THE SECURITIES AND EXCHANGE COMMISSION'S FIRST FIFTY YEARS: AN ACCOUNTANT'S VIEWPOINT

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J. Michael Cook's paper provides an historical overview of SEC action in three areas: (1) the establishment of accounting principles; (2) the establishment of auditing standards; and (3) the regulation of the accounting profession through enforcement actions undertaken by the SEC.

Cook outlines that the SEC took a relatively passive role in standards-setting and oversight in its first three decades, but has become increasingly active. He posits that although the relationship between the accounting profession and the SEC is not one of complete harmony, mutually satisfactory goals can be reached without excessive use of statutory enforcement powers by the SEC. Cook argues that the SEC's positive actions in its oversight of accounting self-regulation show its accommodation to the need of the accounting profession for independence. The author concludes that the SEC has taken an appropriate role in the evolution of its relations with the accounting profession.

1. Introduction

The Securities and Exchange Commission (SEC) and the accounting profession have had a close working relationship since its inception fifty years ago [1]. At times the profession and the SEC have worked together in order to establish sound accounting principles and professional standards. At other times the profession and the Commission have followed divergent, sometimes exclusive, paths to solve accounting and auditing issues. On this occasion, I wish I could report the relationship is one of complete harmony. But this is not the case. Complete harmony in our society, if it ever existed, ended during the mid-1950s. In an increasingly fluid and dynamic society, complete harmony among even relatively stable institutions, whether public or private, is unattainable.

Nevertheless, relative harmony between the accounting profession and the SEC in reaching mutual goals is attainable. This is also attainable without undue coercion or excessive use of statutory powers. The accounting profession expects the Commission to continue to play a significant and forceful role in

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the structure and functioning of the various professions that interact in the securities market.

From an accountant's viewpoint, I will discuss three primary interactions between the accounting profession and the SEC. These include the establishment of accounting principles and auditing standards, and the regulation of the profession through oversight and enforcement actions.

2. The establishment of accounting principles

The SEC's active role and influence in the development of accounting principles has been discussed by many authors [2]. I will not attempt to repeat the details of this development. Rather, I believe, as do many of my colleagues, that the focus of attention should be on the underlying philosophy adopted by the SEC with respect to establishing accounting principles.

The authority of the SEC to establish accounting principles is firmly founded in statutory legislation, including the Securities Act of 1933 [3], the Securities Exchange Act of 1934 [4], the Public Utility Holding Company Act of 1935 [5], the Trust Indenture Act of 1939 [6], and other acts that affect the securities market and the professions that interact with it. From the beginning, the SEC generally adopted a philosophy of allowing the private sector to establish accounting principles. Accounting Series Release (ASR) No. 4 issued in 1938 [7], a year before the accounting profession established a mechanism for formally issuing accounting pronouncements, stated that the SEC would accept in filings subject to its jurisdiction, accounting principles that had substantial authoritative support and for which the Commission had not previously expressed opposition [8].

This philosophy remained relatively unchanged through most of the first three decades of the Commission. Although there were some confrontations between the Commission's staff and the accounting profession involving accounting issues, the tenures of Carman Blough [9], William Werntz [10], and Earle King [11] were primarily devoted to furthering the development of Regulation S-X [12] and to laying the framework within which the Office of the Chief Accountant would function. This is not to imply that these Chief Accountants were not innovators. Carman Blough was responsible for the development of the Commission's approach to the establishment of accounting principles set forth in ASR 4; William Werntz contributed extensively to the development of generally accepted auditing standards; and Earle King was responsible for major improvements to Regulation S-X.

The era of Andrew Barr, who was appointed Chief Accountant in 1956, started without significant departure from the philosophy of his predecessors. The major structural changes occurring in our society, including the commercial development of computers, nuclear fission, and the exploration of space,
however, began to have dramatic effects. While the securities market, the accounting profession, and some industries responded more slowly to this change of pace, nevertheless the impact was felt. Furthermore, several financial scandals occurred in the climate of the 1960s and continued through the early 1970s. These scandals aroused public sentiment for reform. Reform, which is never harmonious, was to be achieved in part through the regulatory powers of the Commission.

