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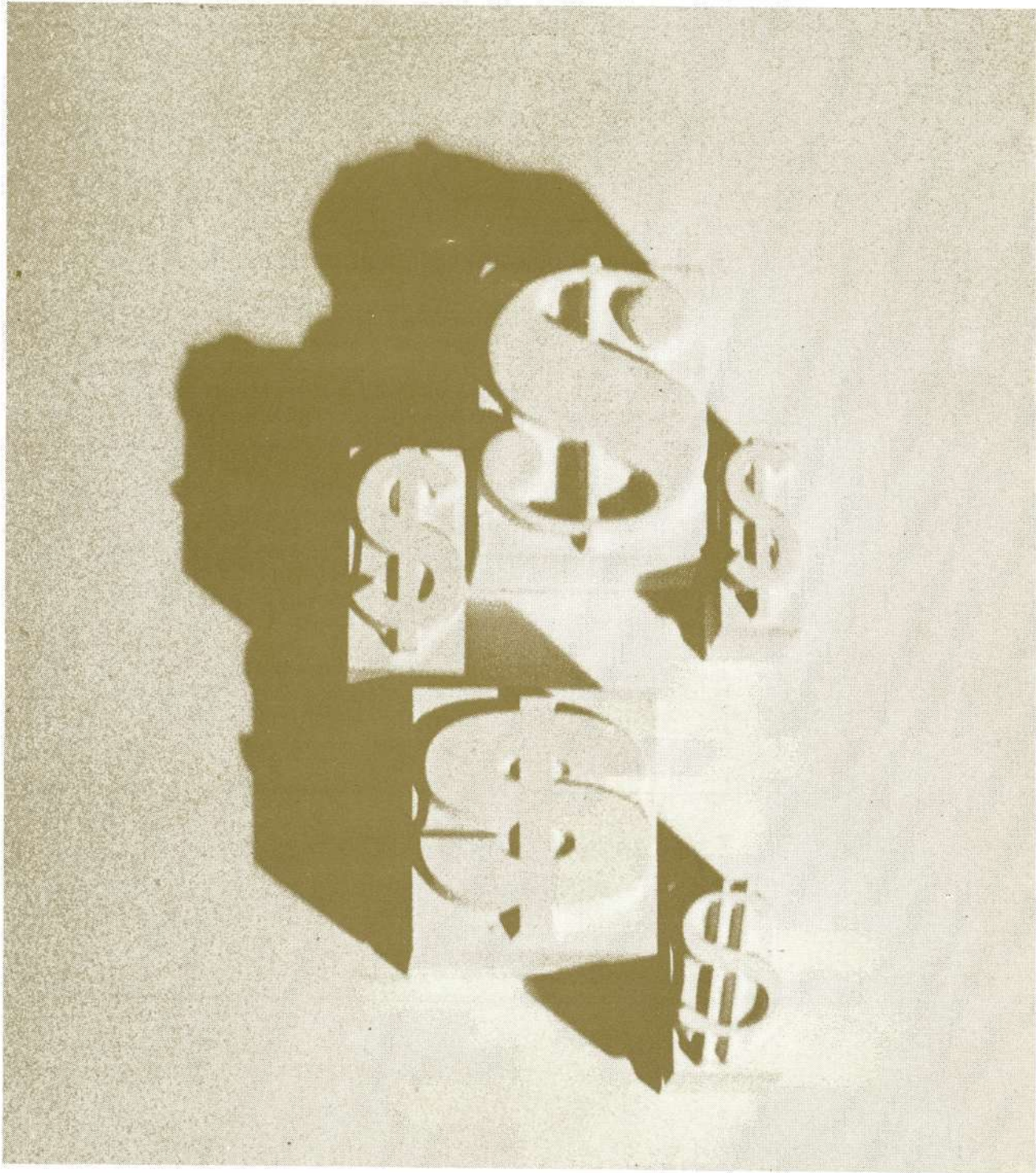
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# Annual Statements of Independence for CPAs ?

