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THE VITAL ROLE OF STATE BOARDS OF ACCOUNTANCY

REMARKS OF

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Last December I had the opportunity of participating in the Fifth Annual SEC Conference sponsored by the Florida Institute of Certified Public Accountants. At that time I discussed my belief that a serious credibility gap existed between the legitimate expectations of the users of accountants' work product and the willingness of accounting professionals to meet those expectations.

I believe that this continuing gap between performance and expectation has two root causes. First, accounting and auditing standards, which are the foundation of the financial communication process, have received deserved criticism. Second, there are too many instances in which members of the profession have not complied with the high professional standards accountants have established for themselves. It appears to me that there is reason for substantial optimism that the Financial Accounting Standards Board, through its work on the conceptual framework and other projects, and the American Institute of Certified Public Accountants, through its efforts to implement the recommendations of the Cohen Commission on Auditors' Responsibilities, will be successful in dealing with the flaws in the financial communication process itself.

There is less reason for optimism, however, that the profession alone will be able to fulfill its goal of

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assuring that practitioners of the accounting and auditing disciplines consistently perform responsibly, competently and with professionalism. In saying this, I have not concluded that private sector initiatives which are still developing will not work, but progress has sometimes been disappointingly slow and certain obstacles to success appear to be rather formidable.

In our July 1979 Report to Congress on the Accounting Profession and the Commission's Oversight Role, the Commission identified several issues which, if not resolved appropriately, would threaten the development of an acceptable self-regulatory structure. These issues include the voluntary nature of the program, the absence of Commission access to the peer review process, and the untested nature of the SEC Practice Section's disciplinary mechanisms. We had also identified these issues in our 1978 Report.

The fact that these issues remain unresolved leads one to question whether the momentum which the profession originally generated is decelerating and undermines earlier optimism concerning the continuing prospects for success of the AICPA's program.

Despite an active membership drive, the majority of accounting firms which audit publicly-owned companies have thus far declined to become participants. Only about 200 of the less than 600 firms which have joined the SEC Practice

Section have clients which are publicly held companies. Of the member firms, only ten underwent peer review last year, and only about another 50 have volunteered to do so in 1979. In addition, remarks of the Chairman of the SEC Practice Section made at the Senate hearings last month cast substantial doubt on the Section's willingness to meet the Commission halfway in assuring that the SEC will have sufficient access to the peer review process to permit a meaningful evaluation of those reviews.

Fortunately, while it may appear that the major private sector approach to self-regulation is losing momentum because of a lack of commitment on the part of some members of the profession, the efforts and effectiveness of boards of accountancy from around the United States appear to be accelerating. The Commission staff report to Congress this year noted the ". . . heightened sense of responsibility on the part of state boards" regarding their role in the process of assuring a high level of quality and professionalism by practicing public accountants.

In my view, there may never be a better time for members of state boards to use that heightened sense of responsibility for the benefit of both the future of the accounting profession and the substantial segment of the public which relies on its work. The issues which have been raised concerning accountants' professionalism will not just

fade away. These are very real problems which must be addressed promptly and effectively to preserve the credibility of our whole financial reporting framework. In today's regulatory climate, with increasing sympathy for less intervention from Washington, it would be regrettable if Congress or the Commission were ultimately to find it necessary to deal with these difficulties through direct federal regulation of accountants.

In my opinion, four broad objectives must be met in order to assure continuing high quality work by accountants.

They are:

Functioning quality control procedures to which all practitioners are subject.

Mechanisms for identifying substandard work and identifying its underlying causes.

Effective remedial and appropriate disciplinary measures for those who demonstrate an unwillingness or inability to meet the high standards of the profession.

Public credibility for all of these measures.

I do not believe any single government or private sector body is in a position to meet all of these objectives in a satisfactory manner. The role which the members of the state boards of accountancy should be playing is particularly significant, however. The Commission, the Congress and the public have every reason to expect that the statutory mandates which state laws typically confer upon

accountancy boards will be utilized in a meaningful and effective way.