During this period, significant changes occurred in the Commission's philosophy with respect to the establishment of accounting principles. Starting in the early 1960s, the Commission modified its case-by-case approach to accounting rule-making on a broader scale. This modification appears to have been directed toward achieving a goal of uniformity in financial reporting, where the facts underlying the accounting issues were likely to be substantially the same among registrants. ASRs 85 [13] and 102 [14] pertaining to the balance sheet treatment of deferred income taxes are examples of this change in philosophy.

Support for the accounting profession's leadership role in the establishment of accounting principles, however, continued throughout much of the 1960s. Even when the Commission disagreed with the accounting profession with respect to acceptable accounting principles, as it did in ASR 96 [15] which permitted the recording of the investment tax credit on the flow-through method [16], there was still support under Barr's leadership for the accounting profession's views. This relationship did become more attenuated though as registrants became increasingly aware of the economic effects of alternative accounting principles.

The accounting profession also was not immune to the structural changes that occurred in the 1960s. The ability of the accounting profession to establish timely accounting principles with a part-time body was seriously questioned, as was its ability to obtain a consensus of support for its views. These changes ultimately led the accounting profession to appoint a broad-based study group to assess the accounting profession's role in the establishment of accounting principles [17]. This group, known as the Wheat Committee [18], made a number of recommendations from which emerged the establishment of the Financial Accounting Standards Board (FASB) in 1972 [19]. The establishment of the FASB, an independent private sector body with a full-time board, staff, and due process procedures, was a significant change in the accounting standards-setting process. The accounting profession, like the SEC, became one of the many constituents of the FASB [20]. Although standards-setting remained essentially in the private sector, achievement of relative harmony became more complicated because of the number of varied constituencies involved in the process.

The SEC, under the leadership of its then new Chief Accountant, John "Sandy" Burton [21], reiterated in ASR 150 [22] its continued support for
private sector leadership, through the FASB, in the establishment of accounting principles. The Commission's support was not, however, as positive as that expressed in 1938. In addition to the structural changes in society, the Commission in the later years of the Barr era and continuing into the Burton era, embarked on an aggressive new program of innovation in the performance of its responsibilities with respect to accounting principles.

ASRs 147 [23], 148 [24], and 149 [25], stating the intent of the SEC to expand disclosure of certain accounting matters to meet the perceived needs of professional investors and analysts rather than the average investor, are examples of this innovation. This development, which ultimately helped pave the way for the SEC's integrated disclosure system in the 1980s, was a notable departure from the Commission's earlier philosophy. Disclosures for professional investors had frequently been relegated to sections of a registrant's annual report other than the financial statements. The Commission did not attempt, however, to define the terms "professional analyst" and "average investor." This left unresolved a key element of the controversial issue of differential disclosure.

Under Sandy Burton's activist leadership, in the early 1970s the Commission was sued by a large accounting firm for allegedly attempting to establish without due process, in ASR 146 [26], accounting principles for business combinations to be accounted for as poolings [27]. The issues involved are still a subject of debate within the accounting profession and those companies subject to SEC registration. The Commission ultimately relented to pressures exerted by registrants and by the accounting profession, and after a due process period issued an amended ASR [28] setting forth the controversial accounting rules relating to planned uses of acquired treasury shares. The lesson learned is that due process concerns apply to the Commission as well as to the private sector.

Starting with the Burton era and continuing through the current tenure of Chief Accountant A. Clarence Sampson, the Commission took other active roles in the development of accounting principles:

- The SEC receives periodic status reports from the AICPA and the FASB and monitors the projects on their agenda.
- The staff of the SEC attends certain meetings of the Financial Accounting Foundation Trustees, the FASB, the Financial Accounting Standards Advisory Council, certain senior committees of the AICPA, and public hearings on current FASB and AICPA projects.
- The staff of the SEC participates in meetings of FASB Task Forces, including the newly created Task Force on Emerging Issues.
- The staff of the Commission has authorization to issue Staff Accounting Bulletins, which set forth its views and interpretations of accounting practices.

Applying a Burton innovation, the Commission has formally declared, in
rare circumstances, moratoriums on the use by registrants of accounting practices that it believes are either questionable or create noncomparability between the financial statements of registrants. Moratoriums have been granted on the capitalization of interest costs by nonutility registrants and recently, the capitalization of internal software development costs by the software sales and service industry. By maintaining a split between those registrants allowed to use the accounting practice in question, moratoriums serve as a potent, perhaps excessive, motivation for the FASB to address specific accounting issues on a timely basis.