by Thomas A. Wise

□ I'd like to say that I am delighted to be addressing fellow financial writers. Ben Franklin once said that there were two ways to achieve fame. One is to write in such a manner as to make men act, and the other is to act in such a way as to make men write. He didn't say anything about speaking. You auditors in my view seem to be having the best part of both those worlds since what you're doing seems to make people write and some of the things you write make people act, sometimes with rage and indignation, but they do react. I've revised my original plans for comments somewhat because on the plane out I was surrounded by a number of accountants (they seemed to have taken over the plane) and I learned that they didn't have a very good understanding of what financial reporters are supposed to do. They were, however, very interested in hearing what financial reporters thought auditors should do. I came away with the conclusion that many had been exposed to reporters and editors who had talked most of the time about reporting problems, deadlines, and makeups and hadn't examined the historical relationship that exists and has existed for some time between our two fields. Thus I think you would like to hear something about what we do, so that then we can talk more authoritatively about what you do. The situation reminds me of a story that Johnny Green, the MGM musical director, once told me about George Gershwin . . . Gershwin was filled with the love of music, particularly his own. He and Johnny Green went out once and Green, in order to break Gershwin away from his composing, got him a gorgeous blonde starlet. They went out to this nightclub where they were supposed to dance . . . the girl wore the most seductive dress possible . . . but when midnight arrived there was Gershwin still sitting down and talking to the girl and tenderly telling her about his music and his ideas. Green interrupted and said, "George, don't you think the girl would like to discuss something else?", and Gershwin immediately said, "Oh, yes, of course, how stupid of me!" and he turned to the girl and said, "Now, let's talk about you for a while—what do you think of my music?"

### *Early Dominance of Business and Financial Journalism*

I maintain that you cannot understand us and we cannot understand you without a little bit of history. I'd like to give you some highlights of the history of financial and business journalism. Many of you may not realize it, because most of you and I have been brought up in a period of the "penny" press, in which advertising plays the key role, but it is a fact that early history of journalism was dominated by business and financial reporting. The desire to have speedy and accurate information stems basically from two different fields: one, the military, and the other, business. Reuters, the press association in England, and the Associated Press in the United States, both had their early success in fulfilling the need for business information. Dow Jones, the financial press service, and some of the other services which have been acquired by Dow Jones, were also born of this need. At the arrival of the penny press, publishers learned that they could make more money by circulating a publication with advertising, particularly if it was a paper that appealed to a large number of people. The financial and business news which used to dominate the front pages and was scattered throughout the paper began to shrink toward the back of the paper. Stories of interest to the general "mass" reader moved to the front of the paper and banner headlines broke forth.

We are now witnessing a phenomenon in which the business, financial, economic, and other serious news subjects, are being restored to proper perspective. Television has taken over the role of the "penny" press and is giving the public most of the general information it wants. TV is trying, as yet unsuccessfully, to present serious subjects which require precise reporting. The business and financial journalist is coming back into his own. Recognition of this is obvious in any paper that you pick up . . . you notice, for example, that the New York Post, with the evening field all to itself, now is carrying stock quotation tables. The Daily News has put them in, and is carrying a regular business and financial columnist. And I believe there are now 12 to 15 TV stations that receive and regularly feature financial and business news.

I might just add that in my own case I had an early relationship with your firm while I was on the Wall Street Journal. I covered the retailing field and that was when I first learned that Macy and Gimbel, when they didn't talk to one another—both talked to Touche Ross. Some of you may remember that in the early forties the battle over LIFO inventory accounting was a "hot" issue. I covered part of that struggle for recognition. It was Arundel Cotter, on the Wall Street Journal at the time, who was one of the leading journalistic advocates of LIFO. He wrote extensively about it, and, at least within our own circle, we always gave him credit for getting LIFO accepted to the extent it has been.

### *How the Business Press Has Reported TRB&S*

To give you some perspective on how we, the journalists and the editors, see you, the accounting profession, is to rattle off the occasions on which the affairs of your own firm have been of interest to us in our pages. You were involved with the California Board of Accounting in 1961, accused, and later exonerated of charges stemming from the investigation of a savings and loan company. We also reported when some of your partners were suspended for practices before the SEC for a very short time many years ago . . . when you resigned from one large client over bad debt estimates and were replaced by another firm under circumstances which immediately attracted our attention . . . when you gave a qualified certificate to one of your N.Y. Stock Exchange clients . . . when you replaced one firm, a large department store chain, after I had carefully detailed how they had replaced *you* a few years earlier . . . when you refused to certify the report of a bank . . . and when a large savings and loan suffered a big loss last year.

