a compromise issuing a revision, ARB 35, but it finally ended up modifying their all inclusive approach. I think it was seen as the SEC's decision not to accept the current operating approach, and their determination to support it that changed the approach.

The other matter occurred during Andy Barr's chief accountantship, November '56 to January '72. The issue was the investment tax credit and the accounting principles board's opinion number two which occurred during the Kennedy Administration. The legislation was passed in order to create an immediate benefit and a very strong incentive using tax credits for increasing industrial investment. When this was occurring the accounting principles board suggested that the proper approach for the determination of the treatment of this be by the matching approach or a differed approach. The credits would be taken over the time period of use of the new equipment. Whereas practice permitted both approaches, that is to say the flow through method, which allowed taking the full credit upfront, versus recognizing the impact of the credit over time. Barr and the SEC permitted both, and caused the APB to reverse its course and accept both. Blough speaking in 1964 said, it's interesting that the Commission came down permitting both, even though the Accounting Principles Board has been considered an authoritative body and established the deferred method. However, the community of practice was not yet obliged to recognize nor did the SEC exclusively recognize the APB.

Later, other contentious matters, such as oil and gas, arose during the era of ASR 150 and the FASB. In such matters, including recent issues over investment securities, the authoritative body has often had to readjust its position. Examples of more recent episodes where the Commission had made its influence felt would have to include SAB 99, Staff Accounting Board 99 under Lynn Turner's chief accountantship, which ended at the start of this decade. Lynn's staff accounting bulletin, while not authoritative as a Commission approved release, reformed thinking about materiality as having important qualitative as well as quantitative properties. Thus in many ways the OCA has substantively influenced practice, not to mention the many advisory and case by case examples which occur on a regular daily basis, which is through a consultative process. In these many different ways, the Office of the Chief Accountant has clearly influenced practice.

**THERESA A. GABALDON:** Gary described standard setting as a public private partnership and my impression is that sometimes it's a partnership that involves a little bit of arm wrestling. But do you think that most people view the balance as about right? Either Gary or Jack.

**GARY PREVITS:** Jack, would you take a shot at it first? I can hit clean up.

**JACK ALBERT:** All right. We try to have a balancing act and many would be surprised as to the consistency of contact, the frequency of contact between the staffs of the chief accountant's office and the FASB. We are in communication almost daily. Now part of it is a practical one, much of the literature is FASB literature and so as a starting point we would like to know what the FASB was thinking when they passed a particular rule or a particular interpretation. We are not necessarily bound by that but its always a good starting point as to exactly what the FASB was thinking in their rules because ultimately as I mentioned earlier, we do have frequent contact with the registrants in some of the areas where the rules are less than crystal clear. It's sometimes somewhat of an art to try to properly interpret the rules to see whether or not the company and its auditors are following the most appropriate accounting. So as a starting point I think we do have a very collegial type of relationship with the respective staffs. The SEC will make suggestions as to where the FASB directs their limited resources. Like every other organization, the FASB does not have unlimited resources where they have to pick and choose which particular areas they look to and we do try to provide some guidance there. I think I mentioned the Sarbanes Oxley having a big influence on what the SEC has done in the past six, seven years and as we are all aware some of the major financial frauds that led to the passage of Sarbanes Oxley Act included the WorldCom and Enron matters. With Enron in particular, there were abusive special purpose entities involved. I think we were instrumental in suggesting to the FASB that they improve the rules on special purpose entities as a consequence of the problems that we all saw from that process.

**GARY PREVITS:** I guess Theresa my comment would be depending on which point in time you were asking the question. There has always been attention, sometimes it would be considered healthy, sometimes less, depending on the emotions, the tenure of the leadership in the major accounting firms and at the institute. But I think what conditions the answer is what the capital market system is structured to be. It is there to facilitate the trading of capital owned ultimately by individuals who have under our constitutional system the right to own and therefore to trade their private productive property and capital. If you go to the SEC website and I think its still prominently there, the role that the Commission plays in advocating for the investor seems to be identified there in the quote of William O. Douglas, who served as SEC Chairman from 1937 to 1939, before becoming a justice of the Supreme Court. Douglas's quote identifies the SEC's role as being the investor's advocate. And using that point in time, I am certain he meant individual investor, not as the term may be understood today, to represent the institutional investor, although certainly indirectly if large institutional investors are served, one would hope that the individual investor also is served. But if the primary role is to serve the individual investor, the SEC is certainly involved in a more popular and fundamental role as a kind of principal strategic purpose. If you go back to some of the data that existed half a century ago, over 90% of corporate equity was owned by the individual investor. Whereas if you look at it today and particularly if you look at companies, either in the Dow Jones 30 companies or any of the Fortune 500, what you begin to see is the dominance of the institutional investors in their ownership of equity,