The SEC also aggressively began to issue ASRs prescribing accounting guidance for registrants on topics on which the FASB had not acted. This guidance is intended to be temporary and ultimately replaced in the accounting framework by a FASB pronouncement, thereby exerting considerable pressure upon the FASB. ASR 190 [29] is a prime example of this approach. From its adoption in early 1976 to its withdrawal in late 1979, ASR 190 required disclosure of certain replacement cost data deemed by the Commission to be relevant to investors. This requirement also provided useful data to the FASB in its project to consider financial reporting in units of purchasing power. When used in a constructive manner similar to that applied in ASR 190, this approach, although perhaps not the best, provides assistance to the FASB in resolving complex accounting issues.

Clarence Sampson has introduced a less formal procedure by which the SEC staff requests the FASB to issue appropriate guidance on questionable accounting practices. In the past year this approach was used to address implementation issues relating to FASB Statement No. 76, *Extinguishment of Debt* [30], and the measurement of compensation involved in stock option, purchase, and award plans involving junior stock. While the accounting issues involved in each of these topics were contentious, many accountants believed that the accounting practices utilized were supported by appropriate accounting literature. The FASB recently issued clarifying guidance concerning each of these issues. In the view of the accounting profession, this approach encouraging timely establishment or clarification of accounting principles is preferable to more formal approaches.

A 1972 Burton innovation, greatly expanded upon by Sampson, is the utilization of Staff Accounting Bulletins to inform accountants of SEC staff positions on accounting matters in processing financial statements of registrants. Since their inception, fifty-seven bulletins dealing with a wide variety of financial reporting topics have been issued. The Staff Accounting Bulletins have generally had a positive effect on the development of accounting principles. Although they only apply to SEC registrants, many bulletins, such as Staff Accounting Bulletin No. 54 [31] pertaining to "push down" accounting, have received some acceptance by the accounting profession as appropriate accounting for non-SEC registrants as well. Some of these bulletins, for
example Staff Accounting Bulletin No. 51 [32] pertaining to sales of stock by a subsidiary, have adopted the accounting profession's view on topics not yet addressed by the FASB.

A footnote in Staff Accounting Bulletin No. 57 [33] has created concern among some members of the accounting profession. The footnote, while recognizing the use of analogous accounting guidance by registrants to account for unique business transactions not covered by existing accounting literature, has been read to imply a lack of professionalism on the part of public accountants. Also of concern in the bulletin are references to preferability, an issue of longstanding conflict between the profession and the Commission, and to the “severe consequences” of reaching a conclusion differing from that of the Commission’s staff [34]. The accounting profession believes that, where appropriate, it has responsibly consulted with the office of the Chief Accountant.

The Commission’s use of the foregoing methods during the Burton and Sampson eras has not gone unchallenged. Certain attempts to establish accounting principles have met with strong resistance from the accounting profession and from the registrants affected. For example, strong resistance from the accounting profession occurred in 1975 when Sandy Burton “innovated” the extension of the accountant’s responsibility for accounting changes by requiring a letter stating whether the change was to an alternative principle that, in the accountant’s judgment, was preferable in the circumstances.

This preferability requirement initially resulted in a confrontation between the SEC and the profession. Professional standards [35] limit the accountant's role to determining whether an accounting change is to an acceptable alternative principle and whether management’s justification for the change is reasonable. The SEC sustained its position that management has a substantial burden to justify a change. This burden is not met unless the reason is sufficiently persuasive to convince the accountant of the preferability of the change.

Another prime example of such resistance occurred after the SEC attempted to establish accounting principles for oil and gas producers. The SEC rejected both the “successful efforts” method mandated by the FASB and the “full cost” method also considered by the FASB. The Commission's determination of the appropriate method, “reserve recognition accounting,” was lobbied against by oil and gas producers. The Commission ultimately turned to the FASB to develop a practical value-based accounting method [36]. This incident posed a significant threat to the continuation of private sector development of accounting principles.

A more recent example of resistance occurred with the SEC’s proposal to require segment information [37] in interim financial statements filed with the Commission. The disclosures proposed are being challenged both by registrants and the accounting profession. They believe that the requirements do
not meet appropriate cost/benefit tests and add to the so-called "standards overload." The profession advocates a careful balancing of the needs of limited investor groups with appropriate cost/benefit constraints and a restriction on the extent of detail in accounting standards.