In non-accounting matters, you made news when you did the study for the National Retail Merchants Association. You said retailing should apply more science and math to retailing. Again we reported when you assessed the Pentagon's cost reduction program and said the plan could result in estimated savings of four and a half billion dollars . . . when you made a report on Vice President Humphrey's assets, he was worth at that time

\$171,000... when a spokesman for Litton Industries, Inc. characterized that company's accounting as very conservative we mentioned all the conservative steps including amortization, spreading the investment credit, writing down the field inventories, and spreading out maintenance contract revenues. And, of course, you got coverage when one large corporation had its famous scandal and you undertook to clarify the conflicts of interest. In summary, then, you made the news... you made waves in the fields of retailing and banking. Most of it was in unfavorable circumstances; you made little news in tax matters, and a modest amount in management services. Oddly enough... and you will note that your partner Robert Trueblood has commented on this... in the past, the understanding of your work and the work of others in the profession has suffered most because of lapses from auditing procedures rather than on questions of accounting principles.

#### *Growth of Press Interest in Accounting*

This summary that I've culled from magazines and newspapers does not refer to what I consider the serious attention that the press began to give accountants in the late 50's and early 60's. Only since 1959, and I like to think that Fortune was among the first, the press began to pay detailed attention to your activities and to others in your profession. At that time, while there were spokesmen for state societies and for the AICPA itself, the accounting firms both big and little had few public information or public relations representatives charged with the responsibility of explaining the background, the role, or the professional duty of the auditor to the public, or even to the press. Today, by contrast, virtually all the major accounting houses, and some of the smaller ones, have public relations counselors. Ten years ago, it was almost impossible to conduct any sort of responsible interview with an auditor who, no matter how understanding or cooperative he wished to be, was severely hampered in what he could say by the ethical code.

Now, the code has been revised to make our relationships not only easier but more rewarding, and where a

*“Your impact  
is predictable;  
ours is  
unpredictable”*

few years ago meetings between auditors and reporters were few and far between, they are now fairly frequent and usually more fruitful. I am happy to pay tribute to your own partner, Robert Trueblood, for bringing much of this about. During his administration as President of the Institute, seminars were initiated between the press and CPA's and these have been hailed by both sides as rewarding. Virtually all of the business publications have now appraised your profession in the typical manner by which all men of success in all fields are greeted. That is, we inform the public of the enormous talent, influence and usually the wealth which our heroes represent. And then purely, you understand, in the interest of balanced, objective reporting, we present close-ups of the warts, the scandals, the weaknesses, and the problems, any one of which may sound so monumental as to suggest disaster awaits around the corner. It would, of course, be presumptuous of me, both personally and on behalf of Fortune, to suggest that journalists have really affected your profession. I still think I can claim, however, that more men were brought up on professional charges because of Fortune stories, than because of the work of any other magazine.

#### *The Issues Behind Selected Cases*

I would like to review some of the accounting issues which were involved in some of the stories—the Atlas Plywood case illustrated dramatically that the financial statements of a company are truly those of the management and that a change of management with a different philosophy of operations, coupled with a change of auditors, could, within the framework of accepted accounting principles, restate the value of assets in such a way as to seriously alter the market value of the company's stock. Both in the great "salad oil swindle" and the Yale Express case, the limitations of the accounting profession, plus those of banking and the warehousing field, were well demonstrated to everybody. And in the case of the article in Fortune about one accounting firm, I was informed recently that SEC Commissioner Cohen used much of the material for that Boston speech in which he raised some questions

about the non-accounting activities of your profession. This recitation of stories is, of course, not intended to suggest how often Fortune has considered your profession newsworthy. It is true, though, that in its first 28 years of publication, Fortune ran one story which might be considered an "accounting story". We have run over 7 stories in the last 10 years, and I'm not including those stories that appeared in the investment column, business men in the news, or subsidiary stories of other major pieces.

