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Privilege of being an accountant

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the privilege of being accountable

by Harry R. Weyrich

It is surely an honor and a privilege—and, indeed, a right—to be held accountable for excellence in the accomplishment of one's professional duties. However, as independent public accountants we face penalties under existing laws and rules which make us legally liable for failure to achieve and maintain such excellence.

This exposure to legal liability, which is so intimately linked to our professional sense of responsibility, is a fundamental component of the profession's ethical structure. While we may look upon such responsibility as a mark of distinction, it is also a sign of the seriousness of our auditing duties and proof of the significance of our role in society. Liability thus becomes a spur to our pursuit of excellence, a form of discipline.

One outcome of our exposure to liability penalties has been the recent plethora of class-action suits against accounting firms. These suits are developing in such volume that insurance underwriters have openly questioned how long they can maintain an interest in providing insurance coverage at reasonable premium rates.

The economic threat represented by lawsuits to which all accounting firms are becoming exposed is substantial indeed. There can be no avoiding the fact that the sheer dollar amounts of these suits could threaten the existence of the professional practice of auditing as an economic undertaking. No profession could hope to survive indefinitely under the kind of punishment that would occur if substantial damages were awarded in many of these cases.

A large percentage of all legal actions involving accountants originate from the public sale of securities for which a prospectus containing financial statements is used. A formula must be found, and I'm sure it will be found, to limit the liability of accountants through a ceiling based upon dollar amounts of such issues. This could be accomplished by an amendment to the Securities Act of 1933 in much the same way that the liability for damages of each underwriter is limited to the total price at which securities underwritten by him were offered and distributed to the public. As matters now stand, the accountant's fee has no relation to the quality of the package being sold or the amount of the issue.

The need for such limitation is found in a pattern of action now taking clear form. With increasing frequency, the Securities and Exchange Commission is filing permanent injunction suits against companies, citing specific violations of securities laws and seeking to enjoin any future occurrence of such violations. If the injunction is granted by the court, and more often than not it is granted, the company is compelled to amend its reports including the financial statements, assuming the SEC charges are sustained. This is usually done without admitting or denying the allegations.

When such amendments take place, as far as the auditor is concerned two sets of figures are obviously in existence, both of which could be equally acceptable. Unfortunately, however, he has now certified the "before" and the "as restated." This sets the stage for civil actions by creditors and stockholders, the claim being they were damaged by actions they took or failed to take as a result of relying on the "before" figures. It is alleged, in effect, that if two sets of figures exist one must be wrong, and that it is the one on which the plaintiff relied.

Naturally, when suits are filed by individual shareholders having a limited number of shares, the economic effects need not be great. But when plaintiffs come forward to represent an entire group or class of security holders and file so-called "class-action" suits involving the company's auditors, either alone or among other defendants, the implications are rather alarming. The courts are being liberal today in recognizing the right to bring class-action suits. If the current action of the SEC against the National Student Marketing Company, its auditors, and its legal counsel should develop into a civil class action, and it probably will, potential alleged damages to the class could exceed hundreds of millions of dollars.

Some who are in a position to know have suggested that there are some 200 suits outstanding against the major accounting firms alone—about triple the outstanding cases of five years ago. The implication present in a developing pattern of such proportions brings the real dimensions of the problem into focus.

However, despite the jeopardy to which we as auditors are exposed, it would be a mistake, in my opinion, if we were to take the position that such suits are being brought by what might be termed professional troublemakers. Certainly this is true in some cases, but we must assume that in most of them the plaintiffs are acting responsibly and in the interests of honest people who feel they have suffered injury.

Protection of the investor is the urgent message written in American economic life following the Great Crash of 1929. While at one time solicitude of this sort was thought of as "coddling," such a notion has been abandoned and is not likely to return. Instead, we have observed the broad trailblazing achieved by the securities legislation of the thirties continued through more protective legislation in later years, with even more on the horizon. For example, the recent Securities Investor Protection Act of 1970 seeks to temper customers' losses, should broker-dealers become insolvent.