and thus their role has expanded in developing publicly available information. Because such institutions are sophisticated, this changes the way in which and in what you disclose based upon the audience being served by the disclosure. I use U.S. Steel as an example only because one of our doctoral students at Case is currently doing some work in that area. Mr. Carduff's work has displayed that over time the shareholder annual reports or the periodic reports (not the 10-K filings) have changed dramatically. U.S. Steel was a model of disclosure when it was formed in 1902 because it had so much substantial individual investment, so much positive tension. I just received my 2008 U.S. Steel annual report the other day, it's a so called wraparound, there is no annual report to speak of. It's six pages of glossy information wrapped around a 10-K. This is a complete change from what it was in the early years. The shift begins in the 1970s and then is evidenced when we had the so called integrated disclosure project in the early '80s where the content of the financial information supplied to the Commission and that found in the management's annual report to shareholders was required to be made identical. Today, for a variety of reasons including legal exposure, publicly held companies have no incentive to prepare a separate report to shareholders, especially when those shareholders are large investment intermediaries, concentrated into a large entity following the repeal of Glass-Steagall. The 10-K has become the legally sufficient response.

**JACK ALBERT:** Just to pick up on Gary's theme with regard to the paramount importance of the users. I think we continue to regard the agency as being an advocate for the investor as in the William O. Douglas days. And I know one of the issues that all standard setters have is catering to the views of the users in trying to get input from the users. I know both the FASB and the SEC go out of their way to try to get input from the financial statement user because that's ultimately who we are trying to serve in the financial reporting process. The private sector, for its part, has commissioned a number of groups to try to solicit the views of users. I remember the Jenkins Committee that was formed 15 years ago before Jenkins became an FASB Chairman that solicited all types of views of users to advise the standard setters which include FASB and the SEC as to what the users needs are in a particular environment. Its not for lack of attention to the users but the characteristic of the user as Gary mentioned has changed over time, that's clear.

**THERESA A. GABALDON:** Certainly, I have heard over the years that there is a public private partnership as far as standard setting, as far as US Accountancy is concerned. One think I have also heard of course is that in this country there is substantially more emphasis on rules as opposed to principles. Could one of you take us back in time and tell us a little bit about the genesis of that and whether it had anything to do with the Office of the Chief Accountant?

**GARY PREVITS:** The turning point from principles to standards occurs in the early 1970s when the accounting profession was growing very rapidly. At the end of World War II, I think the AICPA, then the American Institute of Accountants, had less than

10,000 members. Today, its membership is in excess of 300,000; not all of those individuals are auditors, of course, but they are involved in corporate accounting and reporting as well. The point I am trying to make is when you try to administer accounting in an economy as dynamic and growing as ours, you eventually involve large groups of people who have to have a common educational background if they are going to provide the information needs of a large complex capital market system. You have to have some assurance that when you pick up a phone and talk to someone whether in San Diego or Sioux City, that they will have the same grounded fundamentals about what accounting is and does. So there's a huge educational mandate or impact implied in this over time. In the 1970s, when growth was really occurring, there was a concern that was brought about as to whether individual judgment in applying GAAP could serve such a complex market. My own interpretation would be, as a result of the Continental Vending Case (U.S. v. Ross, U.S. Supreme Court) a criminal case tracing back to 1962, essentially began to question whether or not principles as then established were a sufficient protection for practitioners in a court of law. Now, that's a non-lawyer speaking, and I suspect if there are any lawyers listening, they are going to be saying, "It's not quite that simple." I know that it's not that simple but essentially as a result of two special committees – Wheat and Trueblood – were formed by the AICPA. They began to look at setting standards instead of issuing opinions via a principles board, and refocused the purpose of statements away from stewardship and accountability to owners, toward decision making and the use of cash flows. Both of these were orientations in tune with the rising role of institutional investors in placing capital in operating publicly owned companies. A new structure for authoritative standards was in place, the Financial Accounting Standards Board. Implicit in this was a move away from a common law approach – conventions established by judgment – towards a civil law approach. Now we are 30 years plus later and we are looking back and attempting to assimilate IFRS, and we are tempering for awhile our overt standards setting language, to acknowledge that our process should be more principles-based. Yet both principles and standards are a part of a conceptual continuum, and to some extent an artificial distinction, just as that between art and science. One can argue human knowledge systems until exhaustion. But to get back to the central point, in the 1970s we overtly changed our authoritative process from one issuing opinions to one issuing standards. At the same time, the AICPA code of conduct establishes Rule 203 which requires that such standards be followed with exceptions unless application would ensure a material misstatement. This combination of standards and compulsory application that says you as a CPA must follow the standards of the board recognized by our governing council, brings about a focus not heretofore in existence, not because the SEC recognizes them but because it is an ethical violation not to follow them. So I look at that period in the 1970s, 30 years ago, as a watershed towards standards away from principles.