#### *Working Together on the Annual "500" Issue*

Even more important that these stories is the annual confrontation which takes place between Fortune and the accounting profession on the preparation of the "500" issue . . . Here, I'd like to tell you a little story . . . Normally, to be listed in Fortune's 500 is something that's eagerly sought by most corporations. Two years ago, when we were preparing the 500 issue, based on the 1965 reports, one of our researchers stumbled over an annual report of a gas-producing company with sales of \$69 million. A footnote showed additional sales of \$49 million of refined oil products, which were not included in total sales.

Fortune checked with the management and found that it did not want the sales of its refinery products . . . presumably for competitive reasons . . . to be lumped with gas sales. We checked with the accounting firm whose representative also argued that this was the proper presentation. We disagreed, and added the gas and oil volume together thereby qualifying the company for inclusion on the Fortune 500 list, over the objections of both the management and its auditors. In 1966, the annual report of the company showed that *it had changed* its procedure and has included *all* sales, both gas and oil. In a footnote it explained it was restating the prior year's income. The last "500" issue of Fortune carried the company on the list well up from where it had been in the preceding year. And I'll let you have one guess who the accounting firm was on that case . . . Your firm!

The story simply illustrates the close and increasingly

closer relationship between your work and ours. We use your information . . . sometimes we disagree with you and sometimes we check your information . . . and develop a whole series of stories out of it; we give it greater magnitude, at least in our eyes. I've recited all these relationships between Fortune and you accountants merely to "sketch out" for you the nature of our interest in your activities.

#### *A Journalist Looks at the Audit Functions*

There are three different ways in which we look at you. The first, and the most important, is at your basic role as auditors and accountants. In this area, the issues under debate, I think, are fairly well known. Journalists love comparability, of course, and we like anything that will make it easier for us to make comparisons, particularly dramatic comparisons. However, our own experience with the "500" and the 200 foreign companies is enough to educate us to the impossibility of ever achieving true comparability, particularly among corporations which follow different policies, varying marketing practices and strategies, not to mention the difference in financing, production, advertising, and product mix. We watch closely the proposals by the Institute affecting such things as deferred taxes and the treatment of the investment tax credit. We enjoy it when an accountant reverses himself in the course of an Accounting Principle Board opinion. We also find it delightful where, in the current "ecumenical spirit" of accounting, the resident theologian of another large firm discusses how the "soul" of one of your important clients should be saved, and disputes the views of your firm's theologian Donald Bevis.

We constantly probe and ask about how many ways there are of reporting pension costs and whether there should be three or more ways of reporting drilling costs to an oil company. Can you really understand the value of an oil company if you have no idea of its reserves? There are issues which we, in the monthly field, the weekly field, and the daily press, will be constantly reporting on and we'll be reflecting your various views. Still, I'd like to make one point here, that we still (and

I believe on good grounds) give enthusiastic recognition to the integrity and the character of your work. I checked with SEC on the disciplinary actions of the SEC over the past ten years on CPA's and find that in that decade there have been only 12 disciplinary cases—that's out of 600 firms practicing before the Agency and an estimated 80,000 items involving accounting submitted in the course of that decade. You might even take a little comfort from the fact that this figure is 2 less than the lawyers have experienced in the way of disciplinary action by the SEC in the same period.

The CPA Trial Committee informs me that in last year, 1966, 150 charges were filed against CPA's of which only 17 went to the Trial Board where accountant-CPA's were found at fault. Of that total, 16 were actually disciplined and 1 promised to reform. I'd say that's an excellent record.

#### *How the Accountant Can Pioneer in Taxation*

Now your second capacity, the one in which you are playing an increasing role and are carrying a heavy burden, is that of taxation. It is obvious that you have a much greater influence here than has been appreciated. Taxation is no longer simply a revenue-producing instrument. It is a great social instrument and an economic and political tool as well. Last month in Portland, at the annual meeting of the Institute, some of you were warned by two distinguished scientists, Dr. Simon Ramo and Joseph M. Goldsen, that your profession would play a very important role in the world of the twenty-first century. They urged you to help analyze the nation's social problems and to help correct them. I think, in fact, that you are already deeply involved in the work. The most impressive example that I can think of (and here I make a bow to those members of your firm who are from Canada) is the Carter Report, the report on taxation made by the Canadian Royal Commission.

