

**REMARKS BY CHAIRMAN ARTHUR LEVITT  
SECURITIES AND EXCHANGE COMMISSION**

**“A PROFESSION AT THE CROSSROADS”**

***NATIONAL ASSOCIATION OF  
STATE BOARDS OF ACCOUNTANCY***

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Thank you. It is truly my privilege to speak to so many of you who work, day in and day out, to ensure that America's system of financial reporting remains at the very core of investor confidence in our markets. The leadership of the NASBA over the years, and during this critical time in the profession's history, exemplifies a true commitment to serving the public interest.

In particular, I want to commend your efforts and guidance in working with the Independence Standards Board, and to applaud your recommendations to the Panel on Audit Effectiveness for greater public participation in the profession's oversight. By no small measure, you are helping to ensure that strong, effective, and independent oversight will be a mainstay of the industry's future, and the hallmark of America's marketplace.

As I looked over your agenda for the next few days, I noticed many of the great quotations from the Declaration of Independence you used to introduce each session. These passages capture the rich tradition of this country and the historical significance of today's host city, Boston. But in coming here today, I couldn't help but be struck by how deeply these principles embrace and embolden America's public spirit, born from a time-honored commitment to serving the greater public good.

Today, as we grapple with the profound changes sweeping the accounting profession, we are well served to remember what has acted as this country's own beacon and guide since its beginning: a steadfast commitment to the very principles on which the great nation was built; a promise which says no matter how much things change, certain fundamentals will never be compromised.

In the same way, the bedrock principles of America's accounting profession serve not only as the auditor's guide, but more importantly, they give the auditor's work its relevance. These principles establish a *covenant* with investors: a covenant that says the auditor will remain inquisitive, skeptical, and rigorous; that he will remain free from entanglements or arrangements that threaten his objectivity; that with the auditor's stamp, the numbers speak the truth.

I am proud of, and respect deeply, this great profession. The high-quality work of this country's accountants weaves together the very fabric of our financial reporting system. And, in particular, it's America's individual accountants, including the small practitioners, that serve on the front line and as the final defense for investors everywhere. You've done, and continue to do, this profession proud.

It's a hard, and often thankless, job. As part of a private profession with a public mandate, you face unique pressures and challenges that, every day, demand your tireless scrutiny and keen judgment. But through your steadfast dedication, you have helped lay the foundation for the most transparent and respected capital markets in the world.

Like no other, the accounting profession has been handed an invaluable, but fragile,

*franchise*. Enactment of the 1933 and '34 Securities Acts established the need for accountants to function as independent auditors, requiring that financial statements reported to the public be independently certified. And over the years, the profession has prospered greatly from this Federal mandate. But as an edict for the public good, this franchise is only as valuable as the public service it provides, and as fragile as the public confidence that gives it life.

Today, however, some entities once devoted almost exclusively to auditing now resemble large diversified professional practices. Where management consulting services for traditional audit firms once represented just a small portion of their total revenue, today it accounts for *one-half*. Meanwhile, revenues from auditing services have dropped to only a *third* of total revenues. As a result, auditors who also provide consulting services for their audit clients must now serve *two* masters: a public obligation to shareholders, and a professional duty to management. And when the two come into conflict, the independent audit -- dwarfed by the more lucrative consulting businesses -- too often may be compromised.

As guardians of the public trust, it is *all* of our responsibility to critically ask, "What impact has this changing business mix had on a culture that has long prided itself on objectivity?" "Can the audit engagement partner truly be perceived as discharging his public duties if he's auditing his own work, or shares a business relationship with his own client, or performs a function that's management's responsibility?" Safeguarding the legacy of this public franchise is not a luxury -- it is our *duty*; when we honor the integrity of the independent auditor, we honor something even greater: the confidence of America's investors.

Now, some talk about the changing nature of the accounting profession as a product of new synergies, imperatives, and revenue models. And no doubt, some of today's changes will benefit investors greatly. But the sanctity of respected numbers is as much an imperative in the so-called New Economy as it was in the Old. As history teaches us, the greatest threat to continued prosperity -- to new opportunities and new frontiers -- is a loss of perspective. Nothing guarantees a short-lived and uncertain future more than eroding the very cornerstones on which America's marketplace rests.

In that light, it baffles and sorrows me to see an apparent willingness by some to discount the very ideals that give the profession its credibility -- a willingness to reap the benefits of this public-mandated franchise, but largely ignore the premise of its responsibilities. Unfortunately, this is not a new phenomenon. As a Congressional study of the accounting establishment concluded almost a quarter century ago, "It appears that the [largest accounting firms] are more concerned with serving the interests of corporate managements who select them and authorize their fees than with protecting the interests of the public, for whose benefit Congress established the position of independent auditor."