**JACK ALBERT:** And that coincides with the establishment of the FASB and if you listen to speakers when they are comparing and contrasting international and FASB standards, they will take a stack of FASB documents that constitute GAAP and compare

them with the international standards and the initial reaction is, "Hey, the US accounting standards are overly detailed, what we need to do is move towards a more principles-based standards such as the international standards which in terms of volume are far less. Now SEC has looked at the issue and it's kind of hard to argue against having principles-based standards. It's a very interesting thing, when you go back to our archives, the most significant accounting statements from the SEC have been issued in the form of accounting series releases. They are approved by the Commission. And you go back to ASR 12 which is really the adoption of SX, here was a debate. Do you really need rules? And Regulation SX basically provides a structure for the form and content of financial statements and it has some additional disclosures that are intended not to contradict GAAP but rather to supplement an FASB statement somewhere to get additional disclosures where its been deemed to be necessary. Back in 1940 when SX was initially adopted the debate was whether or not you needed any rules whatsoever or rather you can rely on the accounting profession to determine what the best presentation for their particular client. That was actually a legitimate argument back in 1940. So as the issues have evolved and the various commissions have studied issues and determined that no, you really need a little bit more form and structure to that and the FASB has issued a host of accounting standards. You have gotten to the present situation where now people are looking to cut back on the total volume and to get back to a more principles-based approach. The devil obviously will be in the detail because companies need the security of having guidelines, they don't want to be second guessed by the regulators or in court when in fact their use of judgment has been questioned and its something easier said than done. So its something that everyone is working on in going forward to try to attain a more principles based approach.

**THERESA A. GABALDON:** Jack just referred to ASR 12. I am interested in hearing about what some of the other landmark releases have been over the years?

**GARY PREVITS:** I think you could probably look to each of the chief accountants and find one or two significant releases. As we mentioned with Carman Blough, it has to be accounting series release 4. As he became chief accountant, there is another interesting story we would like to tell about the 1930s, when it was common practice for an income statement to begin with the net sales figure. Absent were details of gross sales and cost of sales because of the argument that to disclose gross sales and cost of sales would be to give up a competitive advantage. One of the things that Carman had to do in his early service in the SEC was to enforce the requirement of the SEC that income statements begin with gross sales, less cost of goods sold. I can't imagine living in a world where an income statement began with net sales and cost of goods sold and gross sales were not provided. But those are the kinds of things that evolve over time, as disclosure expectations change. Today, of course, we have been given the technology of the 21<sup>st</sup> century and instant global reach which place added expectations upon accountants to interpret complex transactions and simplify them.

As to Andy Barr, I would argue that he begins to distinguish himself on the SEC staff during the McKesson and Robbins fraud hearings during the term of Bill Werntz as chief accountant. Andy then succeeds Earle King as chief accountant in 1956, serving during a period of unprecedented prosperity in the U.S. economy during the high point of post-World War II prosperity up through the early 1970s. The establishment of auditing standards as an outcome of the case, in particular extending auditing procedures of receivables confirmation and inventory observation, are in part an aspect of the OCA during this period. Barr left the SEC to serve as an Army officer in Europe, and of course the SEC briefly moved its offices to Philadelphia during the war. The wartime focus does seem to be one wherein securities laws were not as much a matter of attention.