Enforcement actions against registrants and public accountants, a hallmark of the Burton era, serve healthy and legitimate functions improving quality control procedures utilized by the accounting profession. The enforcement actions are also an important weapon to deal with cases involving the intentional misapplication of accounting principles for fraudulent purposes, or so-called "cooking the books" [38]. A perception, however, appears to be growing in the accounting profession that some individuals within the SEC view enforcement proceedings, or the implicit threat of such actions, as an appropriate forum to change established accounting practice or to second-guess accounting decisions made in good faith concerning issues over which reasonable professionals might disagree. To the extent this perception has validity, the matter concerns me and my colleagues. The enforcement environment lacks the due process procedures that are an integral part of the standards-setting process of the SEC and the FASB. Accounting issues may be conceded in such an environment that would be strongly contested in a different, and more appropriate, forum.

The SEC’s contribution to the establishment of accounting principles has been constructive and beneficial. Much remains to be done, however, in order to preserve harmony between the SEC and the accounting profession in the establishment of accounting principles. Such harmony can be achieved through consideration by the Commission of the areas of concern mentioned, through the continuation of cooperative efforts between the SEC’s staff and the accounting profession, and through the responsiveness of the profession.

Harmony will also be furthered through continuation of the Commission’s Professional Accounting Fellow program. Conceived in the 1970s, this excellent program offers outstanding professional accountants from the private sector an opportunity to work for two years under the direct supervision and guidance of the Chief Accountant. Accounting Fellows develop conceptual and innovative approaches to problem-solving within the framework of SEC accounting policies and generally accepted accounting principles. Through their work, the Accounting Fellows obtain further insight into the Commission’s views on accounting principles and in turn impart the accounting profession’s views. Several professionals from our firm have served, or are currently serving, as Accounting Fellows. In their view, and mine, the program has had a very positive effect on the development of accounting principles and auditing standards and in enhancing the relationship between the SEC and the profession.
3. The establishment of auditing standards

Although the Commission's authority to establish accounting principles is based explicitly on enabling legislation [39], its right to establish auditing standards is less certain. Regulations mandate specific audit procedures for only two industries: brokers and dealers in securities [40], and investment companies registered with the SEC [41].

The Commission's role in establishing auditing standards is nonetheless significant. The accounting profession's initial formalization of auditing standards was an outgrowth of the Commission staff's report on its investigation of the McKesson & Robbins case [42]. One staff recommendation in the report was embodied in the 1941 amendment of Regulation S-X that required accountants' reports to state whether an audit was performed "in accordance with generally accepted auditing standards applicable in the circumstances" [43]. This amendment led the accounting profession to adopt, in 1948 [44], the ten generally accepted auditing standards [45] that exist today.

The Commission's influence on auditing standards through the amendment to Regulation S-X was also directed to the development of narrower standards that encompass auditing procedures. In attempting to clarify the Commission's meaning of "generally accepted auditing standards," Statement of Auditing Procedures No. 6, issued by the Institute in 1941, quoted extensively from the amendment:

[In referring to generally accepted auditing standards the Commission has in mind, in addition to the employment of generally recognized normal auditing procedures, their application with professional competence by properly trained persons, and that in referring to generally recognized normal auditing procedures the Commission has in mind those ordinarily employed by skilled accountants and those prescribed by authoritative bodies dealing with the subject... [46].

Auditing standards may be regarded as the underlying principles...which control the nature and extent of the evidence to be obtained by means of auditing procedures [47].

The Commission's approach to the establishment of auditing standards and procedures has generally been to work in cooperation with the profession. As described in the Commission's first report to the Senate Subcommittee on Government Efficiency, the role of the Commission has taken the form of: (1) observing meetings of AudSEC [48]; (2) reviewing working drafts and exposure drafts and commenting upon them, either orally or in writing; (3) monitoring all AICPA projects on its current agenda; (4) having periodic meetings with the planning subcommittee of AudSEC; and (5) publishing results of investigated cases which have indicated those auditing procedures which the Commission believes to have been deficient under the circumstances [49].