While it is true that the Commission is composed of lawyers and economists, the accountants played, I am informed, a critical role; in fact, the Carter Report . . . as it is called after a Canadian chartered accountant who heads the group . . . is considered one of the most

comprehensive ever made. It's being hailed as one of the most revolutionary studies in any field, not simply in taxation. I'm sure that you are all familiar with most of the details: its proposal of the elimination of the double tax on corporate income; the reduction of the tax rate at all levels but restriction on the top rate to 50%; it would also eliminate the preferred status of capital gains and the depletion allowance for mining and mineral properties; special tax treatment for insurance companies and banks, trusts and mortgages. Every one of those developments is of great importance to us—every suggestion there has the possibility of a major story. The argument has been advanced that the 350 different recommendations made in this pioneering report . . . including one which integrates the taxes paid by the corporation with those paid by the individual shareholder . . . are all interlocked. One cannot be passed or separated without affecting the other proposals. This is only one example of the role that you people are playing in taxation. There are many others that interest us in journalism. Any new opinion adopted by the Accounting Principles Board, for instance, seems also to create a related tax problem. Your activity in one field automatically increases the demand for information about you as well as for your services in another field. On the tax point, again, to go to the question of the character and integrity of your profession, the Internal Revenue Service reports that out of 2,000 indictments filed each year by the Department, only 86 accountants, over the last three years, were charged and found guilty in tax cases. Of that total only 22 were CPA's and that covers, the Department tells me, an enormous number of cases. This again speaks very highly of the record of your profession.

#### *Limitless Possibilities in Management Services*

Some firms seem to argue that there is a limit to the type of assignments they would accept. As yet, in discussions, except when there is a very obvious conflict of interest, I have not seen a satisfactory definition of those limits. As I understand the modern management organization, it is one brimming over with so many new

concepts that the auditors will have to be twice as bold as their forefathers to keep pace with management. You will be confronted with requests for advice on personnel incentive plans, EDP systems which involve huge capital outlays, marketing recommendations, mergers and acquisitions and checking internal controls. What is journalism's interest in all those developments? I can't think of one of them which doesn't represent the potential of a major story and certainly a topical story any day. It is obvious that your profession now believes that it can perform these services without a conflict of interest. I think there are two faults with that majority view. The first is that in a society which is just becoming aware of your role and importance, an understanding of these relationships has barely surfaced. I believe, for example, that many of the students and college graduates coming to work with auditors indicate a preference for the management services function rather than accounting. You are taking, in my opinion, too few if any steps to lay a groundwork of explaining *why* there is no conflict or what the limits are. I know that the American Institute of CPA's has had a committee studying the problem and that it is going to make a report. But, I think in some respects this is a self-defeating procedure. If management services are really not in conflict with accounting principles and independence, then who needs the Institute to define the role?

At present your profession seems to be experiencing the first stings of a backlash of comment about your activities. The insurance companies, I understand, have become more exacting on liability policies; the press coverage is getting more sophisticated; the current trial of auditors on criminal charges is a nightmare to the profession, and, despite the motives of the government, this action may wind up weakening rather than strengthening the field. In addition, there are a number of lawsuits still hanging fire with noisy overtones.

#### *Improving Press Relations*

What will you do about it? I think that you're already well aware of the problems and that you're doing a number of constructive things. Your relations with our



field, primarily as a result of the activities of people like Robert Trueblood, John Carey of the Institute, and others have improved and I think will continue to do so. Both our professions are forms of communication. We think ours is a little broader than yours and we touch aspects of situations which are not covered by numbers or rules but which concern people, character, and social, cultural and political forces. You are aware of them and often are deeply involved in them, but you rarely comment on them. Reporting your thinking about these matters is our responsibility.

To discharge our responsibility we must achieve greater familiarity with your work—greater perception—better powers of description and analysis of what you are doing and propose to do. There is one step that I think you could take that I believe would help your cause and improve our capabilities.