And as a profession so rooted in serving America's investors, why do we so rarely hear some leaders in the profession speak of the public interest? Why must we reach for worn, hardbound volumes of speeches by Leonard Spacek, a visionary leader in the accounting industry, to read about the greater social value of the auditor's work, the honor in carrying out the auditor's duties, the privilege of bearing such a critical public responsibility?

Instead, some in the profession seem to be more concerned with expanding their roles so broadly that, all too often, the audit responsibility becomes more a business line used to get a foot in the door for other, more profitable services. The AICPA, the profession's trade organization, has even suggested a new credential, the *Super CPA*, which would somehow qualify accountants to consult and administer a whole host of diversified financial and professional services for their clients.

Or consider this same group's vision for the future accountant, where "CPAs will be experts in all phases of leveraging information" and will "deploy knowledge needed for strategic planning and investments, for marketing decisions, for monitoring internal and external communications, for conducting daily operations, for maximizing the productivity of employee behavior, and for measuring the effectiveness of operations, personnel, and processes."

Do we really believe that the investing public will see the auditor as having only rigorous, objective analysis on his mind if he *also* must consider how his work impacts strategic planning, marketing, communications, and personnel decisions? Don't some of these responsibilities sound more like management's than the auditors'? Is there nothing that those promoting this vision believe is beyond the boundaries of reason?

Maybe that last question is answered when you consider the "New Internet Portal" that the AICPA recently approved. Through this new e-commerce site, in which I understand the current AICPA leadership holds a financial stake, it was reported that CPAs could order goods and services for their clients, "computers, office furniture, publications...No. 2 pencils," and even "a large tractor required by a farmer client." In return, the CPA would receive a commission. This seems to me to be a commercialization of the significant responsibilities well performed by America's professional auditors.

In light of these two developments, I can't help but recall a characterization of auditors from the 1960s, when one author wrote, "...accountants began to take on the corporate mentality, to think of themselves no longer as independent, critical, perhaps even judicial examiners, but as part of management, members of the corporate 'team.' ... 'It was a question of role definition.' Accountancy was losing its soul, then, the way so many souls are lost -- by definition and by degree."

Now, certainly the profession must evolve in lockstep with a more innovative, globalized, and technology-driven marketplace. That's not what's at stake. Indeed, the Commission has been eager to bring the rules governing the auditing profession into the Information and Technology Age -- to make the rules a living and breathing set of standards, flexible and adaptable for a new era, but without sacrificing the principle of independence.

That's also why, however, we've been so perplexed by some in the profession's bulwark approach to modernization of the rules; except, that is, for the investment rules. Faced with the real test -- laying a forward-thinking, comprehensive foundation for the profession -- some would rather focus on parochial, short-sighted interests than long term solutions. Instead of coming to

the table to work through the issues, some would rather form alliances and fight. Instead of discussing how to establish strong, independent oversight of the profession that would serve as a *beacon of the public trust*, some would rather craft a toothless Public Oversight Board beholden to special interests.

This last issue, however, strikes a particular chord of regret. For months now, the Public Oversight Board, under the leadership of former Comptroller General, Chuck Bowsher, has been working with members of the AICPA and the profession to establish a POB with the mandate and the tools to be an independent and effective self-regulatory entity. And recent events have only made it more clear that a strengthened and empowered POB has never been more critical. When the POB commenced a study of firms' compliance with professional independence standards, the AICPA blocked and thwarted their efforts by withdrawing their funding. Simply put, the AICPA flatly rejected the POB's request. What's worse, as the industry's own oversight body, the POB sat powerless without funding to force or take action.

But in reworking the POB's charter, we now have the opportunity to fortify meaningful and functional oversight for the profession. Yet still, some prefer that the POB remain listless -- devoid of the very freedom and independence that gives it authority and inspires public confidence. For instance, a fair-minded proposal that would give the AICPA an equal voice with the POB over the selection of nominated chairs of those committees subject to POB oversight was rejected by the AICPA who offered nothing more than "deference" to the POB's views. Imagine telling America's corporate boards that they are not allowed to select their company's CEO. Are America's investors *really* to believe that the POB is insulated from outside influence if the Board does not have the power to approve the chair of a committee it is supposed to oversee?