Although all aspects of the Commission's role have had an effect on the establishment of auditing standards, the publication of ASRs and, more recently, Accounting and Auditing Enforcement Releases (AAERs), have had
the greatest impact. These releases and actions are in part intended to assist the accounting profession in establishing specific auditing standards. Topics addressed in ASRs and enforcement actions have included: (1) related party transactions, the effect of which on the financial statements being audited is inadequately assessed, or such transactions that are not discovered, or are not adequately disclosed [50]; (2) undue reliance on representations of management, without corroboration through other auditing procedures [51]; (3) inadequate communications between predecessor and successor accountants [52]; and (4) potential deficiencies in systems of quality control procedures within a professional firm [53].

The accounting profession has adopted specific auditing standards or broad guidance, as appropriate, on each of the foregoing issues. However, recent enforcement actions indicate that some of these issues may still be problems that need to be addressed further by the accounting profession.

Although the Commission's philosophy regarding the establishment of auditing standards has not changed dramatically over the years, the pace of activity has picked up, not only with respect to enforcement actions but also where the auditor participates in areas beyond the traditional attest function [54]. Examples of the latter include requirements to review interim financial data, to review "other information" and data in the "Management's Discussion Analysis" section for consistency with the audited financial statements, and to review pro forma and other prospective financial information.

The Commission has encouraged increased auditor involvement through "safe harbor" mechanisms [55], but it is clear that these are temporary measures and that the Commission expects the accounting profession to exercise a leadership role in this area. This expectation has led certain members of the profession to recommend reconsideration of the ten broad generally accepted auditing standards [56] and to consider the extension of the attest function to non-financial representations. In exploring these areas, the accounting profession will continue to work in close cooperation with the Commission.

The accounting profession has historically been responsive to the findings and concerns of the Commission by establishing auditing standards on a timely basis. Commensurate with the profession's performance, the Commission's role has typically been in the form of constructive criticism rather than punitive action.

4. Oversight of the accounting profession

The Commission's overall role in regulation and oversight of the accounting profession has evolved in a manner similar to the establishment of accounting principles and auditing standards. During the first three decades of its ex-
istence, the Commission was relatively passive. The Commission relied primarily upon the accounting profession's independence and its efforts to maintain and improve standards of practice. There were some concerns in those early years about the concept of independence; these concerns were addressed in a series of ASRs and in William Werntz's innovation of instituting proceedings against accounting practitioners under Rule 2(e).

Changes in the Commission's approach occurred during the Barr and Burton eras. Wide differences in their views on accounting principles surfaced between the SEC and the accounting profession, as well as within the profession itself. These differences raised doubts about the profession's credibility in establishing accounting principles. These doubts and other concerns ultimately led to the establishment of the FASB in 1972 [57].

During this same period, the accounting profession was sensitive to increased Commission enforcement actions, numerous legal actions against individual accountants by private litigants, and a generally perceived public concern with the adequacy of audits. In response, the profession and individual accounting firms, with the support of the Commission, made an extensive commitment of resources to develop quality controls. The AICPA also embarked upon an expanded program of continuing education for its members and issued standards for quality control for accounting firms in Statement on Auditing Standards (SAS) No. 4, in December 1974 [58].

The profession had just adopted SAS No. 4 when it was tested by the Commission through sanctions imposed on a major accounting firm in ASR 173 [59]. ASR 173 was significant primarily because of the inclusion of peer review as a sanction against the firm [60]. At that time, such a method of disciplining an accounting firm was unavailable to the AICPA, whose rules of professional conduct applied only to members as individuals. In imposing the peer review sanction, the Commission mandated two reviews at the firm's expense, conducted by a committee, including peers, that was acceptable to the Commission [61]. The AICPA program for review of quality control procedures of multi-office firms was to be observed [62]. The significance of this sanction is illustrated by the fact that the peer review committee expended over 14,000 hours in completing its reviews [63].

ASR 173 was also important because it imposed, in addition to the peer review, many of the sanctions available in the Commission's enforcement "arsenal." Similar sanctions were imposed, at least in part, on virtually every large accounting firm during the Burton era. In addition to peer review, these sanctions included: (1) limiting acceptance of new SEC reporting clients for a period of time, either to firms or to individual practice offices; (2) imposing requirements for studies to be sponsored by the sanctioned firm on the accounting and auditing issues implicated in the enforcement proceedings; and (3) imposing continuing education requirements on the individual professionals involved in the enforcement proceedings [64].
There is no doubt that the enforcement activities of the Commission in the mid-1970s had a significant impact on the accounting profession's development and implementation of quality control procedures. The full significance and beneficial aspects of the Commission's activities were not fully appreciated, though, until the congressional review of the accounting profession in 1976 [65] and 1977 [66].