Their enabling legislation often gives state boards extensive regulatory authority. For example, in the State of Washington, the Board may revoke or suspend certificates, licenses, or permits (as appropriate) for the following causes, among others:

Dishonesty, fraud, or gross negligence in the practice of public accounting;

Conviction of a felony under the laws of any state or of the United States;

Conviction of any crime, an essential element of which is dishonesty or fraud, under the laws of any state or of the United States; or

Violation of the rules of professional conduct promulgated by the board

The South Dakota statute is another representative example of state board authority. The board has broad authority to promulgate rules for the safety of the public and regulation of public accounting. It may issue reprimands or revoke, suspend or refuse to renew any practitioners license for, among other things:

Dishonesty, fraud or gross negligence in the practice of public accounting;

Suspension or revocation of the right to practice before any state or federal agency or commission;

Conduct discreditable to the public accounting profession;

Failure to comply with continuing education requirements adopted by the board as a prerequisite of continuance or renewal of any license issued under the provisions of this chapter; or

Willful violation of a rule or regulation promulgated by the board under the authority granted under this chapter.

The South Dakota State Board also has the power to enjoin acts or practices which violate the relevant chapter of the South Dakota statutes.

If statutory responsibilities such as these were consistently exercised in an assertive but responsible fashion, I believe that the threatening noises from Washington, D.C. with regard to additional federal regulation of accountants would subside. I further suggest that the responsible application of such statutory mandates would provide at least two far reaching and dramatic impacts. First, there would be an obvious and direct effect upon every conscientious professional subject to your jurisdiction. I am convinced that the overwhelming majority of accounting practitioners do not suffer from any shortcomings which cannot be remedied by the practitioners themselves, once identified.

Second, the continued vigilance of state regulatory bodies would provide a strong impetus for practitioners to avail themselves of the benefits of private sector programs designed to sustain the high level of quality which is legitimately expected of the accounting profession.

Participation in a program of objective, periodic peer reviews, for instance, would be of significant benefit to every practice unit which has sufficient incentive to strive for high levels of performance. This, in turn, would actually reduce the work of regulatory bodies such as state boards, because one of the collateral effects of a rigorous regulatory environment is a contraction of the need for direct enforcement activity.

By operating on the accountant's basic sense of professionalism, state boards can provide the impetus to realize substantial benefits to the public and the profession and do so with a minimum of resources. Consider, with me, the tremendous advantages that a state board of accountancy has over the typical law enforcement agency. The traditional policeman can hardly count on any self-help programs by those subject to his enforcement activities to assist him in his job. But the basic professionalism of those whom you regulate is at your disposal to accomplish the preponderance of your objectives. Just as the addition of a small amount of platinum brings about greater chemical activity, state boards can and should act as catalysts for greater activity by members of the accounting profession in the maintenance of high standards.

The kind of regulation in which the private sector has the primary responsibility for keeping its collective

house in order, while the regulators provide the impetus for change and the oversight necessary to sustain quality, has been practiced by the Securities and Exchange Commission for over forty years, with substantial success. And, we have managed to do what is regarded by many as the best job of any federal regulatory agency with one of the smallest staffs. That has only been possible, however, through the maintenance of a vigorous enforcement posture which helps assure that the laws we administer and the rules we write are complied with in good faith by the majority of those who operate in the securities marketplace.

I think it is unquestionable that state accountancy boards must also assure an enforcement framework which lends substance to the legal and professional framework within which accountants practice. However altruistic the motives of individual professionals, private sector participants necessarily balance their self-interest against both the interests of the public and their perceptions of the long-term interests of the profession as a whole. Without the motivations which are supposed to be provided by a governmental unit assigned the task of representing the public interest through appropriate enforcement action, this balancing process almost inevitably tilts toward the self-interest of those being regulated.

If state boards are to play an appropriate role in eliminating the credibility gap, it is imperative that each such board maintain a posture which not only provides appropriate impetus to the private sector, but also provides the framework and discipline demanded by statutory mandate and common sense.

The private sector initiatives which have been the focus of the Commission's concern are important preventative measures. If successful, I firmly believe that the role of government in the regulatory process will be minimized but it will not be eliminated. A need for continuing government oversight and enforcement action will always remain.

There is substantial sentiment in some quarters, I understand, for viewing peer review programs as a substitute for more direct forms of regulation. Although such programs may be a significant factor in the regulatory scheme, neither the Commission nor a state board of accountancy can responsibly transfer its public mandate to private sector bodies. When professional deficiencies are brought to the attention of any state board, it is certainly appropriate to take account of the expected benefits of participation in private programs such as membership in the SEC or Private Companies Practice Sections of the AICPA Firms Division in considering the necessity for additional inquiry or disciplinary action.

Such considerations cannot, however, eliminate the necessity for active oversight and an effective enforcement program. If remedial measures are to be applied, specific needs for such measures must first be identified. This demands active monitoring of the quality of practice of the professionals subject to your jurisdiction. Such active enforcement also helps assure that private sector preventative efforts have substance, by providing the necessary incentives both for quality work and meaningful quality control.