Even the members on the Panel on Audit Effectiveness -- chaired by the industry's well respected members -- called for "a unified system of governance under a strengthened, independent POB." They called for a POB that would oversee standard setting, monitoring, and discipline. They called for an independently funded POB, with greater control of the peer review process and the wherewithal to carry out more special reviews. They called for a POB "whom the SEC, the auditing profession, and the public can look to for leadership." And still, while the most recent draft of the POB charter makes steps towards more effective self regulation, a stonewall by some of the profession's leadership to prevent truly independent oversight continues.

I believe the time has come for the profession's own broader membership -- the smaller, independent accounting firms -- to stand up and take back what some are trying to take from them: the pride and privilege of serving the American public and its investors as the most rigorous, objective, and independent accountants in the world; it's time that the profession's own take back the cause and determine the course; it's time that the profession's own take back the spirit of the franchise that America's investors bestowed upon them long ago.

And it's already happening. I can't tell you how many letters we are getting from smaller, independent accountants who are fed up and tired of feeling that their integrity is under

fire; fed up and tired of feeling like second class citizens when they work every day to ensure that America's public companies are the most respected and transparent in the world; fed up and tired of feeling misdirected by a leadership that, despite *your* own best efforts, is too often ignoring a duty to the public trust.

As one accountant from a small firm recently lamented, "Small firms have to be a member of the AICPA to be peer-reviewed -- we have no choice. But the leadership is spending our money on things that are just not important to us. They've lost sight of the little person, those who make up the bulk of their membership. And we don't have the personnel or the resources to drive our agenda like the bigger firms do. They are telling us what to do, rather than listening to us."

These are all serious public policy issues, which I would like to openly discuss with as many accounting professionals -- from both small as well as large firms -- as possible. I have asked the leadership of the AICPA, which will have testified twice before the Commission, for the opportunity to appear before their annual membership meeting in October. Thus far, unhappily, they have not responded to my request.

Today, I call upon smaller accounting firms across the country to begin an open dialogue with each other and with the leadership of your profession. Establish open forums where you can come together and voice your concerns, formulate agendas, take active roles in the future of your great profession. The current leadership and its trade organization need to hear more of what is on your mind, to listen to your ideas, and to craft a vision that promotes your interests and honors the franchise you guard so vigilantly. And I look forward to meeting with you and attending these events. In the meantime, I hope to meet with a number of representatives from the smaller firms in Washington in the weeks ahead, so that we can learn more about how the Commission can further your interests and address your initiatives.

Still, as we move forward in the rulemaking process to strengthen the independence of America's auditors, I keep asking myself, "Why hasn't the profession taken its own steps long before?" "Where," I've been asking myself, "is the initiative?" The fact is, many of the concerns we have today were raised almost 25 years ago when the same Congressional report concluded, "Public confidence in independent auditors has been seriously eroded." *In two and a half decades, where is the initiative?* If the leadership of the profession will not even stand up and establish effective self-regulation, how can the Commission -- how can the American public -- expect anything less than a profession paralyzed by its own inaction?

Why was it not the profession's initiative -- rather than the Commission's -- to push to establish the Independence Standards Board? Why was it not the profession's initiative to form the O'Malley panel -- which produced more than 200 recommendations for more effective audits? In the wake of widespread independence violations at one large firm, why was it not the profession's initiative to have the POB look into other possible violations?

And even now, why does the leadership of the AICPA reject the recommendations of the public members of the Independence Standards Board and the Chairman of the POB? Why has

the leadership of the AICPA withheld this important information from its members? This leadership knows full well that these outstanding members *all* have recommended and supported the SEC undertaking this rule-making initiative. Could it be the current leadership only wants the ISB to undertake projects that are convenient to this leadership's views? Again I ask, where is the public interest?

If some in the profession cannot bear the weight of their own public responsibilities, the Commission will not shy away from its own covenant with America's investors. And this begins, first and foremost, by renewing a commitment to the public trust. In this vein, the SEC's proposed rules focus on the auditor's independence and those who can influence the audit. Specifically, they are based on the premises that the accountant is not independent whenever he has a mutual or conflicting interest with the audit client, audits the accountant's own work, functions as management or an employee of the audit client, or acts as an advocate for the audit client. And only those arrangements that cannot pass this most fundamental "independence litmus test" have been restricted.

More specifically, most services the proposed rule includes are *already* proscribed under current SEC and profession rules -- and have so for more than two decades. And the Commission continues to welcome a dialogue on those services that the profession feels complement, but do not compromise, the audit, or which firms simply do not believe affect the auditor's independence.