Much has already been written about the congressional review of the accounting profession [67]. As a direct participant in implementing, both within my firm and at the AICPA, the voluntary actions in response to recommendations of the Metcalf and Moss Committees, I met frequently with representatives of the Commission as the accounting profession assessed the viability of various approaches, and developed its program of self-regulation through the SEC Practice Section of the Division for CPA Firms. In my opinion, the Commission, through its extensive involvement and constructive recommendations, provided excellent support and direction to the accounting profession in establishing its self-regulatory framework.

Since 1977, the Commission's oversight and regulation has been focused on the functioning of the SEC Practice Section, the key element of the profession's self-regulation initiative. For the first time, the SEC Practice Section provided a structure within the AICPA for regulation of member firms, in addition to individual members. Member firms are regulated by monitoring compliance with quality control standards through periodic peer reviews, establishing and enforcing membership requirements, investigating alleged audit failures and providing, through the Public Oversight Board, a mechanism for independent oversight to reflect the public's interest in financial reporting.

From 1978 through 1980, the Commission issued three separate annual reports [68] to Congress detailing its oversight of the accounting profession. Since 1980, three summary reports [69] were included as a part of the overall annual report on the Commission's activities. These reports, supportive of the profession's program for self-regulation, identified several areas for further improvement. Although many of the suggestions of the Commission have been implemented by the accounting profession, a few areas, primarily in the functioning of the peer review and the special investigative processes, need "fine tuning." These programs were extensively reviewed in 1983 by an AICPA Committee chaired by former AICPA Chairman Michael Chetkovich. The Committee was charged with reviewing and evaluating all aspects of the SEC Practice Section's activities. The Committee's report [70], issued in June, contains a number of recommendations that are now being evaluated by the AICPA. Many have already been implemented.

The effectiveness of the SEC Practice Section has enabled the Commission to direct its oversight and regulatory efforts to isolated breakdowns of quality controls. Since 1982, when the Commission began separating the reporting of its rulemaking from its enforcement actions, thirty-nine enforcement releases
have been issued, the majority involving public accountants. A common thread in these enforcement releases is that audit failures were primarily attributable to "people problems," and not to weaknesses in generally accepted auditing standards or the quality control systems of the accounting firms.

The investigation of audit failures due to isolated breakdowns in quality controls, or to "people problems," is a legitimate use of the Commission's statutory powers. Such investigations, if used judiciously, can provide useful guidance to the profession. Each publicized audit failure reminds members of the profession to approach an audit with due care, professionalism, and a healthy degree of skepticism.

In the last two years the Commission has instituted some enforcement actions in a manner that is perceived to be an attempt to initiate broad reforms in business ethics. These actions focus on "cooked books," the falsification of books and records, either to manufacture or accelerate revenues or to defer or conceal expenses, or on "cute accounting" or "cute fraud," the misapplication of accounting principles to achieve what one Commissioner refers to as "desired, albeit distorted, results" [71].

Although the underlying motivations of the Commission in these actions are not entirely clear, some accountants feel that the concept of fraud is being inappropriately expanded or redefined. To the extent that this perception has validity, the matter is of concern to me and my colleagues. The enforcement environment lacks many of the safeguards of our traditional judicial environment. Action against registrants and public accountants in areas where valid differences of opinion exist among the regulators and private sector professionals may make headlines, but it may also have negative effects on public confidence in financial reporting.

The Commission's performance of its oversight function has generally been commendable. With the exception of certain enforcement activities mentioned earlier, in only one area, independence, has there been significant differences of views between the accounting profession and the Commission. The Commission's revocation of ASR 264 [72], pertaining to scope of services of the accounting profession, has done much to alleviate this source of disharmony. The accounting profession is keenly aware of the need for independence in the performance of its role in the public dissemination of financial information. We believe that the self-regulatory framework, established by the profession and overseen by the Public Oversight Board and the SEC, is the appropriate mechanism through which professional independence is defined and monitored, and necessary disciplinary action is taken.