Today, new time dimensions are being added to the tasks of financial reporting and communication. What prospectuses and reports to shareholders say about security issues or the financial health of the enterprise is important indeed, but up-to-the-minute "readings" of known important future events or conditions are equally important in such communications. Thus, as auditors we are held responsible or accountable for more than the usual attest functions, the basic objectives of our audit. In the recent National Student Marketing case, the SEC has taken the position that if an auditor learns of an adverse condition that materially affects the financial position or results of operations of his client, particularly in respect to matters on which the auditor has previously reported, he must advise his client to notify the SEC, the stockholders, and other interested parties. If the client does not, the auditor must assume such responsibility. Such a course of action would expose him to further litigation, this time with his (former) client.

Financial disclosure and reporting in simple, clear and understandable terms is indeed the name of the game today. The courts are docketed with many cases of investors whose security holdings have diminished in value, who assert that they would have sold, or would not have bought, before the decline if they had known of the company's real condition. Only a record of complete and adequate disclosure, and certainly a good lawyer, will help the company and its auditors when such assertions are made.

However, to keep things in proper balance, we must recognize that along with this concern for reliable reporting on corporate health, capital must be encouraged to flow toward new as well as continuing enterprises. This is fundamental to the prosperity of our country. But an important part of business prosperity is the selection of appropriate accounting and disclosure policies to present operations and financial positions in an unbiased and understandable manner that cannot be challenged. Responsible management must recognize that smooth upward trends in operating results are not possible at times, and that variations in earnings from one fiscal period or year to another are likely to occur, and sometimes are very sharp. Change to an

accounting method that arbitrarily serves to "smooth out" or obscure unfavorable trend lines resulting from economic conditions is indeed a dangerous practice today.

It would appear that for some years to come we must be prepared to render our best efforts in an atmosphere of accounting confusion and misunderstanding, even facing charges of negligence, carelessness and the like. As time goes on, we must help the public and our clients understand what we really do and what we do not—and cannot—do. It is at this focal point of misunderstanding that much of our professional difficulty lies. We must convey to everyone—especially the financial press—a proper appreciation of the limitations within which we function. They must understand that, among other things, we are not guarantors of financial statements. That should accomplish a great part of the task of bringing our exposure to professional liability into proper balance.

Meanwhile, we must not allow these broad difficulties to slow us in any degree in pursuing excellence of performance, in refining our audit skills and techniques, and in broadening our professional competence. In other words, we must continue just plain doing the best possible job we can on each engagement we undertake. We all know that as a firm we are intensively working on these tasks, through our professional education and development programs, through our Auditape and STAR (Statistical Techniques of Analytical Review), and through our day-to-day efforts on the job to speed the growth of each accountant to full professional competence and stature. Thus, we stand ready to bring to our clients and the public generally the skill, competence and professional care that society demands from us.

In reality, the position we must take is that "Society Is Our Client."

This implies that the total community is the client to whom we are responsible and liable. We cannot afford to believe there is any real conflict between our duties and responsibilities to the clients who engage us and to those so-called third parties who are said to be "not in privity." Since our client is society, we must have equal concern for all of that client's components, and we cannot let our concern be narrowed in any particular way.

Moreover, as we go about our work, we must keep the word "disclosure" in mind constantly. Almost thirty years ago, the SEC said that financial statements have a "function of enlightenment" to perform that cannot be accomplished through formal adherence to accounting principles alone. We must bring to bear a creative willingness to think—and to reject routine performance or rigid adherence to any past practice.

Some say that the pendulum of credibility has swung in the direction of looseness, imprecision, inaccuracy and even dishonesty in society as a whole. We, however, must always be confident that our route as auditors follows the standard of rigorous respect for one's word, for the truth as one sees it, and a zealous search for full and fair disclosure of significant facts. Therein lies the way to move the pendulum back into balance. However, in society's search for credibility and our willing acceptance of liability, we must not be expected to assume a disproportionate share of burdens and penalties. □

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