#### *An Annual "Statement of Independence"*

If auditing firms were to issue an annual statement of independence I believe it would be a big step forward in achieving better understanding all around. I use the term "statement of independence" in place of an annual report because I do not have in mind a report comparable to that of a corporation. I am suggesting a document that is made available through the American Institute of CPA's simply to reassert or reaffirm your basic independence as an auditor. It need not, for example, contain the profits or net income of the partnership but it should contain a statement of total revenues and a balance sheet. And it should give a breakdown of the sources of those revenues, indicating those which come from accounting engagements, those from tax work and those from management consulting activities. Statements of this kind are now made available by brokerage firms, religious bodies, foundations and educational institutions, although most of these organizations are not publicly owned either. Organizations release these reports simply to inform society of their responsible activities.

It seems quite appropriate for auditors, who have contributed so much to the concept of the accounta-

bility of one segment of society toward the whole, to be the leaders in encouraging the trend. By disclosing as much about your operations as is ethically and professionally possible, and as your codes will permit, I believe public confidence and public awareness of your role would be strengthened. Some of your non-accounting activities would then come as no surprise to the nation, particularly if some major scandal erupts in this field two or three years hence. Society, unprepared, would suddenly ask, "How long have these non-accounting services been going on, and what is their role and how can there be no conflict?" It also removes, in my mind, an excuse for government to intervene on the grounds that the public must be protected from things it does not know about. I think the "statement of independence" might also contain mention of any loss or addition of clients, any increase or decrease of staff and office locations, the status of training programs. It would be an excellent opportunity for firms to outline their stand on developments relating to the profession or in national affairs, or which may affect the reporting of corporate financial matters. This might include legislation, electronic data processing, growth of conglomerates, or various other international developments.

It might seem that both the public and the press will be interested, primarily, in a statement of major accounting firms and, therefore, the smaller independent firms will resist the idea. But there *are* major accounting firms, those who audit the corporations which we carry in our list of 500, and which are considered the nucleus of our national economic and industrial strength. Those companies and your relationship to them are *too* important and require *too* much understanding to let the question of the smaller firms and their hostile attitude be a deciding factor in opposing this suggestion. I think a suitable yardstick might be any accounting firm which derived more than one half of its income from publicly-owned client firms. These accounting firms would make such statements available upon request. Eventually, I think it is possible that a new form of organization specifically designed to combine the activities of professional people whose work is totally in-

involved with corporations, such as lawyers and certified public accountants and actuaries and corporate public relations counselors, might come into existence. Then, you may be able to have the benefits of a corporate form on such matters as capital gains and limited liability while at the same time you could protect professional status and relationship which exist between the various professions and their clients.

#### *Where Accounting Now Stands*

I think that, probably more than any other profession, you accountants stand at the center of the economic system, not in our own country only but in the whole free world, and probably your counterparts in the totalitarian world occupy a critical position as well. The struggle in the world is composed of many elements and is of course ultimately dependent upon man's view of himself and his fellow man, his role and his goal. But the hub of controversy at the moment is which economic system or systems best serve man in a peaceful existence. So that the workings of our system, its mechanics, its rewards, and its handicaps are clearly understood, it is imperative that there be no confusion about what you, the accountants and the auditors, tell the rest of us about the stewardship of our economic assets. It is after all the ability of man to have faith in his fellow man and a willingness to trust his fellow man that is the basis of a free society. You are the guardians of that voluntary trust in economic matters. If we lose confidence in you, the whole structure is in danger.

It does no good to say that the standards of your profession here are higher than elsewhere in the world, that your men are better trained and that your disciplines are more rigorous. That's to be expected. The assets involved are greater; the risks are greater; and the penalty for failure is catastrophic. Moreover, you are only in the infancy of your responsibility. The related issues of social accounting and international accounting are topics familiar to you, but still not even glimpsed by the rest of society. The journalist, whether of press or TV, has the critical role of explaining these developments intelligently and clearly and lucidly to a

mass audience of laymen. It is important that our liaison improve, for without jeopardizing our mutual independence, we are jointly involved in the task of distributing knowledge, information and understanding. *Your discipline is more exact; ours is more impatient. Your readers are identified; ours are widespread and varied. Your impact is predictable; ours is unpredictable.* Your work is an historical record; we may use your record to change history. But, whatever lies ahead of us, let me stress one point: it is not your knowledge or your training or your competence or your motives or your character or your integrity that is at issue; it is your stamina, your will power! You know what has to be done—will you do it? I think so. I think you must. I don't really think you have a choice. Thank you.