5. Conclusion

Over the past fifty years, the Commission has done a commendable job interacting with the accounting profession in the areas of standards-setting and
oversight. Although there have been isolated instances of disharmony as the Commission and the profession have sought to achieve their respective goals, these differences have not been insurmountable. As long as a spirit of cooperation and mutual trust exists between the Commission and the profession, this relationship should continue to develop. I look forward to the next fifty years of this continuing relationship.

Notes

[8] Id.
[12] 5 Fed. Sec. L. Rep. (CCH) ¶ 68,001. Regulation S-X was adopted in SEC Accounting Series Rel. No. 12, Adoption of Regulation S-X – Amendments to Form 15 and Form 17 (Feb. 21, 1940). The regulation codified existing instructions as to form and content of financial statements. The regulation's requirements were intended to elicit informative disclosures, but did not ascribe accounting methods. Amendments have been adopted from time to time, with a recent general revision in 1980.
[16] S. Davidson, C. Stickney & R. Weil, Financial Accounting 643 (2d ed. 1979). The flow-through method is a means of accounting for the investment tax credit to show all income statement benefits of the credit in the year of acquisition, rather than spreading them over the life of the asset acquired.
[17] Chatov, supra note 9, at 232. In January 1971, an AICPA conference recommended appointment of two study groups to examine APB operations and the objectives of financial statements. The AICPA Board of Directors approved the conference's recommendations. The first study group, headed by Francis M. Wheat, a lawyer and former SEC commissioner, was directed to consider more than APB operations. The second group was headed by Robert M. Trueblood, chairman of Touche Ross & Co.
[18] Id. at 233.
[19] Id. at 233–37. The Wheat Committee submitted its report to the Board of Directors of the AICPA on March 29, 1972. In May the AICPA Council adopted its recommendations which included the formation of a Financial Accounting Foundation (FAF) to be governed by nine trustees “who would have the duty of appointing members to a Financial Accounting Standards Board (FASB) and of raising funds for its support.” The seven-member FASB would be full-time and fully remunerated. A Financial Accounting Standards Advisory Council (FASAC) of not less than twenty members was also to be formed.
[20] Id. at 235.
[31] SEC Staff Accounting Bull. No. 54, Push Down Basis of Accounting Required in Certain Limited Circumstances (Nov. 3, 1983). The statements in Staff Accounting Bulletins are not rules or interpretations of the Commission nor are they published as bearing the Commission’s official approval. They represent interpretations and practices followed by the Division of Corporation Finance and the Office of the Chief Accountant in administering the disclosure requirements of the federal securities laws.
[33] SEC Staff Accounting Bull. No. 57, Accounting for Contingent Warrants Issued by a Company to Certain of Its Major Customers in Connection with Sales Agreements (July 18, 1984).
[34] Id.
[35] The auditor’s role in determining whether an accounting change is to an acceptable alternative is set forth in Section 546 of the AICPA’s Professional Standards. Relevant excerpts are as follows:

546.01 When there is a change in accounting principles, the independent auditor should modify his opinion as to consistency, indicating the nature of the change. The auditor's concurrence with a change is implicit unless he takes exception to the change in expressing his opinion as to fair presentation of the financial statements in conformity with generally accepted accounting principles. Nevertheless, in order to be more informative the auditor should make his concurrence explicit (unless the change is the correction of an error) using

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the expression "with which we concur." The form of modification of the opinion depends on the method of accounting for the effect of the change, as explained in paragraphs .02 and .03.

.04 The auditor should evaluate a change in accounting principles to satisfy himself that (a) the newly adopted accounting principle is a generally accepted accounting principle, (b) the method of accounting for the effect of the change is in conformity with generally accepted accounting principles, and (c) management's justification for the change is reasonable. If a change in accounting principle does not meet these conditions, the auditor's report should so indicate and his opinion should be appropriately qualified as discussed in paragraphs .05 through .11.

3 Accounting Principles Board Opinion No. 20, paragraph 16 [AC section A06.112], states: "The presumption that an entity should not change an accounting principle may be overcome only if the enterprise justifies the use of an alternative acceptable accounting principle on the basis that it is preferable." The requirement for justification is applicable to years beginning after July 31, 1971.