I mentioned Earle King earlier, in the context of the all inclusive income episode. He also was, I believe, the first chief accountant to be involved in a 2(e) proceeding against a large firm, involving a client, Thomascolor. Release number 73 comes to mind. The Commission decided to suspend the ability of a firm to practice in front of the SEC. Even for a brief time, this disturbs all the timetables for registrations and other activities for all clients of a firm when your firm is not permitted to practice before the SEC. I believe Sandy Burton also used this type of sanction briefly so it was later used in other circumstances to discipline firms. Jack, what other ones come to mind?

**JACK ALBERT:** I would pick on the Rule 2E theme because I think that's a very significant area. That's something that also illustrates the interaction with the Office of the Chief Accountant and the Division of Enforcement. This is an issue that always requires a great deal of serious time and effort on the staff's part because the implications are so great for the accountants that are involved in the process. And what you will see recently in what used to be Rule 2E is now referred to as Rule 102E and there's suspensions. From our standpoint they apply to practicing before the Commission as an accountant, they also apply to lawyers, of course but that would be more of the general counsel's office's involvement. But what we see these days is that Rule 102E suspension is not directed solely against the CPA that is working in a major accounting firm of a medium size or a smaller accounting firm. But also where a corporate controller or CFO is involved in fraud, or involved in books and records violations. The SEC has taken action under Rule 102E to suspend them despite of the fact they are not CPAs. I think there is a couple of cases that illustrates this quite well. There is the ProQuest matter wherein we took action, suspending a non-CPA who was a controller type. There is a Armstrong determination which was the basis for the ProQuest matter. In all of these instances, the SEC staff spends a great deal of time laboring over the process. We have to go into a legal area, we have a so-called Wells notice where we would advise the individual's legal representative of the fact they were considering making such a recommendation to the Commission that affords them the opportunity to head off the process to raise some arguments as to why we should not take such an action and as a consequence of that it's a very seriously considered matter when the Commission ultimately takes such an action. We have had occasions

where the chief accountant and the Division of Enforcement have been in different positions on a particular matter and that has resulted in discussions at closed Commission meetings as to the relative merits of the two conflicting positions. But it's been a serious enough issue that the Commission has heard the arguments and determination one way or the other.

**GARY PREVITS:** Theresa, I think you are on to something. I'd like to spend a little more time in discussing the idea of historical setting which makes it clearer to me that, without allowing some time to pass, it is difficult to evaluate the most recent chief accountants, such as Bob Herdmen, Don Nicolaisen and Conrad Hewitt. That said, the SEC Historical Society has completed interviews with all but the most recent chief accountants, and having undertaken two with Mike Sutton and Lynn Turner, I certainly believe more information about the OCA can be found from listening to them.

However, due to timing and health circumstances, Sandy Burton was not interviewed, and so a part of the discussion today should focus on his role. First his role in ASR 150, establishing SEC recognition of the authoritative standing of the FASB is very important. Next the manner in which peer review was introduced as a mechanism of discipline comes about in ASR 173. Finally ASR 190 requiring replacement cost information and ASR 203 addressing inflation accounting. Also ASR 177 which established the notion of overseeing a client's selection of new accounting principles to assure it is preferable under the circumstances traces back to Sandy's term of office. Sandy had a view of scope of services which was more likely to support an expansion of services than to restrict services that firms were permitted to undertake. This view, along with revisions to the competitive practices of the professions which flowed from the Federal Trade Commission, worked to support more services being offered. That had implications for scope of services by auditing firms, and created issues for people like Mike Sutton and Walter Schuetze to deal with, particularly when scope became concerns about independence.

We talk a little bit about independence, and yet it's one of the major issues that each of the chief accountants had to deal with, because of the crafting of the term – independent public accountant – in either the rules or in the legislation. It's a peculiar circumstance because there is a whole literature around what independence means in the practicing accountant's lexicon, and it evolves again over time as to what are proper independent activities. When there are 10,000 CPAs versus 300,000 CPAs, and when there are issues of family and gender balance viewed within family relationships and career patterns – it becomes very complex and confusing, and as a result independence concepts begin to differ. I think the independence issue is one that all of the chief accountants have had to address and some have had more difficult challenges than others and that is something we haven't spent a lot of time talking about but clearly there is a history there.