As part of this dialogue, the Commission has already held two public hearings and has two more scheduled this week. We've heard from companies such as Du Pont and Merck, pension funds such as TIAA-CREF and CalPERS, individuals like Paul Volcker, John Whitehead, accounting firms, both small and large, and many others, who came forward to testify about their views over the types of services many auditing firms today are offering their audit clients.

We encourage firms to *make the case* why services such as investment banking, actuarial work, or the internal audit function are necessary to perform a quality audit. For example, some tell us information technology services enhance the quality of the audit. But 75 percent of the time, auditors are not performing both of these services for the same client. And does this mean that those firms selling their IT divisions can no longer perform quality audits? I want to hear from the firms why they feel internal audit outsourcing and financial system design and implementation -- the two services not already fully proscribed -- improve audit quality. As of now, that request has largely gone unanswered.

We have heard a number of concerns expressed, especially by smaller firms, about whether they will be restricted from offering the types of general business and tax advice they have been providing over the years to many of their clients. We intend to listen to your views very carefully and address them, providing clarification where necessary. Despite what some in the industry with the "sky-is-falling" mentality have been alleging, the proposed rule does *not* restrict tax compliance and planning services, nor does it restrict general business advice. In fact, the rule specifically states that auditors should be able to provide advice on internal controls and

perform specific internal audit projects.

Small accounting firms are part of the spirit and heartland of American business. Professionals in the small firms are known and trusted by the heads of community banks, furniture stores, restaurants, and local leaders. Their passion, their mission, and their instincts are focused more on providing a reliable audit and sound business advice, rather than on a broad array of exotic services. Having started a number of small businesses myself, I cherish the integrity and dedication that is their hallmark. I would do nothing to impair their business. I regret that their trade organization does not adequately distinguish between their needs in the battle being waged by a handful of the largest firms to obtain multi-million dollar system and outsourcing consulting contracts from audit clients at the potential expense of independence.

Let's put aside the sweeping predictions about being forced to sell off entire consulting practices, or the skyrocketing cost of audits, or new rules being the death knell as we know it of the largest firms. Instead, let's work together to craft modern, flexible, and long-term rules that will serve America's markets and America's investors for decades to come. While two industry leaders are now engaged in such a dialogue, the public interest calls for much more.

And the time to act is *now* -- before we go down a path where it becomes difficult to turn back; before we go down a path where business relationships and shared interests have become so complex that the value of the independent audit is engulfed in a sea of entanglements. If we take the right steps today, there will come a time when we will look back and wonder how we ever considered allowing the auditor's unique franchise -- and with it, the public trust -- to be sold for the price of short term profit.

## Conclusion

For most of my years at the Commission, *independence* has been the centerpiece of so much of my thinking about our markets. Independence from impediments to progress. Independence from narrow or special interests. Independence from arcane or outdated thinking. Independence, in short, from anything that has the potential to erode -- rather than inspire -- the *faith of America's investors*. It's something I feel passionate about. It's something that has given America's companies their global preeminence. It's what has made our marketplace second to none. And it's this independence that raised the quality and integrity of our financial information to the highest standards in the world.

I spent many years in the private sector -- first as a broker, then as head of a small firm, then a larger firm, an exchange, several boards, and a number of audit committees. I know the importance of high-quality information, of being able to analyze and act on information you trust. And I know the value of customers and clients believing in what you do, and what you say. To me, preserving and promoting that confidence is just plain good business. But when it's the cornerstone of your brand -- *the very heart of your franchise* -- I simply do not understand why you wouldn't do anything and everything to protect that trust.

As the department chair of a major university's accounting program recently wrote, "I implore anyone who is currently a student or relatively new to the accounting profession to do all

you can to bring honor to this once much more proud profession. Please do better than my generation has done." Never before has it been so clear that the accounting profession is at a crossroads.

This morning as I walked through Logan Airport I could not help but notice the many advertisements for the big accounting firms. They seem to always extol their IT talents, corporate finance capabilities, and financial planning tools. But rarely do I see an advertisement that conveys to the public and their clients their passion for living up to their public mandate of keeping the sanctity of the numbers inviolate -- never a mention of the public interest.

This nation's auditors are part of an honored tradition that has sustained for America the highest level of investor confidence in the world. I call today for a contract between the small and large firms, your trade group, state regulators and the SEC to renew and enhance our obligations to America's investors. A contract that lifts up the profession's precious franchise, that breathes new life into a covenant that proudly tells investors, "We hold your trust sacred." A contract that pays heed to the voice of the small firms -- the soul of the profession. And a contract that ensures an enduring vibrancy for the profession's future as much as a timeless fidelity to its great legacy.

Thank you very much.

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