[37] Goldwasser, supra note 27, at 330. A reporting requirement imposed upon publicly held corporations whereby specific balance sheet and operating statement accounts must be disclosed for major lines of business and geographic segments of the reporting company representing ten percent or more of certain specified accounts.
[38] Id. at 321. "Cooked books" or "cooking the books" are phrases frequently employed by the SEC to refer to financial records which have been intentionally prepared to distort financial conditions and results of operation.
[39] See supra notes 3-6 and accompanying text.
[40] Minimum audit requirements for reports of financial condition filed by brokers and dealers in securities and certain members of national securities exchanges are set out in Form X-17A-5. L. Rappaport, SEC Accounting Practice and Procedure 40-41 (1959).
[41] Id. When securities of investment companies registered with the SEC are in the custody of the company itself or are held by members of national securities exchanges, audit procedures must meet the requirements of Rule N-17F-1 and 2.
[44] The standards, with the exclusion of item (4) under "Standards of Reporting," were approved and adopted by the membership at the annual meeting of the American Institute of Accountants in September, 1948. The substance of item (4) was approved at the meeting of November 1949. See infra note 45. Committee on Auditing Procedure, American Institute of Accountants, Generally Accepted Auditing Standards: Their Significance and Scope 13 n.1 (1954).
[45] Id. at 13, 14.

General Standards
1. The examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor.
2. In all matters relating to the assignment an independence in mental attitude is to be maintained by the auditor or auditors.
3. Due professional care is to be exercised in the performance of the examination and the preparation of the report.

Standards of Field Work
1. The work is to be adequately planned and assistants, if any, are to be properly supervised.
2. There is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.
3. Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination.

Standards of Reporting
1. The report shall state whether the financial statements are presented in accordance with generally accepted principles of accounting.
2. The report shall state whether such principles have been consistently observed in the current period in relation to the preceding period.
3. Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.
4. The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an over-all opinion cannot be expressed, the reasons therefor should be stated. In all cases where an auditor's name is associated with financial statements the report should contain a clear-cut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking.


[47] Id.

[48] AudSEC, The Auditing Standards Executive Committee of the AICPA, was succeeded by the Auditing Standards Board (ASB). ASB, like its predecessor, is responsible for devising and promulgating auditing standards for the profession. See Goldwasser, supra note 27, at 14, 16.


[54] The attest function of a CPA is to render an opinion that a company's financial statements are fair. Davidson, supra note 16, at 636.

[55] A “safe harbor” mechanism is designed to recognize in an SEC rule the Commission's view that if certain data, such as forecast information or inflation information, have a reasonable underlying basis, are prepared with reasonable care and in good faith and are presented with adequate disclosure, the data does not constitute an “untrue statement of a material fact” or a “manipulative, deceptive or fraudulent device.” Such a mechanism is designed to encourage company management to present meaningful user information that is derived from the historical financial statements without fear that the presentation of such prospective data will subject them, and their auditors who are associated with such data, to unreasonable liability under the securities laws. One example of use of a “safe harbor” mechanism was in connection with ASR 190 pertaining to disclosure of certain replacement cost data.

[56] See supra note 45.

[57] See supra notes 18 and 19 and accompanying text.


[60] Id. at 409.

[61] Id.

[62] Id.


[64] Accounting Series Releases, supra note 59, at 409.


[66] Id. The 1977 review was conducted by the Subcommittee on Reports, Accounting and Management of the Senate Subcommittee on Governmental Affairs, chaired by Senator Lee Metcalf. Public hearings were held by the Metcalf Committee. Accounting and Auditing Practices and Procedures: Hearings before the Subcomm. on Reports, Accounting and Management of the Senate Comm. on Governmental Affairs, 95th Cong., 1st Sess. (1977).


[70] The formal title of Chetkovich Committee is the American Institute of Certified Public Accountants SECPS Review Committee. The report, first issued in June 1984 and formally published by the AICPA in December 1984, is entitled, "Review of the Structure and Operations of the SEC Practice Section: Report of the SECPS Review Committee."


[72] The disclosure requirements of SEC Accounting Series Rel. No. 264, Scope of Services by Independent Accountants (June 14, 1974), specified that nonaudit services performed by independent accountants for their audit clients be included in proxy statements. The Commission found the requirement to be insufficiently useful and rescinded it in January, 1982. See 48 SEC Ann. Rep., at 21 (1982).

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