**THERESA A. GABALDON:** Now, you just mentioned the name of Sandy Burton, Gary. Over the years I have heard it hinted in some quarters that accountants are, how should I put this? Not the most exciting group you have ever met. I am sure that's just bad press but every now and then you will hear somebody say, "Oh, but there was Sandy Burton." Can either of you explain to me why he's a stand out?

**GARY PREVITS:** He had a tremendous ability to amicably debate issues on his feet and not to be unpleasant about it. He could disagree without being disagreeable. I remember a conversation with him at the time of the AICPA centennial in 1978. I think he had a lot of gusto and a lot of verve. He was just kind of a pleasant individual despite the fact you might disagree with him. Somewhat similar, also a very colorful individual was and is Lynn Turner. I say that with a smile in my voice because you know Lynn, he may be right or may be wrong, but he's never in doubt. You just kind of smile and perhaps grind your teeth when you don't agree with him and appreciate him when you do. Indeed, those personalities stand out as higher profile and outspoken. Others come across as being quiet and representing thoughtful and more deliberate. In my view these include Walter Schuetze and Mike Sutton – and yet they certainly belie the image of accountants as being dull. Both were very active and very approachable despite their serious or quiet demeanors. Perhaps this is why they weren't seen in media terms as prime time characters, who might have their own television show. They weren't the Drew Careys of their day. Both Lynn and Sandy had that persona; they had this way of having an audience built into their constituency.

**JACK ALBERT:** I think one of you started off by asking about John Burton, of course, one of the characteristics of his tenure was he started what we referred to as a accounting fellowship program, which is very interesting part of the work of the chief accountant's office. Because basically, it brings people in from the private sector for a two-year period. Most of them have extensive experience with the accounting firms, I guess this one of them from industry. But it's been very, it's been mutually beneficial, it has benefited the chief accountant's office by our ability to get fresh looks at things, and get perspectives from people who have been out in the field more recently than some of us have. And it's benefited the individuals involved by giving them a sense for how the SEC is operated. So I think that's a testimony to Dr. Burton who started the program over 30 years ago.

**GARY PREVITS:** I would like to add some kudos as well to Clarence Sampson who expanded that program to include academic fellows. We tend to take the educational feed stream for granted. Yet, without such individuals, where would we be? There now has been a generation-long community of earned doctorates in our profession, several of whom have been SEC academic fellows: Mark Taylor, now a member of the Auditing Standards Board; Ray Stevens, recently retired from Ohio University; Jerry Arnold of Southern California; Fred Skousen of BYU, and many more who served at the SEC, thanks to the program that Sandy started and Clarence adapted and expanded to accept academics.

We haven't mentioned the two chief accountants that came to the SEC from the University of Maryland. Clarence [Sampson] served a long tour of duty from 1976 to 1988, and then became a member of FASB, an interesting sequel. Usually, we have people coming from the private sector into the SEC, but Clarence was a government career person. He served as a deputy under Sandy, and he also served under Andy Barr. He is the longest serving chief accountant after Barr, in the last 25 years.

He was followed by Ed Coulson, another University of Maryland graduate and someone who began his career at the SEC. Both of these individuals served in the transition period of the 1970s and 1980s. Standards becoming the issue of conceptual framework was a big issue for Clarence. International was a big issue for Ed. Even though Ed served a much shorter term, I think he was pretty well liked and effective for the time when he was in the office. And Jack you served with him, didn't you?

**JACK ALBERT:** I did. And as you mentioned this, I was going through my papers and I came across a very interesting letter from Clarence to Don Kirk who was the chairman of FASB at that time, and it's dated July 1985. In that letter Clarence suggests that the board, headed by Don Kirk, study this issue of mark to market accounting. Now does that tell you that this issue has been around for a long time, given the Congressional interest in mark to market accounting this year?