In addition, each state board must also deal with the small minority of practitioners who are unwilling or unable to respond to their professional and legal environments in a constructive fashion. Outright incompetence and willful deficiencies in performance are both serious affronts to the pervasive professionalism which characterize the vast majority of practicing accountants and intolerable threats to the public trust and confidence which we are all seeking to restore. They should be dealt with accordingly.

It is also important to remember that the process of restoring the credibility of the accounting profession must itself have credibility. This goal is only hindered by such things as closed door hearings and secret sanctions. I am sure that all of you take your responsibilities seriously enough to be confident that your regulatory activities are

both meaningful and in the public's interest. That should leave little hesitancy to make that fact known to the public which you serve.

I recognize that the goals and objectives I have set forth are not ones which can be met with ease. Fulfilling these difficult and complex obligations is absolutely necessary, however, if we are to avoid more far-reaching changes which could be even more painful. The challenges facing state boards are particularly difficult ones for several reasons.

First, and I'm sure foremost in many of your minds, is the ever-present difficulty of assembling the resources necessary to accomplish the tasks at hand. As with nearly any arm of government, you are somewhat at the mercy of the political and legislative processes in attempting to make budgets fit goals. You may rest assured that, as a Commissioner of an agency with one of the smallest budgets in Washington, you have my sympathy. Nevertheless, the budget process is necessary to allocate limited funds and performs a positive function as long as it does not result in the withholding of resources necessary to carry out basic legislative mandates.

State board members who are committed to switching from a passive to an active role have been innovative and skillful in overcoming such problems. Some, for instance, have supplemented their staffs with dedicated practitioners

working on behalf of the board for nominal compensation. Steps such as this, which make maximum use of available resources, may be of considerable help in convincing cost-conscious legislators to expand the board's resources.

In enlisting support for meaningful expansion of the board's role in assuring quality performance, state board members also may wish to consider the possible benefits of having the views of the Commission or its staff brought to the attention of state legislators.

A second, although considerably less widespread, problem which may be hampering progress toward consistently meaningful regulation at the state level, is the somewhat myopic view which some state board members apparently take toward their proper role in the regulatory framework. I mentioned earlier the necessity for boards to take an active regulatory stance not only as part of the legal framework in which they function, but also to provide necessary impetus to private sector initiatives. It is also important to recognize a collateral risk in attempting to substitute emphasis on other regulatory mechanisms, such as private sector initiatives, the licensing process or continuing professional education, for the more direct benefits of a positive enforcement program. That very real risk is the danger that the appearance but not the substance of effective regulation will be created. In many ways, such an approach

may be worse than no regulatory program at all, since the long term effects of additional damage to public credibility may be substantial.

Finally, there is a problem which, I am glad to say, is relatively isolated. A few state boards apparently still cling to the belief that maintenance of their traditionally inactive roles is a viable alternative. In the present atmosphere, it seems to me that such a posture is ultimately so self-defeating as to require little discussion. If even only one or two jurisdictions gain a reputation as havens from the process of change, the pressures for Federal regulation or even Federal licensing may become overwhelming.

I believe that the time has arrived for each of the state boards of accountancy to begin playing a uniformly meaningful role in bringing about changes necessary to help close the credibility gap. There is little doubt that events of the past several years have created serious public cynicism about the roles of government, the professions and business. State boards of accountancy have perhaps been the unhappy targets of a double dose of this cynicism, associated as they sometimes are with both the accounting profession and the government establishment. This is a kind of bad news/good news situation, however. On the one hand, it is no doubt uncomfortable to be viewed as a

major cause of simultaneous credibility gaps. On the other hand, a unique opportunity is presented to exercise leadership in restoring credibility for both of these sectors.

The professionalism of accountants which I perceive as a critical element of this effort provides a foundation for exercising leadership which may be unequalled by any other group. Despite events which have shaken certain institutions and eroded public confidence generally, the accounting profession has done a better job than most in retaining its tradition of service to the public. To the extent that both the profession and its individual members continue to react responsibly to valid criticism and to develop creative and meaningful solutions, there will not only be a resurgence of confidence but also a reduced need for Federal legislative and regulatory reactions. The necessary mechanisms are in place and if the traditional strength of accounting professionalism is encouraged and harnessed, the present system can be made to work effectively. May we all be equal to this challenge.