**THERESA A. GABALDON:** Yes, indeed. And it reminds me of something I had been meaning to ask which is, do you think that you can describe the history of Office of the Chief Accountant in terms of cycles, that is, issues keep coming around. Or can you describe it more aptly in terms of swings from public to private and back again. Or is more like a trend in a specific direction? Or all of the above?

**GARY PREVITS:** I will take one shot at that. When you look at the appointment process for commissioners, at the discretion of the President, and you think about the role of independent regulatory agencies, you can't help but conclude that they are nearly the fourth branch of government. They are not constitutionally based in that direct way. You do have to read the political will that gets individuals elected into the White House. Then, you look for a translation of that political will into what the independent agencies will or won't do to be responsive to the President who makes those appointments. Of course, Congress is not without its authority because it provides the budget. I think you do have to understand that the independent regulatory agencies are independent in one sense, but their role is to serve the view of public interest that has been popularly represented in the most recent set of elections, and read both the White House and the Congress. Shifts in mood, or if you will, attitude based upon contemporary issues that are faced in the marketplace do become reflected in the administration of the SEC.

**JACK ALBERT:** I don't really see that dramatic a difference. When you have Democratic administration, possibly you will have a more hands-on approach and

perhaps a few more rules whereas a Republican administration, you are likely to have more of a laissez faire attitude to business. But I think that the differences are very subtle and there... I think if you track each of the chief accountants that I have served under, I think you'd really have difficulty in assessing political influence in the work product.

**GARY PREVITS:** You know, the one point that does come up there, Jack and I don't think I disagree with you, when I was preparing my archive interview with Mike Sutton, he commented upon how impressed he was coming in from the practice community to the dedication of the staff. He put it in a very colorful term. He said, "They salute the flag every day." Meaning there is a commitment to the public interests at the staff levels, that I think assures that any tendency to sway doesn't go too far.

**THERESA A. GABALDON:** Well, we've got just a minute to summarize and I guess I will ask you, Gary if you could in 25 words or less tell us, how financial accounting today is different than it was in 1935, the year the first Chief Accountant took office?

**GARY PREVITS:** I think we have seen that the SEC has created a process and body of knowledge around financial reporting and disclosure, from substantial authoritative support to preferability to the initiation of peer review and the support for private sector initiatives. While we don't have census data, we have probably closer to half a million accountants practicing as auditors, preparers or financial executives in public companies and investment intermediaries that could not have been foreseen in the 1930s. The size of the economy and its dynamics globally and nationally is such that if we hadn't had the Commission now, we likely would have established it. I'm not saying it was inevitable, but when one considers the history of federal regulation in this country, beginning with the Interstate Commerce Commission in the 1880s through the Environmental Protection Agency in the 1970s, securities regulation in a context of working with a private sector profession seems to have become a part of our mixed economy.

**THERESA A. GABALDON:** And Jack, 25 words or less on the changes that you have seen in your tenure with the Commission?

**JACK ALBERT:** We have a globalization aspect that probably wasn't even envisioned back in 1935 when you have just so many more multi-dimensional companies that are serving the securities markets both here and abroad.

**THERESA A. GABALDON:** Jack and Gary, thank you for sharing your thoughts on the SEC Office of the Chief Accountant, the guardian of the financial markets to some. Today's program is now added to the growing number of materials on accounting already in the museum collections, particularly the 1940 McKesson & Robbins report was referred to earlier; previous Fireside Chats on forensic accounting in September 2004, and on the accounting aspects of the Foreign Corrupt Practices Act in September

2007; the 2007 Annual Meeting; and interviews with former SEC Chief Accountants Andrew Barr, Carman Blough, John C or Sandy Burton, Edmond Coulson, A. Clarence Sampson, Walter Schuetze, Michael Sutton, and Lynn Turner.

Today's Fireside Chat can be accessed again on-demand in the Programs section of the museum in both MP3 and transcript format.

Next month's Fireside Chat will look at the SEC Office of the Chairman. Our panelists will be Leonard Leiman who worked with the SEC Chairman Manual Cohen in the 1960s, and Peter Derby who worked with the SEC Chairman William Donaldson earlier this decade. The chat will be broadcast on Tuesday, May 12th at 3pm Eastern Time. It will be free and accessible worldwide without prior registration. Please plan to join us again on [www.sechistorical.org](http://www.sechistorical.org). Thank you for being with us today.